A. T. International

Working Paper

MICROENTERPRISE DEVELOPMENT IN THE URBAN INFORMAL SECTOR

Case Studies from Brazil and the Philippines

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With an Overview by Doug Hill

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PREFACE

The case studies that appear in this volume were initiated in the spirit of an internal learning experience at A.T. International. A first effort at taking an in-depth look at an expanding global portfolio of microenterprise development projects, the scope of analysis was limited to but four programs in two countries. Given the modest nature of the investigation, we do not presume to describe any truths about the relative merits of differing approaches to small-scale enterprise assistance in developing nations. Our task has been to reflect critically on dissimilar project experiences and strategies in order to enhance A.T. International's supportive participation in the development of entrepreneurial endeavors in the informal sector.

By publishing our thoughts we now hope to contribute to the dialogue about effective approaches to small-scale enterprise development. Towards that end, critical comments from interested readers will be welcomed greatly by the authors and by A.T. International.

OVERVIEW

Doug Hill

HISTORICAL BACKGROUND

The Informal Sector and Its Role in Developing Economies

For several decades many development economists have characterized the economies of less developed countries (LDCs) as dualistic in nature. As originally fashioned, the dual economy model implied the co-existence of both a "traditional" sector and a "modern" sector, the latter incorporating "activities directly related to foreign investment and advanced Western technology" (House, 1981, p. 357). This original conceptualization anticipated that the Westernized modern sector would be the source of dynamic economic growth and that, over time, the traditional sector would wither away. In more recent years, the original traditional-modern dichotomy has been superceded by new descriptors which have redefined the dual nature of developing economies in terms of an interrelationship between "informal" sector and "formal" sector activities.

Activities in the "informal" sector are characterized by ease of entry, by small-scale, family operations, and by a reliance on indigenous resources. In contrast, activities in the "formal" sector are characterized by difficulty of entry, by large-scale, corporate operations, and by a reliance on overseas resources. While informal sector activities are labor-intensive and tend to use adaptive or appropriate technologies, formal sector activities are capital-intensive and often use imported technologies. While average wage and profit rates are low in the informal sector, they are relatively high in the formal one. While the market for the informal sector is highly competitive, that for the formal sector is generally protected through tariffs, quotas, and trade licenses (ILO, 1972).

Despite the fact that informal sector activities have often been either inadvertantly discouraged by inappropriate economic policies or actively harassed by unsympathetic government agents, the informal sector has shown no signs of "withering away." In many instances its relative size, in terms of active participants, has, in fact, increased vis-a-vis that of the formal sector. In a majority of developing countries the informal sector has come to be recognized as a large, if not major, source of off-farm employment. It is also the primary supplier of goods and services to low-income groups. As a result, the development community has demonstrated a growing interest in promoting the informal sector's potential for generating future employment and income opportunities. To a large extent, that interest has focused on that multiplicity of small-scale economic endeavors that have become known as "microenterprises."

Microenterprise Development: Problems and Programs

Microenterprises involve a range of economic activities including vending, services, and manufacturing. Cigarette and food hawking, newspaper and magazine selling, fruit and vegetable vending, paper and plastic recycling, shoe repair, upholstry, carpentry, tailoring, dressmaking, baking and craftwork are all typical microentrepreneurial endeavors. Operated on the sidewalk or out of the home, microenterprises are usually capitalized out of individual or family savings and are characterized by the most informal of financing, planning, and accounting systems. Employees if any, are few in number with family members providing the most common source of labor. In rural areas the microenterprise usually supplements subsistence and marginal cash-crop family farming. On the urban fringe, microenterprises often constitute the sole economic activity of a substantial number of individuals populating the "squatter settlements" and "cardboard cities" that ring the metropolitan centers of developing countries.

Given their often precarious nature, the likelihood that such small-scale enterprises will make an increasingly significant contribution to alleviating poverty and unemployment in the future depends heavily upon the degree to which their economic viability and growth can be nurtured in the present. While the constraints to enhanced profitability and expansion are numerous, a lack of access to capital on reasonable terms is generally seen to be the most primary one (ILO, 1972; World Bank, 1978). Viewed as too risky and too disaggregated for loan consideration by the commercial banking sector and so small that they are beyond the reach of government credit programs for small and medium sized businesses and industries, microenterprises are forced into accepting either supplier credits or loans from informal sector moneylenders on extremely disadvantageous terms. Additional constraining factors include, among others, unreliable and costly sources of raw materials, limited local markets, lack of training in production planning and bookkeeping, and impermanency of location (USAID, 1981).

To date programs seeking to address these constraints on the economic viability and growth of microenterprises have been sponsored primarily by private voluntary organizations and, to a lesser extent, by private business. In some cases the projects funded have focused on community-based development efforts; in others the focus has been on reaching out to microentrepreneurs on a small group or individual basis. Both programmatic and project goals vary as well. For some the goal is to establish client microenterprises as viable means of self-employment, which means assisting them to increase their profitability to a level that provides a stable and sufficient source of individual or family income. For others the goal is to expand the size of the individual microenterprises to the point that they generate employment for others beyond the microentrepreneur and his or her family. Oftentimes this goal includes enhancing both the microentrepeneur's risk-taking ability and "bankability" to the point that commercial loans from the formal sector are forthcoming.

A. T. International's Involvement in Microenterprise Development

For its part, A. T. International recognized early on that the area of microenterprise development provided fertile territory for the organization to fulfill its mandate of promoting access by low-income populations in developing countries to technologies appropriate to their sustained development. Since 1978 when it began operations, A. T. International has concentrated one-third of its grant portfolio on innovative projects geared to the needs of the small-scale enterprise sector. Grant recipients, more than thirty in number, have included both grass-roots organizations actively involved in providing credit, training and other services to microenterprises in localized areas as well as larger intermediary organizations that, operating on a national or regional level, provide financial and technical assistance to such smaller groups.

However, A. T. International's role in the development of the small-scale enterprise sector goes beyond that of being a mere disburser of funds. Organizationally, A. T. International is also committed to learning from the projects that it supports and to sharing that learning with both its grantees and the larger development assistance community. To this end, two A.T. International units, Policy and Communications Services and the Small Enterprise Development Group, have assumed joint responsiblity for analyzing a number of A. T. International project experiences in microenterprise development. This working paper is the initial product of that joint effort.

CASE STUDY SUMMARIES

Representing considerable spread in terms of geographic location, level of approach, focus of effort, guiding assumptions and project goals, the A. T. International portfolio in microenterprise development is clearly a heterogeneous one. That fact affords A. T. International both the opportunity and responsibility to bring to light the potentialities and possible limitations of different methodological approaches to microenterprise development. Recognizing that opportunity and responsiblity, the projects for these case studies were consciously selected for the contrasting characteristics that they demonstrated -- as will be apparent in the thumbnail sketches that follow.

Brazil: The UNO Program of Assistance to Microenterprises in Caruaru, Brazil

Uniao Nordestina de Assistencia a Pequenas Organizacoes (UNO) was incorporated in 1972 as a private non-profit organization operating in Recife, Pernambuco, Brazil. Constituted for purposes of developing a program of assistance for small-scale enterprises owned and operated by the poor in the Greater Recife area, UNO received support from a broad spectrum of state and national governmental entities as well as from organizations in Brazil's private business and banking sectors. UNO also received considerable foreign support in the form of planning and promotional activities conducted in its behalf by Accion International/AITEC, a U. S. private voluntary organization. During the period 1972-1979 UNO developed and refined a program of credit and technical assistance to what they termed microempresas ("microenterprises") that attracted considerable international interest. By 1979, UNO's organizational credibility was such that it was designated as a key participant in the Polonordeste Project, an integrated development scheme for the interior of the state of Pernambuco. That designation placed UNO in a position to design and implement a second program of small-scale enterprise assistance that would service the microempresas of the Caruaru region.

In 1980 A. T. International entered into a relationship with UNO that, in a relatively condensed period of time, has produced considerable learning for both organizations. A. T. International's first intervention was a grant of $15,000 that enabled UNO to evaluate its first eight years of existence by collecting and assessing data on the performance of its client microenterprises. Later in 1980, A. T. International provided a second grant of $35,000 to support a Recife workshop at which UNO shared information derived from that evaluation with representatives of some twenty organizations from other parts of Brazil as well as from the rest of Latin America and the Caribbean -- all of whom had heard of UNO's work in microenterprise development and wanted to learn in some detail the structure and process of UNO's methodological approach as well as its costs and benefits.

In 1981, A. T. International made three more grants to UNO totaling $69,000. Those grants assisted UNO to establish its program in Caruaru -- a program which, in terms of size and scope, would be considerably larger than its Recife predecessor. The first grant supported a major planning effort which defined the characteristics of microenterprise activities in Caruaru and identified adaptations in UNO program methodology appropriate to Caruaru's particular context. It also enabled UNO's Caruaru program manager to visit and study similar programs in Colombia and the Dominican Republic. A key recommendation arising from the study/visit was the formation of producer and trade associations to facilitate both bulk purchases of raw materials and marketing. The other two grants enabled UNO to test the association concept by financing two associations, one of microentrepreneurs producing metal cowbells and the other comprised of small-scale manufacturers of clay bricks and roofing tiles.

In terms of guiding assumptions, UNO does not believe that the growth potential of most microenterprises is such that they can be expected to grow into formal sector operations of significant employment capacity. It does believe that microenterprise development programs offer an effective way of assisting low-income populations to attain viable self-employment and improved family income. Credit is the backbone of the UNO programs in both Recife and Caruaru and the emphasis is on getting loans out quickly to as many individual microenterprises as possible. UNO does not discourage repeat customers regardless of their individual growth and employment potential. Credit-worthiness, as evidenced by the repayment of previous loans, is the sole criteria for continued support. With the advent of the Caruaru program credit was complemented by training. In addition, two special components were established: a technical assistance component, set up in conjunction with the Technological Institute of Pernambuco, and a cooperative and association formation component. The latter component represented a considerable departure from past efforts. In working to form associations and cooperatives, UNO is consciously attempting to change the microentrepreneurs' economic context by assisting them to by-pass middlemen bottlenecks in material supply and marketing. Such work entails considerably more staff/client contact than UNO's streamlined credit operation. In the area of staffing, UNO recruits university students as its front-line promoters.

The Micro-Industries Development Center of the Philippines

The Micro-Industries Development Center of the Philippines (MIDC) is an intermediary organization set up in late 1980 by program leaders from a number of Philippine agencies active in microenterprise development. As a non-profit, non-stock company, MIDC gives legal identity to a group of institutions with complementary objectives and programs and allows them to pool their resources and experiences in a manner that maximizes their impact on the small-scale enterprise sector. MIDC also plays a brokering role -- making matches between institutional donors and its member organizations as well as between formal and informal sector enterprises. A. T. International is supporting MIDC with a grant of $40,000. This support was predicated on A. T. International's interest in learning about the function, structure and process of such a brokering apparatus and in assessing whether such an institution could be an effective mechanism in scaling-up existing microenterprise development programs. The programmatic efforts of both MIDC and two of its member organizations are described and analyzed in the case study.

The first of those member organizations is Manila Community Services, Inc., (MCSI). A non-stock, non-profit corporation, MCSI was founded by a number of church groups in 1968. Its organizational interest has consistently been that of assisting the residents of Metro Manila's barangays ("squatter settlements") to collectively address the problem of unemployment and underemployment that confront those populations. Until 1976, MCSI's approach to this problem was through job skills training programs implemented by local community organizations. However, recognizing at that time an inability to place but a limited number of trainees, MCSI shifted its approach to microenterprise promotion via credit and training services.

Like UNO, MCSI does not anticipate that its clients will be likely to experience the kind of growth that would enable them to take on a significant number of new employees. Its goal is simply one of seeing that its client enterprises become stable operations that afford their owner/operators a viable livelihood. MCSI does expect, however, that its clients will demonstrate a certain amount of growth -- as evidenced by the limitations it places on the number of loans a client may receive at any particular loan level. While MCSI attracts clients via its credit component, its emphasis, in terms of staff time utilization, is more on providing very simple and practical business training and advisory assistance. MCSI's front line staff is a volunteer one and is comprised of successful microentrepreneurs who are recognized community leaders.

While MCSI is an entirely private voluntary organization, the Micro-Industry Development Program (MIDP) -- the other MIDC member organization dealt with in the case study -- operates as an official branch of the Philippine Ministry of Trade and Industry. Established in 1978 as an experimental pilot project serving the Metro Manila barangays, MIDP originally focused its attention on small groups of microentrepreneurs whom it had organized for purposes of collectively receiving both technical and training assistance from MIDP staff and credit assistance from public and private financial institutions. In 1981, MIDP's status was upgraded to that of a program. Responding to lessons learned in its project phase, MIDP staff shifted their assistance focus from group-owned to individual or family-owned microenterprises. Staff also upgraded the program's credit component vis-a-vis its formal business advisory and training services -- though, in practice, staff time utilization continues to favor the latter. MIDP's staff are college graduates and the majority have degrees in commerce or related disciplines. In contrast to MCSI, MIDP's goal goes beyond that of seeing the microenterprises it services grow to the point of constituting viable self-employment options. Its guiding assumption is that, with the right combination of training and credit, its clients will be able to expand considerably -- eventually graduating into formal sector operations with notable employment generation capabilities.

PROJECT IMPACTS

Economic Growth and Viability

As the preceding thumbnail sketches indicate, all of the programs reviewed desire economic growth and viability for their client enterprises -- though perceptions differ about just how much growth is attainable. With respect to economic growth, none of the program clients interviewed had achieved the ideal of "passing-up" to commercial bank loans and graduating out of the informal sector. Available program documentation indicates that, in fact, relatively few microenterprises served have actually realized significant, measurable, and sustained business growth. This observation should not be taken to imply that these credit assistance and training programs have not been without impact. On the contrary, in almost all cases access to credit and training has resulted in increases in output, sales, and profits within the lifetime of the loan. The problem seems to lie with the fact that increases in business earnings are rarely reinvested in the enterprise or held aside as a working capital fund that would make it possible to sustain the increases engendered. For the microentrepreneur, an immediate family need almost always takes precedence and, rather than being reinvested, profits are consumed in the form of better nutrition, medicines, schooling for children, and improved housing or on such familiar events as births, deaths, and marriages.

While sustained economic growth has not been achieved, there is an almost universal perception among participants that their economic endeavors have become more viable as a result of these programs. Participation has bred self-esteem and the act of successfully repaying a small initial loan has given many the confidence to take on the risk of a second, larger and longer-term one. For many, an economically debilitating dependency on moneylenders has also been eliminated. However, until self-sustainability is actually achieved, it is necessary to be cognizant that in eliminating an unwanted dependency, another, albeit more desirable one, is being created.

Employment, Job Cost, and Job Quality

Of the programs reviewed, MCSI has the greatest tendency to work with the smallest of small-scale enterprises. For this reason, it is not surprising that MCSI's 313 clients do not provide the equivalent of full-time jobs for more than 400 people, including themselves. Both UNO and MIDP work with somewhat larger microenterprises and would appear to average between two and three employments per client, though, as with MCSI, employees are typically family members. Data gathered indicates that the number of full-time equivalent employees among clients served varies with the type of economic activity involved. Manufacturing and processing microenterprises tend to employ the most (four to six persons, including the owner, per business), services somewhat less, and vending the least (one to three).

Because many of these jobs already existed before program loans were made, attempting to estimate the number of jobs actually created and their cost in terms of either total program costs or the value of total credit extended becomes a somewhat questionable exercise. Given both MCSI's and UNO's focus on establishing viable self-employment as opposed to creating new jobs, it is not surprising that neither makes such an attempt. MIDP, on the other hand, holds job creation as a primary program objective and, making the attempt, roughly estimates a program cost (overhead and loans) of between U.S. $645 and $1,613 per full-time job "created." While this cost appears high compared to a Philippine annual minimum wage of U.S. $860 and is high, presumably, in comparison to either MCSI's or UNO's costs, it is quite favorable compared to the estimated $28,670 cost of creating a new job in the Philippine formal manufacturing sector.

However, it is misleading to compare the relative costs of job creation in the formal and informal sectors without pointing out the relative desirability of two such jobs. A job in the informal sector involves long hours, low wages often at piece rates and, for the reason that labor requirements may change on a weekly or even daily basis, almost no security of employment. Such a job does not compare in quality to employment in a formal sector factory where hours are shorter, wages are three to four times higher and one has at least some job security and perhaps even a health and pension plan. Viewed in this light, what can be said for these programs is that they make a modest contribution towards providing employment for an ever increasing number of low-income individuals who lack land, education, or any likely prospect of formal sector employment -- and that they do so at a relatively low cost.

Income Generation

The preceding discussion of reinvestment and consumption suggests that the programs appear to be having a positive effect on family income. Individual interviews carried out during the course of the study corroborated this impression with clients reporting that daily incomes had, in some cases, risen considerably as a result of their participation in a microenterprise development program.

However, none of the programs reviewed actually collect hard data on the income effects of their activities. This is unfortunate given that, in order to continue to attract external support, such programs should, ideally, be able to demonstrate that a unit of support will reliably lead to an increase in family income. The situation is not an incomprehensible one, however, given that the desire to keep program costs to a minimum often suggests limited data collection and that most program staff recognize that clients are reticent to provide accurate information in this sensitive area.

In spite of these caveats, stronger efforts need to be made that will enable these programs (and their backers) to gain better insight into how their clients are, actually, rather than presumably, being affected. In this regard it should be neither too time consuming nor too costly if, on the basis of information picked up in the natural course of staff/client interaction, a running account of major changes in the net family worth and disposable income of their client population were to be established. An advisable level of documentation would indicate income changes through tracking sales, average household expenses, major purchases for either family or business, inventory purchases and extraneous family income. This information could then be measured against an accounting of staff time and other overhead costs involved in both the processing and monitoring of loans and the provision of business advisory and training services plus records of loan repayment, arrearages, and defaults. Such a system would enable the programs to clearly establish their overall cost-efficiency level in this area of primary programmatic impact. In the Philippines, an intermediary organization like MIDC would be well-placed to play a significant role in assisting its member organizations to define and establish comparable approaches to such documentation.

CRITICAL LEARNINGS

All of the programs reviewed are interested in the possibility of up-scaling microenterprise development efforts and in packaging and promoting their activities for transfer to other organizations. For this reason, the case studies consciously attempt to bring to light factors that appear to be critical to programmatic success as well as ones that suggest barriers to replication. Highlighted below by programmatic element, these observations or "learnings" should be recognized as indicative rather than conclusive in nature.

Credit

According to clients, credit is the program service of greatest utility, and it is obviously what attracts them to these microenterprise development programs. For program initiates, a trial loan fund such as that employed by MCSI, is particularly useful. Starting a first-time client out on a very small, short-term loan enables a program to test for credit-worthiness while building the microentrepreneur's self-confidence and familiarity with a credit institution. Subsequent loans of increasingly larger amounts, each predicated on the successful repayment of the preceding credit extension, keeps risks within manageable limits for both the program and the microentrepreneur and also ensures that loans are used effectively.

With estimated repayment rates of 94% and 100%, respectively, both the UNO and MCSI programs underscore the credit-worthiness of the small-scale entrepreneur. In UNO's case the high repayment rate appears to be due to an extraneous factor. Failure to repay an UNO loan would mean inclusion in the Brazilian government's national listing of persons who fail to make good in a debt --

which effectively precludes a future loan from almost any source. In MCSI's case, high repayment results not only from the careful staging and phasing of loans previously mentioned, but also from the fact that, as loan guarantor, the street-wise volunteer community leaders select clients carefully, maintain close personal contact, and collect payments on a frequent, oftentimes daily basis that is consonant with their client's cash flow cycle. In contrast to MCSI and UNO, MIDP has been less successful in achieving a high repayment rate. This seems to stem from two factors. First, apparently anxious to move their clients up to "bankability," MIDP may encourage clients to take on loans that are excessive in terms of absorption and repayment capabilities. Second, MIDP staff, university graduates with mainly middle-class backgrounds, have taken some time to acquire the "street savvy" of their MCSI counterparts in selecting clients or in being "hard-nosed" when payments are in arrears.

Training

Often illiterate and uninitiated to either banking or record-keeping procedures, the typical microentrepreneur is generally seen to lack the skills requisite to business expansion. As a result, microenterprise development programs usually include management training and business assistance. Program initiates, however, often perceive that their informal systems are adequate to their needs and only accept bookkeeping and business planning courses in order to qualify for credit assistance. MIDP pre-credit training courses on management and accounting principles offer a case in point. While the courses are intended to help clients to use their credit more productively and to diminish loan defaults, client perceptions are that they are not particularly useful to their endeavors. Given that few microenterprises are apparently destined to grow to a point where such training would be useful, universal administration of management training does not look like a cost effective proposition.

The kind of training most widely appreciated by clients is that offered in the form of practical tips on an informal, on-site basis. MCSI's business assistance is provided in such a manner, with volunteer community leaders offering advice on where to get a good buy on supplies, how to dress up a display, and how to avoid harassment by an unsympathetic official. UNO takes a similar approach -- the focus is on the most basic of information (how to open a bank account) and on informal exchanges of business expertise.

Case study observations make it clear that considerable room exists for improving the staging and phasing of training and credit so that client needs can be served in a cost efficient manner. Research in this area would seem an appropriate activity for MIDC or some other umbrella-type intermediary offering programmatic assistance to its member organizations. In terms of a basic guideline, only minimal staff time should be spent on client training at the trial loan credit phase, when the primary program objective is to establish basic credit-worthiness. Once credit-worthiness is established and a client demonstrates a willingness to take the steps necessary to incrementally expand and stabilize the microenterprise, additional staff guidance in the form of business tips on practical production and merchandizing techniques would seem called for. Finally, when credit and advice are being translated into sustained increases in output, sales and profits, more formal training in bookkeeping, unit costing, and business planning would seem appropriate. An analytical tool for assisting program staff to evaluate a client's relative stage of development is offered in an appendix to the Philippine case study.

Technical Assistance

Microentrepreneurs typically choose a line of endeavor based on past individual or family experience. As a result, many times they have more expertise in questions of technology and production system choice than the program staff serving them. When enabled to invest in new equipment, few are lacking in knowledge about what particular pieces of equipment are most appropriate to their needs. The UNO interviews do indicate however, that what is oftentimes lacking is adequate training in equipment maintenance and repair and that a shift in focus to this aspect of technical assistance would enable client entrepreneurs to save money on repairing their chosen technologies.

Client Selection and Grouping

MCSI clients are selected informally, primarily on the basis of the volunteer community leader's knowledge of their personal reputation. In UNO's relatively high volume operation, clients are, to a certain degree, self-selected. Local microentrepreneurs are invited to a "consciousness raising" meeting, and those who attend become eligible for the credit program -- although a formal, albeit streamlined, credit proposal is filled out and reviewed by BANDEPE, the state bank which administers UNO loan funds. MIDP staff involve themselves in more lengthy studies of loan feasibility. These studies sometimes require as much as two weeks of work to complete because of their level of specificity. The fact that there is no relationship apparent between the amount of information a program collects on its potential clients and their business plans and the overall repayment rate on the loans granted, would warrant against using formal sector methodologies to select clients for informal sector assistance programs.

Lessons learned in early phases of both the MIDP and MCSI programs suggest that grouping clients as joint recipients of credit disbursals entails certain difficulties. Fighting for their own survival, clients are reluctant to take the risk of being financially responsible for someone else whose economic condition is equally or, perhaps, even more precarious.

Grouping for purposes of sharing expertise and discussing mutual problems appears more productive and, as UNO's Caruaru experience with cooperative and association development demonstrates, is a logical strategy for addressing problems of raw material access and marketing in areas of mono-production. Cooperative and associative groupings -- particularly staff intensive activities -- also require that staff have an intimate understanding of production and distribution systems.

Staffing

The majority of the tasks involved in microenterprise development programs do not require highly skilled professionals to carry them out successfully. In fact, the university trained professional not only tends toward a level of sophistication that is inappropriate to the microentrepreneur's scale of operations, but is also oftentimes of a class background that does not enhance operational effectiveness in the microentrepreneur's social milieu.

Street savvy and practical business experience seem to be the most important characteristics of effective front-line staff. Consequently, the utilization of local community leaders who are successful small-scale entrepreneurs themselves is a logical approach. When such services can be obtained on a voluntary basis as they are in the MCSI program, the cost efficiencies are considerable.

However, a solid network of community leaders is never established quickly. When up-scaling to a considerably larger volume of beneficiaries is the goal, the employment of local university students can, as UNO illustrates in Caruaru, prove an effective compromise. Not yet encumbered by "professionalism," they are often adept at picking up street savvy, and several can be hired at the cost of a business school graduate.

EMERGING ISSUES

The Role of Risk Aversion in Behavior Change

The Brazil and Philippine case studies make clear that the clients of microenterprise development programs very often display behavioral patterns that are not ideal in terms of programmatic objectives. However, much of this behavior is perfectly rational when understood in terms of risk avoidance.

For example, the fact that MIDP clients tend to provide staff interviewers with less than accurate information about their family resources and are reluctant to keep close business records makes good sense of divulging such information entails the risk that it might fall into the hands of tax collectors, neighbors, relatives, or competitors who could use it to the microentrepreneur's disadvantage. Likewise, UNO staff seeking to break down some of the debilitating aspects of supplier credit dependency, were frustrated by the fact that clients would forego even the marginal benefits of buying over time when they used UNO loans to pay off suppliers in full (without discount). However, from the clients point of view, impressing a traditional supplier in this manner is not irrational. If a program should evaporate, the supplier will be needed once again as a primary source of credit. Finally, the tendency of clients to use credit-engendered profits for meeting basic family needs rather than for reinvestment is hardly irrational behavior when it is recognized that the family unit constitutes the microentrepreneur's most basic and dependable long-term support system.

These few examples suggest that, just as attempts to incorporate more modern agricultural technologies into peasant production have precipitated serious investigation into the role of risk aversion in the rural informal sector, the current effort to develop entrepreneurial efforts in the urban informal sector will necessitate similar research on the role of risk aversion in shaping the behavior of microentrepreneurs.

The Role of Microenterprises in a Strategy of Growth with Equity

The development assistance community has tended to look at the promotion of microenterprise development programs as a strategy for promoting both economic growth <u>and</u> more equitable development patterns. While the programs reviewed in the Brazilian and Philippine case studies are too few in number and too young to serve as any kind of test of the viability of that strategy, it is important to note that equity rather than growth appears to be their long suit thus far.

In terms of economic growth and employment generation, it is clear that programmatic impact has been modest, though both time and the incorporation of suggested improvements in methodology may alter that fact. In terms of equity, it is clear that these programs are having a positive impact on income distribution by making self-employment a more viable source of family income for the urban poor. Admittedly, the benefits of an increased income may not be sustained beyond the period of assistance and, but for the spread effects of family consumption, appear to be largely limited to program participants. But neither UNO nor MCSI staff have been disappointed with the equity effects they are producing. They rightly recognize that providing assistance to disaggregated low-income urban populations in a remarkably cost-efficient manner is no small accomplishment.

While the weight of evidence from these case studies suggests that microenterprise development programs may be viewed as an important equity-producing counterpart to programs of economic growth, the jury will be out for some time on the extent of their direct contribution to economic growth. In the interest of advancing the state of knowledge in this area and better informing its own future activities, A. T. International is committed to continuing to examine the policy implications of both these and other projects in its small-scale enterprise portfolio.

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PART ONE

The UNO Program of Assistance to Microenterprises in Caruaru, Brazil

Henry Jackelen

AUTHOR'S NOTE

This report reviews the evolution of the Uniao Nordestina de Assistencia a Pequenas Organizacoes (UNO) program of assistance since 1972 to very small enterprises in Recife, Brazil, and the extension of that program to the Caruaru region in 1980. It also assesses the impact of the program upon participating microenterprises in Caruaru. Special attention was given to UNO's efforts there to create producer associations and cooperatives and to work in the area of appropriate technology.

I researched this report during a two-week visit to Recife and the Caruaru area in February of 1982. During the period I interviewed twenty UNO staff members ranging from superintendent to promoters in both Recife and Caruaru as well as over 40 microentrepreneurs. I also was able to participate in some five meetings of associations and cooperatives of microenterprises formed or in the process of formation by UNO. Finally, I reviewed numerous client files and records of the program. The analysis is limited somewhat by the lack of accurate baseline data, as is shown more fully in the body of the report.

I was given the full cooperation of UNO leadership and staff -- without their insight the report would not have been possible. I would like to express my gratitude and admiration to them, without holding them responsible for the views and interpretations in the report.

Henry Jackelen
July 1, 1982
Washington, D.C.

I

THE SETTING

Brazil, the fifth largest nation in the world in geographic terms and sixth in terms of population, is a country that has undergone profound changes in the last 20 years resulting in enormous growth of the informal sector. Like many Latin American countries, the major change occurring in Brazil during this period has been a significant "deepening" of the industrial process as a result of import substitution policies on the part of the government. This "deepening," or creation of more capital intensive industries to produce needed heavy machinery and equipment to supply the consumer goods manufacturers, has required a substantial shift in the distribution of income in the country to meet the required capital needs. During these years, Brazil inspired confidence in a diverse group of international banks and transnational corporations who, in many cases, made Brazil their largest overseas investment or debtor.

These policies brought international attention and interest to Brazil, particularly during the so-called "miracle" years between 1968 and 1976, when the GDP (Gross Domestic Product) of Brazil grew at an average real rate of over 10% per annum, one of the highest rates of growth in the world. These continued high rates of growth resulted, in overall economic terms, in a four-fold increase of Brazil's GDP from 1960 to 1980. These impressive growth rates, which have catapulted Brazil to the position of being the 10th largest economy in the world, have led many analysts to use Brazil as one of the most successful development cases in recent years.

This analysis is misleading, however, as it does not take into account the effects of this development on the vast majority of the population in terms of migration, overall distribution of income, and regional disparities. In terms of migration, Brazilian society has undergone a massive transformation, from a population that was over 50% rural in 1960, to a population which is now over 60% urban. This massive shift occurred primarily because, on the one hand, government policies favoring a concentration of land holdings resulted in the eviction of rural land populations and, on the other hand, a rising level of expectations among the rural populations led them to move to the cities and to look for jobs in the industrial sector. In this same period, the Brazilian population, which grew at an average rate of 2.7% per annum, practically doubled.

This overwhelmingly urban population is characterized by its youth -- it is estimated that over 50% is under seventeen years of age -- and its poverty. These trends exacerbate the traditional problem of labor absorption. Estimates are that 100,000 new potential workers enter the labor force every month. The plight of these newly urbanized populations is clear when one looks at figures on how income is distributed among the population. (See Table 1.) Although the distribution improved marginally from 1972 to 1976, the general trend is undeniable and the lower strata of the population is receiving less and less of the overall "pie." In 1976 the poorest 40% of the population had only 9% of the income, while the richest 20% had 65%. This process is not unique to Brazil and is to be expected during a process of capital intensive industrialization. These factors have created, in a short period of time, crowded urban areas with insufficient infrastructure and not enough job opportunities to absorb the wave of migrants coming to settle in "favelas" or slums. These economic and demographic pressures have forced the creation of large masses and rural urban unemployed or underemployed labor which have had to resort in many cases to independent economic activities in a wide variety of endeavors which have come to be known as microenterprises.

The Northeast: Brazil's LDC

In addition to understanding the problems brought about by industrialization and urbanization, it is also important to know something about the problem of regional disparities between the developed southeast and the under-developed northeast. Some analysts have suggested that the best way to understand Brazil would be to see it as a vast geographic expanse containing three separate "countries" -- distinct and different areas each over two times as large as France. The first of these would be the developed southeast, the land of progress where most of Brazil's "miracle" took place. Less than 20% of the geographic area, this region contains 60% of the total population and generates 80% of the nation's economy.

Table 1

DISTRIBUTION OF INCOME AMONG THE POPULATION

Percent Share of Total Income

	1960	1970	1972	1976
Richest 20%	54	62	68	65
Middle 40%	34	28	25	26
Poorest 40%	12	10	7	9

The second would consist of "Brazil's India" -- the northeast -- an area known for extreme poverty. A third of the population lives in the northeast, which although it is as large geographically as the developed southeast, generates a mere 15% of the nation's economy.

Finally, the third area would be Brazil's frontier land in the vast Amazon region, an area that encompasses roughly two-thirds of the entire country. Only 10% of Brazil's population lives there and 5% of the nation's economic activity takes place there.

UNO (the Northeast Union of Assistance to Small Organizations). the organization whose program is the subject of this report, is involved with the urbanized populations in Pernambuco, in the northeast, the second of these "countries."

Rich in tradition and history, the northeast region was the site of Brazil's earliest development in the beginning of the 16th century. Until the early 19th century, it dominated Brazil largely through the prosperous sugar trade. With the demise of the plantation system and the emancipation of slaves in the late 19th century, the northeast took a back seat to the emerging southeast with its new European immigrants and nascent industrialization.

In the northeast vestiges still exist of the old plantation system. Poverty, malnutrition, and illiteracy are commonplace in its primarily rural population. Two-thirds of the 35 million inhabitants of the nine states comprising the northeast live in rural areas, but many of those people are landless. Those who are landowners usually live on ten hectares or less. At the same time, 40% of the arable land is owned by less than 1% of the farm owners. While 40% of Brazil's agriculturally employed population lives in the northeast, only 20% of the nation's agricultural output is produced there, a reflection of the low productivity and chronic land tenure problems of the area.

Much of the region has a semi-arid climate and extensive areas of poor soils. Periodically serious droughts cause waves of migration to urban centers in the region, as well as to the rich southeast. Labor in the northeast has a long history of being exploited. In the past it was quite common to see recruiters -- followed by buses and trucks -- who would contract cheap male labor for construction work in the southeast. This was particularly true during the boom years. Now the boom is over and laborers from the northeast are returning to their homes.

In the middle and late 1950s, the federal government created SUDENE (Northeast Development Agency) and Banco do Nordeste Brasileiro (Northeast Development Bank), two federal agencies with mandates to stimulate growth in the region. Over time the government has created a complex system of incentives destined to attract investment in the region. These policies have, by and large, created a favorable climate for investment with tax incentives, subsidized loans, as well as federal funds being invested in preferential shares. Unfortunately, the type of industries that have benefitted from these incentives have been, for the most part, capital intensive. As a result, there has been little impact on the chronic unemployment problems of the region. In agriculture the pattern of incentives has caused, with few exceptions, large land holdings which have not helped the chronic land tenure problems of the region. In general, these policies have aided the region in attaining reasonable levels of economic growth -- close to 8% per annum -- during the period 1967 to 1977, but with little beneficial effect for the vast majority of the population. The region still lags substantially behind the rest of Brazil and the gap has been widening. Per capita income for the northeast was over 40% of the national average in 1949, and decreased to 35% in 1978.

Pernambuco

Pernambuco, one of nine states in the northeast, represents only 6% of the region geographically but has close to 20% of the region's population. Consisting of a strip of land 200 kilometers wide and running 700 kilometers from the coast inland, Pernambuco has three distinct areas. The fertile coastal plain makes up roughly 17% of the state in geographic terms and has 52% of the state's 8.5 million inhabitants. Over 1 million of those inhabitants live in the principal metropolitan center of Recife. The second area is an intermediate zone covering some 20% of the state, with close to 30% of its population where Caruaru -- the major urban center of the area -- is located. Finally, the third area consists of the semi-arid "sertaõ," which is 63% of the state's area and where only 19% of the population lives.

The UNO program assists microenterprises located in two of the regions named above: the Recife metropolitan area located in the fertile coastal region and Caruaru and other urban centers located in the "agreste" region where agricultural production is marginal.

Recife, a city of over 1 million inhabitants, is one of the oldest and most important cities in Brazil. Its port -- from which a significant amount of Brazilian sugar is exported -- is a main source of employment, second only to the industrial belt that rings the city. But Recife, like all other major urban centers in Brazil has a limited labor absorption capacity as migrations to the city have far exceeded new jobs created each year. Recent studies show that close to 30% of the population living in the outskirts of Recife are recent immigrants (four years or less).

UNO studies show there are at least 35 to 40 thousand microenterprises located in and around Recife. The larger concentrations of these are in the newly settled poorer outskirts of Recife. UNO believes that this informal sector is growing. However, its share of the economy has been diminishing over time, reflecting the patterns of accumulation and concentration which have characterized the Brazilian economy since 1964.

UNO's analysis of some 500 microenterprises in Recife selected at random revealed the following characteristics:

- Microentrepreneurs were, for the most part, 25 years old or more, having had some type of job experience (mostly menial).

- The sector in which most (over 40%) microentrepreneurs are involved is commerce. Many are recent migrants from rural areas with little or no previous experience.

- The concentration of microenterprises in commerce is understandable due to two fundamental realities: the capital required to begin selling is low and little experience is needed.

- What could be called industrial microenterprises comprised only 14% of the sample. These entrepreneurs tended to be older, more experienced and second urban-based generation.

- Most of the industrial microenterprises were furniture makers, metal workers, and ceramic and shoe makers.

- The second largest sector, where roughly 25% of the microentrepreneurs were engaged, is services. Most microentrepreneurs in this sector are involved in auto mechanics, electrical repair, and photography.

- The average overall number of employees was three (including the owner), with family members being the most common source of labor. Industrial microenterprises employ the most (four to six per business) and those involved in commerce the least (two to three).

- Sixty percent of microentrepreneurs make between one and five times the minimum monthly wage and some 30% are able to make between five and ten times the minimum. That explains the motivation for starting a microenterprise. In relative terms, these enterprises provide a reasonable income. Roughly 80% of these entrepreneurs work solely in their own business.

- The average family size of a microentrepreneur is five members.

- Close to 50% of microenterprises do not pay rent since they either own the premises or are squatters.

- The only government programs that have attempted to assist this population have been social programs in the areas of health and education. Most of these have been ineffective until very recently. There have been no attempts to design economic programs for development of the informal sector. UNO, then, is the only organization working with this large population.

Caruaru and the "Agreste" Region

The predominant activity of this region is agriculture, which accounts for the economic activity of 70% of the population. The rural based population lives, for the most part, on small farms. Some 65% of these farms are only 10 hectares or less, and only use 12% of the total arable land, while some 8% of farms are over 50 hectares and use 63% of the total arable land. The per capita annual income of these small farmers is below US$200 per annum.

These subsistence levels have led to urban migrations in the region, and the seven cities of more than 20,000 inhabitants are growing rapidly. Of these urban centers, Caruaru is by far the largest, with over 100,000 inhabitants. Other cities vary between 20 and 40 thousand inhabitants.

Among the urban inhabitants the predominant activity is commerce, with each city having a large open market ("feiras") at least twice a week. The Caruaru feira is particularly famous and operates seven days a week with the major concentration of sellers on Wednesdays and Sundays. These feiras sell a wide variety of goods -- ranging from food to household appliances to artisan goods -- and resemble a huge open-air department store. In Caruaru it is estimated that over 60% of the microenterprises are engaged in commerce, while some 30% are involved in industry, with the remainder in services. However, it is interesting to note that in some urban centers due to the phenomena of mono-production, or large concentrations of microenterprises involved in very specific production activities such as clothing manufacture from remnants, shoe making and cowbells, the predominant activity is industrial. Examples of this are Santa Cruz do Capibaribe and Toritama where 90% and 74% of microenterprises fall into this category.

An estimate of the number of microenterprises in the region is difficult, but it is conceivable that there are some 50 to 60 thousand. This number is surprisingly large, compared with the number of microenterprises in Recife, an area roughly equivalent in population. However, the microenterprises in the agreste region are much smaller and more concentrated around one activity than they are in Recife. For example, in Santa Cruz do Capibaribe over 1,000 entrepreneurs out of a population of 27,000 make textiles from remnants. In another area located around the city of Pesqueira, as well as in smaller cities in the vicinity, some 10,000 women are doing embroidery work, each constituting an individual microenterprise.

UNO program managers maintain that microenterprises in Caruaru and Recife are basically similar, with the same priority of needs, especially credit. The only major difference between the two is the phenomena of mono-production in the Caruaru region.

II

HISTORICAL DEVELOPMENT OF THE UNO PROGRAM

UNO was established in 1972 largely through the efforts of AITEC, a Boston-based non-profit organization, that after several years of working in the community level in Latin America, came to the conclusion that the most effective way to assist low income populations was to identify and nurture entrepreneurs operating tiny enterprises in the informal sector. In fact, the term "microenterprise" was coined by UNO to differentiate this sector from the small business sector for which in most countries assistance programs of one kind or another already existed. UNO operates in Brazil but is considered the pioneer in the field of assisting microenterprises in all of Latin America and has evolved over time from a simple program limited to Recife, to a multi-faceted program operating in several distinct areas in the state of Pernambuco. The UNO "model" has been adapted for use in other Latin American countries.

UNO's institutional evolution was determined by two major developments which drastically altered the capabilities and effectiveness of the institution. The first was the inclusion of UNO by the World Bank in 1979 in the Polonordeste (The Northeast Integrated Development Program) project, an integrated development scheme for the interior of the state of Pernambuco. The project was co-financed by the federal government of Brazil (65%) and the World Bank (35%). As a result of its work in the project, UNO designed and implemented a program in the Caruaru region larger in size than the original Recife program in terms of microenterprises serviced. The second development was a major change in the operating procedures of the State Bank of Pernambuco (BANDEPE) in 1980, which, by enabling UNO to process loans to microenterprises in a rapid, effective manner, enhanced enormously its capabilities and capacity for growth.

Phase I: 1972 - 1978

UNO began by designing and implementing a method of making credit and, to a lesser extent, training and technical assistance available to microenterprises in the greater Recife area. The impact of this help to microentrepreneurs was limited because the banking sector, in particular BANDEPE, was not able to process loan proposals efficiently. Hence the number of microenterprises serviced -- in terms of loans -- was restricted roughly to 200 per year. As the stated priority of the program was to extend loans to entrepreneurs, the banking sectors' inefficiency frustrated the effectiveness of the program.

During this period, UNO developed a training program in which 26 courses were given in three basic areas. These courses were attended by a total of 533 entrepreneurs, mostly participants in the credit program. Other activities consisted of surveys (over 5,000 microentrepreneurs were surveyed) and in-depth analytical documents prepared in conjunction with the federal university on the importance of the informal sector and the role of the microenterprise within that sector. For UNO, this period from late 1972 through 1979 was primarily one of institutional learning.

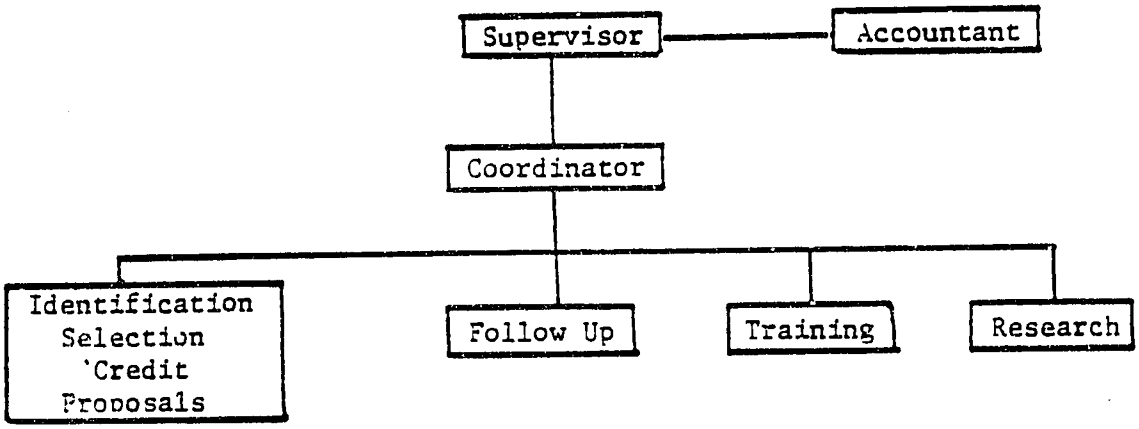
By 1978, after various experiments, UNO had devised a mode of operations that depended on using university students as its "front line," or promoters. These students would be recruited in their first or second year and, it was hoped, would remain with the program for a period of three to four years. The salary UNO was able to pay (one minimum wage per month) was low -- not enough to pay for the expensive evening college tuitions of Recife. The only students who could afford to work for the program were those studying at the Federal University (a free university) which has a daytime curriculum divided into two sessions -- morning and afternoon. Thus teams of students could work at UNO either in the morning or afternoon. Before the expansion into Caruaru, this "front line" consisted of 38 students working half-time, supervised by two full-time staff members, one in charge of selection and credit proposals and the other in charge of follow-up. Over 70% of these students were involved in the identification, selection, and credit proposal area of the program.

Added to this was an administrative structure consisting of the superintendent and coordinator, along with an accountant and support and clerical staff of nine individuals (including two office boys). There were also eight full-time staff members, one in charge of the training program and the others involved in various functions from training to research. (See Figure 1.)

The credit mechanism developed by UNO in this period -- by far the most important aspect of the program -- entailed a long process of negotiating with credit institutions in both the private and public sectors. The main problem UNO encountered

Figure 1

UNO ORGANIZATION CHART (1979)



was the reluctance of banks to make loans accessible to microenterprises. Banks considered the risks and operational cost in dealing with a microenterprise portfolio to be too high. Throughout 1973, UNO lobbied its cause in the financial sector with some success, as it was able to get two banks in the private sector to agree to lend to microenterprises if UNO did all the preliminary work (identification, selection, credit proposals). Funds for these loans were provided by the banks through the goodwill of the directors and were covered by a partial guarantee of UNO. This relationship worked reasonably well until 1976, when commercial rates, which had been fixed by the Central Bank, were freed and banks had second thoughts about continuing to lend to the microenterprise sector as the opportunity costs became too great. With the changes in banking legislation, UNO was forced to concentrate its efforts with the state banks, particularly BANDEPE, even though they were much more bureaucratic and less efficient than the private sector banks. By 1978 a majority of the credit was being processed through BANDEPE.

The Credit Mechanism

The basic UNO model, developed in 1973, is still used today. The process of extending loans begins with teams of university students conducting a survey of a specific area, attempting to identify and document all existing microenterprises. UNO attempts to deal with microenterprises in all sectors (commerce, service and industry). Depending on the sector, for UNO a microenterprise is an enterprise whose sales, assets, etc. do not exceed certain fixed amounts, stipulated in Table 2. UNO has no minimum limits for defining potential clients, and, although six months of activity is preferred, UNO is quite flexible and has even dealt with start-up situations.

The promoters compile a list of the microentrepreneurs in a given area, make a contact with them to explain the UNO program, and invite them to a meeting. UNO calls this meeting "consciousness raising" (sensibilização). The UNO program is discussed in more detail, along with the importance of the microenterprise sector to the local and national economy.

Those microentrepreneurs who attend the meeting are then visited by the promoters, and data is collected on sales, assets, and the family income of the owner. Within a short period of time a second visit is made to verify data and ensure that the microenterprise meets UNO's criteria. A decision is made as to how much the loan will be and to what use the money will be put.

With the data collected during the two visits, the promoter then fills out a credit proposal, which is reviewed and approved by the supervisor.

Table 2

MAXIMUM LIMITS ESTABLISHED BY UNO
FOR MICROENTERPRISES

	Commerce/Service	Industry
Maximum family income	US$ 9,000*	$ 9,000
Maximum annual sales	$ 43,000	$ 60,000
Maximum fixed assets	$ 36,000	$ 50,000
Maximum number of employees	5	10

* UNO uses MVR (maior valor de referencia) units, which the government established as a measure to help compensate for inflationary distortions. To make the table more meaningful these amounts were converted using CR$/US$ rates as of February 28, 1982. These limits have stayed the same in MVR and dollar terms since the beginning of the program.

The bank double checks the credit-worthiness, processes the proposal, and issues a loan agreement. UNO visits the microenterprise within two weeks after the credit is made to check that the money was spent on what was agreed to previously. After this visit, UNO visits the microenterprise only two more times during the life of the loan.

The maximum loan is $3,000. The average is $1,500. Loans are granted in three categories:

- 100% working capital loans: 15 months maturity, 3 months grace, equal monthly payments thereafter.

- 50% working capital loans; 50% fixed assets: 18 months maturity, 6 months grace, equal monthly payments thereafter.

- 100% fixed assets: 24 months maturity, 6 months grace, equal monthly payments thereafter.

Interest charged is 25% per annum. Seven percent of the amount credited to the microenterprise's account is discounted and allocated in the following manner: 3% is commission charged by UNO; 2% goes into a loan guarantee fund; and 2% is the bank's commission.

Training. Until its operation in Caruaru began, UNO's training program concentrated on three areas: banking services, administration, and sales. Of the three, the most important was banking services, which consisted of one or two two-hour sessions in which microentrepreneurs were taught how to fill out checks and deposit slips and how banks operated in general. All courses were taught in a participatory fashion in which microentrepreneurs were asked to share experiences with each other.

Summary. Table 3 summarizes UNO's activities during its first phase. Several interesting observations can be made by looking at these figures. First of all, it can be noted that to a great extent clients select themselves. This occurs between the first contact and the subsequent meetings, where, on an average, 36% of those contacted showed sufficient interest in the UNO program to attend the meeting. Of this group, an average of 74% had credit proposals processed for them.

Table 3

UNO: PHASE I (1973-1978)

	1973	1974	1975	1976	1977	1978	Total
Microenterprises surveyed	339	1,042	1,200	1,156	487	884	5,068
Microenterprises selected	184	385	437	238	106	468	1,818
Credit proposals completed	48	243	356	283	141	271	1,342
Loans granted	32	174	212	147	150	138	853
- *new loans*	(32)	(162)	(143)	(104)	(92)	(98)	(631)
- *refinanced*	--	(12)	(69)	(43)	(58)	(40)	(222)
- *percent refinanced*	--	7	33	30	39	29	26
Amount loaned (in CR$000)	391	1,941	2,755	1,846	3,127	3,593	13,653
US$ equivalent	64,000	286,000	339,000	173,000	221,000	199,000	1,282,000
Average loan in US$	2,000	1,600	1,600	1,200	1,500	1,400	1,500
Total program cost (in CR$000)	474	1,004	1,240	1,949	2,291	4,495	11,453
US$ equivalent	77,000	148,000	153,000	183,000	162,000	249,000	972,000
Number of employees	9	17	22	26	28	33	--
Program costs in US$ per loan	2,400	850	720	1,240	1,080	1,800	1,140

* Dollar amounts in this table and in Tables 4 and 5 should be considered tentative, as severe distortions exist. Conversions were made using average exchange rates calculated by the Central Bank of Brazil. The general formula the Brazilian government uses for devaluation is a weighted difference between the inflation rates of Brazil's leading trading partners and domestic inflation. However, it is generally conceded that the cruzeiro was overvalued between 25 to 40% during this period. The conversions were made using the average exchange rates; no adjustment was made for the fact that most activity falls within the second and third quarters.

The major bottleneck of the program can be seen in the discrepency between the amount of credit proposals processed and loans granted, which reached its low point in 1978, when only 50% of credit proposals actually resulted in loans being granted in the same year. By far, the most important reason for this was bureaucratic delays on the part of the bank's, which reached 180 days in some cases and averaged over 100 days, seriously hampering the program's credibility and resulting in many microentrepreneurs withdrawing their requests.

Several factors influenced the large fluctuations in activity that can be seen in the 1975-77 period. Where changes in bank legislation forced UNO to operate with state banks, it look longer to process proposals and large backlogs piled up. This put a strain on the program because more time had to be spent working with the complex bureaucracy of BANDEPE and trying to keep the microentrepreneurs from losing interest in the program. A flood in the Recife area in 1977 also affected the program by forcing UNO to cut back even further its activities with new clients and concentrate on helping its existing clients, who were suffering severe losses.

A tentative stab has been made in measuring the cost-effectiveness of the program in terms of overall costs to loans granted. This would appear justified as the stated priority of the program is making credit accessible to the microenterprise segment of the economy, the vast majority of whom have had to rely on informal sector sources (i.e., intermediaries and "loan sharks") for handling their needs. Comparing the average program cost per loan granted to average loan we find that in 1975, the year when most loans were granted, for every two dollars loaned, one dollar was spent in program costs. This ratio was reversed by 1978 as bank delays hindered the program's effectiveness.

Phase II: 1979 - 1981

Impressed with UNO's operating in Recife, the World Bank sought to include microenterprise development in the Polonordeste program. UNO was included in the Polonordeste project for one of the interior regions of the state of Pernambuco (Agreste Setentrional). The Polonordeste project is an attempt, largely through the efforts of the World Bank, to create an "integrated" development approach to rural areas that encompass all dimensions of a region's economy. It is a five year endeavor which will use some US$120 million (35% World Bank, 65% Brazilian federal government) geared mostly to rural-based development (irrigation, agricultural extension services, infrastructure, credit, etc.). However, the project recognizes the importance of the small urban centers and their role in providing employment through "non-farm small enterprises," as well as the need for training and credit for this sector. The Agreste Setentrional has several urban centers, the largest of which is Caruaru, where UNO was to begin its program.

The mandate given to UNO through the Polonordeste program was an ambitious one that envisioned the creation of a central office in Caruaru plus another five offices in the largest towns in the area. It was also envisioned that UNO would incorporate a new element in its approach: technology. The project appointed ITEP (Technological Institute of Pernambuco) in conjunction with UNO to analyze and assist microenterprises in the field of appropriate technology. The four individuals working on technology are paid by ITEP.

Expansion into Caruaru. Starting in mid-1980, UNO began its efforts in Caruaru and, using an approach already well established through years of experience in Recife, began undertaking in-depth research into the socio-economic conditions of the microenterprises in Caruaru and the other smaller urban centers where UNO would operate. It became apparent at once that within this region a phenomena existed quite distinct from anything UNO had even run across before: mono-production. Within the region there were large concentrations of microenterprises producing textiles, tiles and bricks, embroidery, shoes, cowbells, or handcrafted items made of clay and straw.

These producers were in general located in one area which varied in size from a community of 20 cowbell producers to a city of 27,000 inhabitants (Santa Cruz do Capibaribe) where UNO estimates there are over 1,000 microenterprises involved in producing textiles from remnants. In general, these entrepreneurs had been producing the same items over a long span of time, ranging from generations in the artisan tile and cowbell areas to five to ten years in the textile area.

UNO found that these producers had serious problems marketing their finished goods and purchasing raw materials. Almost all microenterprises have these problems, but, for mono-producers they are aggravated because "intermediaries" can bargain down prices of finished goods and, conversely, a small group of wholesalers can control the needed raw materials at high prices. The reason for this dichotomy is that on one hand large concentrations of microenterprises producing the same groups of products makes them vulnerable to price competition while on the other hand the scarcity of capital characteristic of microenterprises makes them vulnerable to having their sources of raw material dominated by a small "CARTEL" of wholesalers who have the needed capital. In addition, in all areas UNO decided to explore the need for technical assistance, ranging from simple courses in maintenance and repair to help in dealing with appropriate technological change.

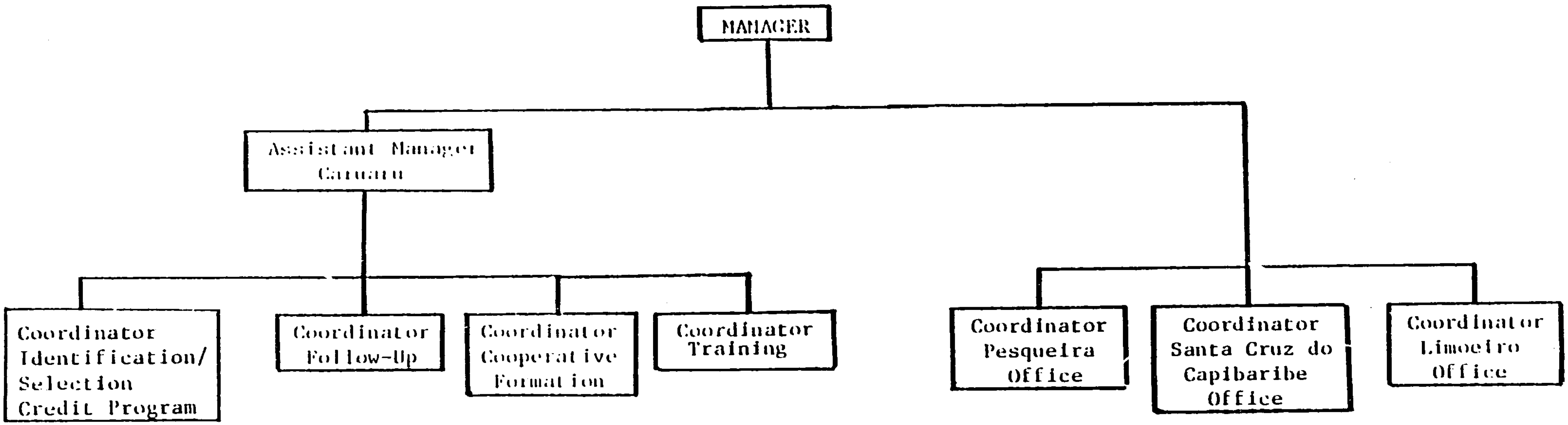
Based on these findings the Caruaru program began to take shape in four separate and distinct areas. In order of priority they were credit, cooperative/association formation, appropriate technology, and training. Replicating the methodology used in Recife, the Caruaru program would use credit as the backbone of the program under an identical arrangement with the same financial institution, BANDEPE. Similarly, training would replicate the Recife program, with one important distinction: courses would be geared to technology problems in specific areas of production ranging from repair and maintenance to improvement of production processes, as well as courses in cooperative law. However, the focus on appropriate technology and cooperatives was new.

UNO decided that to make the Caruaru program effective it would be absolutely necessary to develop a way to assist microentrepreneurs to create associations and cooperatives. Thus UNO set up a department with a staff of experienced individuals that would deal solely with the creation of associations and cooperatives. And to provide technical assistance a specialized group of six individuals would work with microentrepreneurs on a one-to-one basis in a myriad of technologies, with each individual having a separate expertise. (This technical team was paid for with ITEP funds.) These two new areas of operation eventually had an influence on the Recife program.

Changes in BANDEPE's Operations. The major bottleneck UNO faced up to 1979 was BANDEPE's inability to rapidly process loan applications. This situation changed markedly in 1980, as can be seen in Table 3, when BANDEPE reorganized and streamlined its operations. Up to that point, all of UNO/Recife's loans had been processed through one agency. With the changes, UNO was able to send clients to a number of agencies both in Recife and the Caruaru area. The latest agreement between BANDEPE and UNO, signed in late 1980, stipulates that BANDEPE will credit the client's account ten working days after UNO delivers the loan application. BANDEPE retained the right to veto credit if a credit check showed any previous credit problems. At present UNO is operating with nine branches of BANDEPE (four in Recife and five in the area handled by Caruaru). The agreement with BANDEPE is working perfectly. Loan applications, which took an average of well over 100 days to process in 1979 are now being processed in 10 days. The funds for these loans come 70% from the federal government and 30% from BANDEPE.

Figure 2

ORGANIZATION OF THE CARUARU OFFICE



Organizational Changes. In Caruarú, due to the differences in the university system in comparison to Recife, UNO found it was feasible to hire full-time employees (university students who study at night and university graduates) to do the "front line" work of promoters. The limited job possibilities in the area make it easy to find well-qualified people to do this work full-time at salaries starting at only two times the monthly minimum wage.

As the Caruaru office handles an area measuring over 200 square miles, it was necessary to decentralize and to establish regional offices. At present there are offices in Santa Cruz do Capibaribe, Pesqueira, and Limoeiro, each with a small staff of between four and six. The Polonordeste project envisions the eventual establishment of seven such regional offices. UNO decided that for the sake of the program it was necessary to do this slowly, bringing staff members up through the ranks and not rushing expansion. This approach has apparently paid off in terms of effectiveness. Figure 2 shows the organizational structure of the Caruaru central office as of February 1982. The Caruaru program is supervised by the manager and the assistant manager, the latter being in charge of the Caruaru office, the former directly supervising the work of the other offices and of the assistant manager. Beneath them is the rank of coordinator. There are two levels of coordinators: regional and departmental. Department coordinators, working out of Caruaru, are responsible for specific functional areas, while the regional coordinators run the regional offices. There are at present 16 professionals and 3 support persons on the staff of the main office in Caruaru: 7 work on credit proposals; 4 on cooperative formation; 2 on follow-up; and 1 on training, along with the manager and assistant manager. This staffing pattern reflects program priorities. Credit continues to be the backbone of the UNO program with training as a complement, and, due to the realities of the region, the formation of cooperatives and associations is of major importance.

With the successful expansion of the program into Caruaru, UNO had to take steps to create a strong control function for the entire organization. The increased volume of financing alone (1,004 in 1981, compared to 225 in 1979) has made this a requirement. This meant separating the Recife operations from the central administration.

In addition, UNO is already turning its sights to two new areas: Sertão, the most depressed area of Pernambuco; and Tracunhaem, a city located close to Recife. Plans call for a major structural change in the overall organization of UNO in the next six months. The new structure (see Figure 3) shows a quantum leap in the dimension of activity of UNO from a localized program to a diversified program operating in several distinct areas.

Figure 3

PROJECTED ORGANIZATION OF UNO
(to be implemented in late 1982)

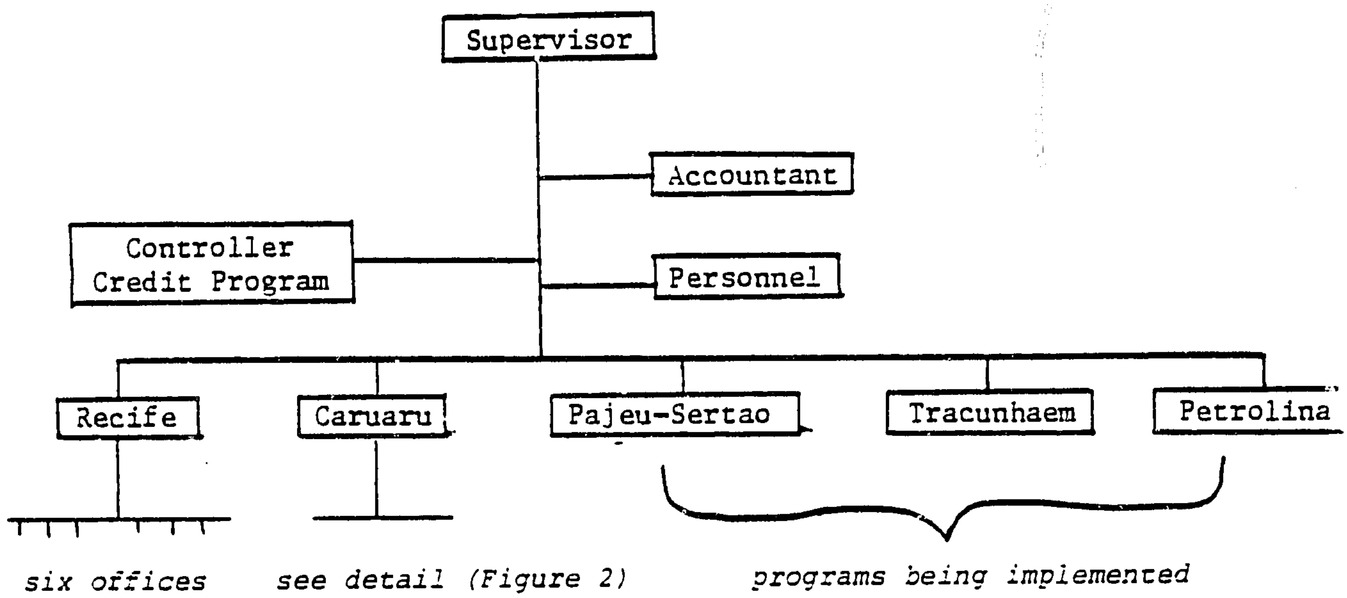


Table 4

PHASE II (1979-1981 - ESTIMATES FOR 1982)

	1979	1980	1981	Total	1982 (estimates)
Microenterprises surveyed	1,782	1,437	2,110	5,329	4,000
Microenterprises selected	729	795	1,250	2,774	3,000
Credit proposals completed	432	438	958	1,828	2,300
Loans granted	225	470	1,004	1,700	2,070
- *new loans*	171	354	860	1,385	1,800
- *refinanced*	54	116	144	314	270
- *percent refinanced*	24	25	14	19	13
Amount loaned (in CR$000)	7,201	30,268	147,000	184,469	518,000
US$ equivalent	269,000	573,000	1,552,000	2,394,000	3,047,000
Average loan in US$	1,200	1,200	1,500	1,400	1,500
Total program cost (in CR$000)	9,420	23,696	67,125	100,241	199,888
US$ equivalent	351,000	449,000	709,000	1,509,000	1,175,811
Number of Employees	50	66	93	--	165
Total program costs/ # of loans in US$	1,560	955	706	887	568

Table 5

COMPARISON OF RECIFE AND CARUARU PROGRAMS (1981)

	Recife	% of total	Caruaru	% of total	Total
Loans granted	387	39	617	61	1,004
new loans	(291)	*(34)*	(569)	*(66)*	(860)
Amount loaned (in CR$000)	55,000	38	92,000	62	147,000
US$ equivalent	581,000		971,000		1,552,000
Average loan in US$	1,501		1,573		
Total program cost* (in CR$000)	23,038	40	34,844	60	57,822
US$ equivalent	243,300		368,000		611,000
Number of employees	31	47	35	53	66
Loans per employee	13		18		
Program cost per loan in US$	627		600		
Program cost per employee in US$	7,838		10,514		

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* Cost of program does not include general administration, which totalled CR$ 9,243,000 or US $97,602.

In recognition of the benefits of having branch offices, demonstrated in Caruaru, the UNO Recife is now dividing its operations into six offices or teams located close to the concentrations of microenterprises in the outlying urban areas of Recife. With this separation into six teams, productivity is expected to increase markedly as promoters will be located close to their clients, eliminating long hours of travel. (UNO at present is located in the downtown area of Recife.) It is also hoped that establishing UNO's presence in the poorer communities will in itself attract more microenterprises to the program, diminishing the need for identifying microenterprises. It should be noted that this change is in large part due to another World Bank project geared to assisting medium sized cities in Brazil as well as the success of the Caruaru program.

Rapid Expansion of the Program. Table 4 demonstrates the rapid expansion of the program and Table 5 the breakdown of activities between Recife and Caruaru. In three years the program was able to double the number and amount of loans granted compared to the preceeding six years. Due to the bank changes discussed earlier, over 80% of this increase in volume took place during 1980 and 1981.

Several positive trends can be seen in the cost effectiveness of the program. In 1978 it took $2 in program costs to deliver $1 in loans to microentrepreneurs. In 1981 program costs for the same $1 in loans had been reduced to $.45. This occurred at a time of expansion and diversification. The crucial correlation between credit proposals and loans granted went from 50% in 1978 to over 100% in 1980 and 1981 and, as noted earlier, credits were processed in very short periods of time. Finally, the expanding volume of business represents a much smaller percentage of refinancings, increasing the number of new beneficiaries. As Table 5 shows, the Caruaru program was more cost effective than the program in Recife, averaging 18 loans per employee -- close to 50% more than Recife. The real difference is even greater, as the Recife program is essentially a credit program, while the Caruaru program is heavily involved in cooperative formation, an activity that requires a lot of staff time. The equally revealing cost comparisons show that the higher paid staff in the Caruaru program are proportionally more productive. This analysis is somewhat of an oversimplification and is deficient in that it does not take into account the different program settings. Recife personnel insist that the Caruaru area is a much easier region in which to establish confidence, as it did not go through the demoralizing phase of bank delays that were common in the early days of the Recife program. In addition, microentrepreneurs themselves have had very little prior exposure to assistance programs, which in general have led to cynicism among the microentrepreneurs located in Recife.

During this phase of rapid expansion the Recife program itself underwent very little change, with growth resulting more from changes in BANDEPE than from changes in the program itself. One modification in the basic methodology described earlier was made as a result of Caruaru's experiments. This consisted of combining two steps of the process (selection and analysis), thereby cutting down time delays. As a result, microenterprises are visited only once (after census) for data collection, after which the credit proposal is prepared. In Recife, some microentrepreneurs have obtained loans within two weeks after a visit, the average being 20 to 25 days.

New Methodologies. The Caruaru program had to create new approaches which would allow it to help microenterprises form associations and cooperatives. The one point that all staff members agree on is that the process of group formation is a long and involved one, and that each group is totally different. It would be impossible to develop a standard methodology like the one used in the credit program. Through its credit program UNO gets a good idea of what community needs are via socio-economic analysis, interviews, and staff experience. Based on all of this UNO staff approach selected microenterprises, many of which have not participated in the program and ask if they would be interested in attending a meeting with other microenterprises who make the same type of products to discuss common problems and possible solutions, among them the possibility of UNO arranging credit for them. Groups invited are usually around 30 out of which 15-18 turn up. The most significant aspect of this loosely defined methodology is the group dynamics of the meetings. The UNO staff act as facilitators and moderators keeping the groups focussed on the issues raised. In all of UNO's work in this field, there have been long periods of weekly meetings (between six to twelve months).

The two main themes that constantly are discussed are lack of microenterprise control over the sale of its products and the purchase of its raw materials. Microenterprises over and over express their frustration at being exploited by intermediaries selling their products and by wholesalers from whom they buy raw materials. The sequence of subjects then discussed is whether as a group there are more conditions for bargaining and how to take group action. Here UNO plays a vital role in explaining clearly the differences between informal group actions such as group purchases and sales, and the more formal group actions like the establishment of cooperatives.

After the issues have been discussed, the long process of defining what action the group will take begins. UNO's credit program is a vital part of this process as in a sense it is the cement that keeps the group together and makes whatever action decided upon viable. Once the action has been agreed on, UNO helps the group to proceed to the next phases: election of the group leaders and methods for implementing actions agreed on.

<u>1982 and Beyond</u>. As long as UNO can get the funds allotted to its program from the government, it seems clear that the 1982 estimates (see Table 5) are well within reason. Additional staff and the decentralization of operations in Recife should bring that program up to the same level as the Caruaru program.

III

IMPACT OF THE UNO/CARUARU PROGRAM

This chapter is an analysis of the impact of the UNO program in Caruaru in its various facets. The attempt here will not be to <u>quantify</u> the effects of the program, but to discuss the effects of its methodology through observation, interviews, and examination of records. At this point the only way a serious "scientific" study could be made of the UNO program's effects -- in terms of sales, employment, net worth and other indicators normally used in looking for change over time in microenterprises -- would be to create a sample group of entrepreneurs at the time UNO begins working with them and to keep accurate data from the beginning.

For data on sales, employment and net worth to be used in an evaluation, it is necessary to have accurate, historical data to analyze the before and after situations. However, UNO's methodology is not geared to generating such data. At present data is collected in a one-hour interview between an inexperienced college student with little training in business and an entrepreneur who keeps no records, is normally somewhat distrustful, and who is usually more in control of the interview than the interviewer.

Lack of data is not a negative point for UNO, as it prides itself in streamlining its methodology and granting credit in a short period of time. If attention were given to the need for collecting data, changes that would have to be made in the program's methodology would drastically reduce UNO's ability to get credit out. In addition, Brazil's 100% per annum inflation requires sophistication in analyzing data.

These points aside, much can be said about the impact of the UNO program in Caruaru, in light of its four areas of activity: credit, association/cooperative formation, technology, and training.

<u>Part 1: Credit</u>

Credit is the stated priority and the backbone of the UNO program. However, before looking at the impact of the credit program, several points must be made about UNO's selection criteria. UNO does not select microenterprises for the credit program on the basis of their capacity for growth and employment generation. Nor does UNO analyze "profitability" as a factor for credit approval. The only factor that matters to UNO is size of microenterprise (i.e., the enterprise must qualify as a microenterprise according to pre-established criteria) and what amount of credit the microenterprise can realistically pay back. (See Table 2.)

During 1981, UNO/Caruaru was able to process 617 loans. Of these loans, 569 (or 93%) were to new clients of the program. A vast majority of these microenterprises had no access to formal sector financing and suffered from severe cash shortages, causing them to plan their production or services in extremely short cycles. They were, by and large, family-run enterprises with family and business resources intermixed, and, although their owners and employees were not among the poorest of the poor in the region, they had received very little help or assistance.

Roughly 50% of the loans processed were to small stores and vendors and represented some 40% of the total amount loaned. Fifty percent of all loans were for amounts varying between $500 and 800 and approximately 70% of the amount lent was for working capital purposes.

Given that the basic premise of the UNO program is that the microenterprises' greatest need is credit and that they are, in general, credit worthy, perhaps the first important factor to analyze is the repayment history of UNO's burgeoning loan portfolio. Without getting into the merits of whether credit is the priority need or what the impact of the credit program is, the first thing the UNO program must show is a high repayment rate which will justify in part the basic premise. This analysis becomes even more important given UNO's extremely liberal method of selecting microenterprises and that the enormous growth since 1980 of the credit program has coincided with what is probably the worst economic crisis in Brazil's history, which along with natural disasters such as droughts and floods, has affected the Northeast region. These factors combined would give the numerous skeptics in the formal sector even more cause to believe that microenterprises are unacceptable risks for financial institutions.

UNO's extremely liberal methods of selecting microenterprises has enabled it to service large numbers of microenterprises that have been existing on the margins of the economy by providing them with credit in a timely fashion. Thus, UNO should be evaluated on the important question of loan repayments. Whether these microenterprises have been valid credit risks is a crucial question in evaluating the effectiveness of the UNO program.

Unfortunately, an analysis of loan repayments is extremely difficult. The present system UNO has for control is inadequate, especially given the expansion in lending capability since 1980. Numerous problems exist.

Lack of information: Any control system UNO creates has to be based on information from BANDEPE, which at present is woefully inadequate. Instead of using the traditional method of analysis that controls a portfolio based on 30/60/90/120 and 120+ day delays, BANDEPE provides UNO with only three categories of information about each loan: principal and interest of loan matured and not paid, principal matured and not paid, and principal outstanding. No information on how long a loan has gone unpaid is given. Getting such information requires painstaking work in going back to client files and calculating how many payments have not been made. As the computerized system usually implies delays in processing payments, practically the entire portfolio appears as past due at least 30 days.

The other complicating factor is that UNO has five offices which process loans, and the computer listings from BANDEPE give no indication of where loans were processed. Again painstaking work in examining records of client-by-client is required to discover where loans were processed.

Lack of infrastructure: UNO does not have the required sophistication to control a loan portfolio well in excess of $1 million. BANDEPE's reporting problems aside, UNO does not have a staff with the experience to establish proper controls in this crucial area. UNO managers are well aware of both problem areas and are negotiating with BANDEPE to solve the information problems. In addition, they plan to hire an individual with qualifications to be a "controller" of the lending area.

The importance of this area cannot be underestimated. UNO's loan approval process is very rapid, decentralized and flexible, and can only be effective if there exists a counterbalance of very efficient controls and record-keeping at the administrative level. This is crucial to management's ability to identify and address problem areas as quickly as possible.

In spite of these problems, there are tests that can be made on the portfolio that, with some historical data, can give a good indication of the repayment rates. The tests applied were determined by the information available from BANDEPE. Two of these categories of information contain the most important data: principal matured and not paid and principal outstanding.

The average maturity of the portfolio is between 12 and 15 months, and loans have 3 to 6 months grace periods with equal monthly payments thereafter. Using the above categories, it is possible to determine problem loans by separating out those which have principal outstanding equal to or less than principal matured, the logic being that loans over 180 days overdue should be considered problem loans and will show up in this listing with principal past due greater than or equal to principal outstanding. The hypothetical example in Table 6 illustrates this logic.

Using this formula -- principal in arrears greater or equal to principal outstanding -- enables one to identify the most serious cases of non-payment. Its use is not foolproof, however. Loans that have been paid and are close to final maturity, and may be only one month in arrears, will show up in this listing even though they are not seriously overdue. Also, loans on which no payments have been made will not show up until they are very seriously in arrears. (Although such cases are not common.)

Using the formulas just described basing the calculations on the December 31, 1981 computer printouts, it was found that the total principal of problem loans was Cr$2,858,143 (Cr$1,684,988 in arrears and Cr$1,173,155 outstanding). The total principal of problem loans was 2.03% of total loaned (Cr$140,669,000). This statistic accords with what UNO has stated about its program, that it has a repayment rate of 98%.

However, using the total portfolio causes a distortion because the volume of lending increased dramatically in the second half of 1981 and loans showing payment problems were probably made in late 1980 or early 1981. Therefore, it is necessary to try to compare problem loans with volume of loans processed in the same period.

Of the Cr$2,858,143 in problem loans, CR$1,526,209 -- or 54% -- were loans made between October 1980, and March 1981. During that period the total amount loaned was Cr$26,463,000. Problem loans are 5.8% of this total.

A 94% repayment rate is then a fairly accurate measure of the credit worthiness of UNO's entire loan portfolio. (As BANDEPE does not separate its records according to the different UNO offices, it was impossible to come up with statistics for Caruaru separately.)

An analysis of two older portfolios that precede the one analyzed here confirm this repayment rate. (See Tables 7 and 8.)

Table 6

COMPUTING REPAYMENT RATES

(A hypothetical example to illustrate the method used)

Month	Principal in Arrears on a Loan of $120 for 15 Months with a 3 Month Grace Period — assumption 1 (no payments made)	assumption 2 (3 payments made)	assumption 3 (4 payments made)	Principal Outstanding
1	-	-	-	120
2	-	-	-	120
3	-	-	-	120
4	10	-	-	110
5	20	-	-	100
6	30	-	-	90
7	40	10	-	80
8	50	20	10	70
9	60*	30	20	60
10	70	40	30	50
11	80	50*	40*	40
12	90	60	50	30
13	100	70	60	20
14	110	80	70	10
15	120	90	80	0

* Point at which loan would be considered seriously in arrears using the formula described in the text.

Table 7

REPAYMENT RATES OF BANCO DO NORDESTE LOAN PROGRAM

	Number of Loans	Amount Loaned	% of Total
Total for program	144	CR$ 5,000,000	(100)
Fully repaid	108	3,150,000	63
Outstanding	36	1,850,000	37
- *with payments in arrears*	18	432,169	8
- *fully matured and unpaid*	13	322,463	6

Table 8

REPAYMENT RATES OF BANDEPE LOAN PROGRAM

(First Portfolio)

	Number of Loans	Amount Loaned	% of Total
Total for program	694	CR$ 24,288,000	(100)
Fully repaid	582	17,301,000	71
Outstanding	112	6,983,000	29
- *with payments in arrears*	74	1,316,308	6
- *fully matured and unpaid*	60	906,876	4

These portfolios, which date back to 1978-79, show repayment rates of 92 and 94% respectively. These figures are accurate as these portfolios have had no new loans in over one year and are only being repaid.

The problem loans in the December 31, 1981 portfolio indicate that loans to the retail sector are higher risk than loans to the service and industry sectors; 75% of problem loans were in that sector, which made up only 60% of the total portfolio. That this sector represents a higher risk is not surprising since it generally consists of microenterprises with only one or two people working with limited product lines. If they are unsuccessful, they are able to vanish very easily. A 94% repayment rate, considering all factors, should be considered an excellent repayment rate and strong evidence that the UNO program has been successful in achieving its main objective. As noted, problems exist in control which, if solved, could markedly improve an already good record. The program management recognizes this and has made it a priority. Finally, the program only discounts 3% of all loans for a guarantee fund. In light of the evidence, thought should be given to increasing this amount to 6%.

Part 2: Formation of Cooperatives and Associations

UNO/Caruaru began its work with cooperatives and associations in July 1980, and undertook three specific projects almost immediately.

1) Assistance to microenterprises in Santa Cruz do Capibaribe, resulting in the creation of three groups, for the purpose of purchasing raw materials.

2) Work with clay artisans in Alto do Moura, resulting in the formation of a legal association to secure clay deposits for the artisans and to deal with community problems.

3) Work with tile and brick makers in Bezerros, resulting in the founding of a marketing cooperative to reduce the dependence of these microentrepreneurs on intermediaries.

These efforts involved, in total, over 220 microenterprises (160 clay artisans, 40 textile manufacturers, and 26 tile and brick makers) and three totally different approaches based on local circumstances. In late 1981, UNO began work with yet another group of 20 cowbell manufacturers in Santa Tereza dos Chocalhos.

This area of endeavor marked a major departure for UNO. Contrary to the original premises and assumptions of its program, UNO began to try to change the behavior of microentrepreneurs in a very dramatic fashion. Similarly, UNO decided to try to change the economic environment affecting microenterprises by giving them the bargaining power to counteract exploitative middlemen. While the methodology used up to this point had stressed minimal contact with microentrepreneurs in order to maximize the number that the program could reach, this new activity would entail substantial involvement of program staff with microentrepreneurs on a weekly basis.

The area of association and cooperative formation is the first totally different program ever attempted by UNO since its inception. The importance of association and cooperative formation can be seen in the number of loans given to microentrepreneurs involved in associations and cooperatives. In 1981 such loans numbered 68 out of 617 loans, or 11%.

Santa Cruz do Capibaribe

The first phase of UNO's work in this case was an in-depth socio-economic study. The study revealed that the predominant activity of the area consisted of textile manufacture from remnants imported from the large textile manufacturers located over 1,400 miles away in São Paulo. The fact that so many people in a small area are involved in the same business was in part due to how the industry was introduced into the region. Three enterprising individuals decided to try to use the abundant labor force of women by giving them remnants to sew what is considered "third and fourth class" clothing, to be sold in the poorer markets in the interior of Brazil. With the cyclical problems of drought and unemployment resulting in large migrations to urban centers like Santa Cruz, women began gravitating more and more towards this activity.

The microenterprises vary in size from those employing three people (one cutter and two seamstresses) and using two or three old sewing machines (many over twenty years old) to those with industrial quality machines employing six to ten people. The average numbers of employees is two. There are also a large number of "jobbers" -- women who own one machine and perform work for a microenterprise.

The most important channel for marketing goods is through the open air markets, held two days a week, when buyers from all over the northeast and northern regions of Brazil come to purchase. These buyers tend to purchase in small quantities and, in some cases, develop a steady buying relationship with one enterprise. Average sales for microenterprises in this sector is around $700 per month. Average family income is $145.

Eighty percent of these entrepreneurs purchase all raw materials from local warehouses at from two to three times the price charged in São Paulo.

Based on this data, plus much more not detailed here, UNO concluded that the main problem of microenterprises in this sector is their extreme dependence on the local wholesalers, who not only charge exorbitant prices but also keep the micro-entrepreneurs on a tight line by being the only source of financing available to them. Behavior patterns exist which are extremely difficult to change. Patron/client relationships have developed between the microentrepreneurs and the local wholesalers, who allow the entrepreneurs to make monthly purchases with the "privilege" of paying when and as they can, with no interest. Instead of analyzing the prices they are charged, the microentrepreneurs tend to be very grateful for what they perceive as the wholesaler's leniency. In addition, the wholesalers take advantage of the entrepreneurs' reluctance to be in debt and in many cases charge the same exorbitantly high prices for purchases paid for one time or paid in full at the time of purchase.

Other problem areas were also identified, but by far it was in the area of raw material purchase that UNO felt it could make a difference.

Group I: Based on data collected in individual surveys, UNO invited 22 individuals to a meeting. the principal criteria being that these individuals were amongst the poorest in the region; they were jobbers, not themselves microentrepreneurs. The meeting was attended by only 10 of the 22 invited and served to establish UNO's credibility. During the meeting it became clear that these jobbers were reticent about associating in a common endeavor and mistrusted UNO, perceiving it as a government program, and fear of tax collectors. (Some of the jobbers, fearing that UNO might be connected to tax collectors, gave out erroneous data about themselves.) However, it also was clear that obtaining raw materials was the most important problem of these individuals, who were well aware of the high prices they were paying.

During the second meeting, to which an additional 12 jobbers were invited, an atmosphere of confidence was created and participants felt free to talk openly. UNO then found out for the first time that very few of the individuals were actually jobbers. Most were actually in better situations than UNO surveys had showed.

UNO began to guide the individuals toward creating a group that would have the ability to purchase raw materials directly from São Paulo. It should be noted that the UNO team relied greatly on the dynamics of the group and, while offering suggestions, made it clear that they would respect all decisions made by the group. The group began to gather momentum as it became clear to individual members that, by pooling their resources (i.e., loans extended to them individually by UNO), they would have enough money to go to São Paulo and purchase remnants in larger volume at cheaper prices.

The process was a long one; UNO began meeting with this group in late September of 1980, but it wasn't until June of 1981 that the "group" purchase was made. During this period, meetings were held almost every week.

During this long period the group was preoccupied with deciding who would go to São Paulo with the group's money and arrange the purchase. The group proved to be susceptible to members imposing themselves on it and dominating its discussions and decisions. One member -- who was much better off than the others -- was insistent that he go to São Paulo as he had contacts there, having purchased there in the past. UNO staff became apprehensive about the group's ability to resist this strong minded individual, even though members, outside the meetings, voiced doubts about him. UNO then proposed that an UNO staff member accompany the buyer. The member who had imposed himself on the group then changed his strategy and stated that, as he was going to lose a lot of time going to São Paulo, the group members should pay him a fee based on a percentage of remnants bought for each one. After heated discussion, the group expelled this member. They apparently judged that he had intentions that would have been negative to the group and could not be entrusted with a large sum (over $10,000) of money. They chose two others, among the poorer members of the group, to go to Sao Paulo.

The purchase of remnants in São Paulo was a tremendous success for the group. All members were able to buy supplies that would last over three months for half the price, and the remnants were of a better quality than those purchased in Santa Cruz. Once this task was accomplished, however, the group lost its dynamics, and attendance at meetings dropped off. Aside from a small joint purchase made locally, the group has been unable to take any other action. UNO's position is that new financings will not be available until 80% of previous financings have been paid off.

Group II: The second group formed by UNO really cannot be analyzed in the same light as the others, because it consists of five members of a family dominated by a patriarch, and does not accept any outsiders. The economic situation of these members is far better than that of the other groups. The patriarch owned several industrial machines and had his own car and a good home.

The members never really formed a group. The patriarch put together the financings and went to São Paulo to purchase material. UNO's participation was minimal and consisted solely of granting credit.

Group III: This group was established in the same way as the first group, but the individuals chosen were, for the most part, poorer than the first group. The group evolved in a parallel fashion to Group I, but unfortunately the results were not as beneficial.

Once again, the crucial decision in the life of this group was choosing who would go to São Paulo and, once again, one member was able to impose her will. However, in this instance UNO did not intervene and the woman went to São Paulo and purchased poor quality remnants for all members except herself. The result was that the group received remnants that were, in great part, unusable, and members lost interest and became cynical about the benefits of group action.

Discussions were held with UNO staff and interviews conducted with members of these groups revealed the following:

Results: Group I members benefited substantially from UNO's intervention, not only because of the purchase of remnants, but also because many had used the financing to buy sewing machines. In some cases these microentrepreneurs had actually doubled their production and as a result were generating employment as well as greater profits.

However, the patron/client relationship between microenterprises and remnant middlemen in Santa Cruz proved to be very strong. Rather than change their buying patterns after their successful purchase, Group I members continued with their traditional buying habits. UNO was unable to instill in Group I a discipline whereby the substantial benefits of their successful purchase would, at least in part, accrue over time towards a new purchase. The problem here was also one of a lack of mechanism. After the São Paulo success, attempts were made for local group purchases but, in addition to the traditional patron/client problem, members were expected to come up with lump sums -- something they were completely unaccustomed to.

Group III members had little or no change as a result of UNO's program. In fact, the impact seemed negative as expectations had been raised and no benefit realized.

In both Group I and Group III the passivity of members due to lack of experience and insecurity allowed for selfish individuals to impose their will. UNO was able to intervene in a timely fashion with Group I but did not learn sufficiently from that experience to intervene in like manner with Group III.

UNO's credit program was the determinant in getting these groups to take action. In fact, contrary to what the groups may have expressed to UNO, it was the credit component that kept them together. This is particularly clear in the experience of Group I, even though their experience was beneficial, they have not taken any further action in the eight months since their successful purchase.

Alto do Moura: Association of Clay Artisans

Alto do Moura, located some 8 kilometers from Caruaru, is known throughout Brazil for its artisan work, particularly for its clay figurines. The production of clay figurines began 30 years ago with one man, Mestre Vitalino, who became nationally famous and inspired several to imitate his unique style. The result is that today there are over 200 clay artisans in Alto do Moura. This artisan colony was seriously threatened in late 1979 and early 1980, when the owner of the land containing the clay deposits attempted to prevent access to it by the artisans. The issue became widely known, to the point where the powerful Brazilian television network -- T.V. Globo -- did a program on Alto do Moura.

UNO's involvement began during the latter part of 1981, when the artisans were becoming increasingly frustrated with the government's lack of attention to their problems, not only in terms of access to clay reserves, but the lack of health and education services as well. UNO began by first identifying these problems, visiting individual artisans, and then calling a meeting. Well over 100 artisans attended.

The immediate problem was clearly seen as the need to have some representative entity that could be an effective lobbying force for the artisans. Added to this was the need for the group to have legal status as it was clear that the government was becoming sympathetic to the plight of the artisans as a result of increased public attention given to their problems.

With all this in mind, UNO helped the artisans to decide on a legal association that could own and administer the clay deposits on behalf of all artisans. Thus, in August of 1981, the Association of Residents of Alto do Moura -- ABMAM -- was created. Instead of being solely dedicated to the needs of the economic activity -- artisan work -- it was decided that the association's mandate should encompass the needs of the community's infrastructure, as well as health and education problems. The statutes, with UNO's guidance, were non-restrictive insofar as non-members would be allowed to purchase clay at the same price as members.

With the association in place, lobbying efforts intensified and the government expropriated (with renumeration) the land containing the clay deposits and donated it to the association. Other promises were secured from the government: a teacher for the community, a school, a health post, road improvements, and a telephone. Of these problems, however, only the telephone has materialized as of February 1982, while the government's promises date as far back as early 1980.

The association has some 160 members, 30 of whom have not paid their dues (approximately US$.50). It was able to secure a sizable space where meetings and parties are held and where a permanent exhibit of artwork is being established. It is also the location of the community's only telephone.

It is important to note that UNO's role has been solely that of an advisor, and no credit has been given to any of the members. However, UNO's participation was important in giving the group guidance in how to organize and what legal structures to adopt.

The artisans were brought together by a common need: supply of raw materials, which replaced credit as the focal point of group formation. The association they formed has been an effective force in lobbying with the government to guarantee the supply of clay and make it available at prices 30% below what artisans used to pay, thus ensuring the continuation and increasing the profitability of artisan activity in Alto do Moura.

There are some negatives. Although Also do Moura is a poor community, it is highly stratified, with some well known artisans buying and affixing their names to the work of poorer artisans and selling it at higher prices. UNO has been unable to affect this exploitation, although it is attempting to do so, and continues to raise the issue with the directors.

The directors of ABMAM (some eight individuals) are practically all part of the "elite" of Alto do Moura and are quite paternalistic toward their members. (This is interesting as these directors were elected in a meeting where over three-quarters of the membership were present.) Much of the membership feels alienated from the association, and meetings are poorly attended (for example, only 30 attended the February 1982 meeting; six were directors).

In talking with non-members of the association, a certain mistrust of and, at least in one case, animosity towards the leadership could be detected. On its part, the association does not see the need actively to recruit members or convince them that the association is good for them. It expects the artisans to join out of their own motivation. However, in discussions with the author, artisans located a mere ten yeards from the association's headquarters (one of the nicer buildings of the community) showed misperceptions about what the association is, who it is for, and what it has done.

Bezerros Cooperative

By far the most significant achievement of the UNO program is the area of association and cooperative formation was its work in Bezerros, located some 25 kilomters from Caruaru. Here UNO brought about dramatic changes in the lives of the tile and brick-makers of the area. Not only did UNO help establish a permanent institution -- a cooperative -- but it affected the economic environment as well, changing the relationship between the brick and tile-makers and the middlemen.

UNO's involvement began in July of 1980, when a group of tile-makers requested help in establishing some form of union. The tile-makers felt that somehow they could create a union which would enable them to be eligible for government health services. UNO's first step was to go to the area and research the situation.

What UNO found in the Bezerros area was a concentration of over 250 tile-makers, of which 200 were barely subsisting. This concentration is located along the banks of the Ipojuca River, where tile-making has been carried out for probably well over 50 years. The quality of the clay is so high that primitive production methods are adequate for producing an acceptable quality of roof tiles, bricks, and clay pipes.

In researching the socio-economic situation, UNO found that, due to this large concentration of producers, middlemen were able to take tremendous advantage by bargaining down prices and holding out until the necessity for money was so great that the producers would take the middlemen's price. As these producers kept no records, UNO made an in-depth analysis and found that they were actually selling at 10% below cost, computing one minimum wage per producer. (It should be noted that the regional minimum wage is considered insufficient to maintain a family of five.) Meanwhile the middlemen, most of whom owned trucks, were making profits ranging from US$600 to 1,000 per week on four to six truckloads.

These factors led UNO to believe that the best strategy for this population would be the creation of a cooperative. UNO thus began a process of weekly meetings with the producers to educate them and explain to them the possibilities and potential of such action. These meetings were long protracted affairs because the producers did not believe that it was within their capability to change the situation they were confronted with. Some 30 producers participated in these meetings, 26 of whom would be the founding members of the cooperative.

In March of 1981, the Ipojuca River flooded, destroying several production facilities. This accelerated the process tremendously as the creation of the cooperative became increasingly necessary. After the flood, UNO made an emergency effort to provide producers with financing to rebuild their production facilities, and the cooperative was founded on April 26, 1981. Due to the complex bureaucracy governing cooperatives in Brazil, the cooperative was not fully legalized and operational until December of that year.

It is interesting to note that UNO's files show that even after the financings were made in March of 1981, a great majority of the producers continued to believe that the cooperative would be, at best, only a partial solution to their problems and that they would have to continue selling to middlemen.

The patron/client relationship between middlemen and producers in this area is deep and complex. Over time the situation of the producers had deteriorated to a point where they would have to ask for advances from middlemen. This occurred with a majority of the producers and gave the middlemen added leverage over an already vulnerable population. The producers' attitude toward the middlemen was a passive and accepting one, along the lines of, "If I had a truck I'd do the same thing." To change from this to a militant attitude of group cooperation was a quantum leap for these people, even after a long nine month process of meeting with UNO staff on a weekly basis.

From the beginning, the role of UNO in the establishment of the cooperative was predominant, to the extent that an UNO staff member (who had been involved in the process since the beginning) was named general manager of the cooperative at the request of the producers themselves.

Several issues had to be resolved before the cooperative could be founded, the crucial one being the commitment by members to deliver all their production to the cooperative. Other issues were the election of directors, the need for standardization of tile size, and setting the prices at which the cooperative would buy from its members and sell in the market. (It was decided that the cooperative would pay 15% over costs to the producer and sell to third parties at 25% over its purchase price, thereby helping to capitalize the cooperative.)

The newly-formed cooperative was able to lobby successfully with the mayor of Bezerros and secured a large tract of land located on the main highway that traverses the state of Pernambuco. This area is the size of a soccer field and is completely walled in and secure for storing production of the coop's members. The cooperative was also able to secure a loan of Cr$4,000,000 to be used to finance producers on a rotating basis. The cooperative also applied for a Cr$7,000,000 loan through Polonordeste to cover the purchase of a truck, production financing, and one year of salaries for the general manager and an accountant working half time.

The first major problem UNO faced was the selection of the cooperative's president. The members unanimously elected a producer whom UNO had mixed feelings about since he was a well-known "wheeler dealer" and had questionable intentions. UNO was able to resolve this problem by having him disqualified based on the bank's refusal to accept his signature. He had a history of writing bad checks. Once again, a passive, insecure group had chosen a leader who imposed his will on them. UNO was able to resolve the problem, convince the president to resign (although continuing in the cooperative) and arrange for the election of a suitable member.

The cooperative that became operational in December of 1981, consisted of 26 members, 6 of whom were relatively well-off, with a monthly production capacity as follows:

	Av. Monthly Production	# of Producers	Total
Roof Tiles	40,000	26	1,040,000
Bricks	16,000	26	416,000
Clay Pipes	4,000	6	24,000

Based on the above estimates at full production, and at the newly established prices, the cooperative should be able to sell roughly US$50,000 of tiles, bricks and pipes per month, and buy US$37,500 worth of production from its members.

The cooperative began operating in January 1982. It is seriously hampered because it does not own a truck and is forced to contract sales and send buyers directly to the producers to pick up their goods. This situation is somewhat dangerous, as the cooperative at present is relying on the same middlemen who have always operated in the area and who are not pleased with the cooperative's actions. The general manager visits each member on a weekly basis and tabulates what production will be delivered and, based on this, how much credit the member wants in advance. The cooperative then draws down on its line of credit and pays members. To date the cooperative has not established the capability of being able to market the entire potential production of its members, as it has been unable to establish strong links with buyers outside of the traditional middlemen. This has not been a serious problem so far, since rains have hampered production. The cooperative has, however, a significant inventory of finished goods (all located on each member's lot) and was, as of February 1982, close to drawing down the last amount available under its line of credit.

There can be no doubt that the cooperative is existing in a hostile environment, as it poses a serious threat to age-old patterns of exploitation by middlemen. In fact the general manager, an UNO employee, has received death threats. If the cooperative is able to survive in spite of the hostility, there is every indication that it will grow and provide many needed services to its members. About six individuals have already expressed interest in joining, and the potential here is for over 200 additional members. Other than the benefits of setting fair prices, the cooperative will be able to implement important technological changes (see Part 3 on technology) which will increase productivity and possibly introduce new, more profitable products. Health services will be available to its members for the first time. Most important, members will be able to expand their businesses and have a guaranteed outlet once the cooperative establishes itself in the marketplace.

Discussions with UNO staff, interviews with members and attendance at a cooperative meeting during the author's visit, revealed that income has already increased. Also the attitude of the members is more confident and they are beginning to believe that the cooperative can be a viable enterprise, can in fact, solve some of their problems. This change in attitude was exemplified in the general meeting where it came to light that five or six of the members had been selling directly to middlemen. The membership unanimously agreed that strong measures should be taken to prevent this and that members who do not comply with the rules of the cooperative should be expelled.

However, the cooperative is in a vulnerable situation. It is totally dependent on UNO financing. Insufficient groundwork has been done to guarantee sales of members' production. The cooperative members are still very dependent on the general manager, who dominates their meetings and decisions.

The cooperative will always be dependent on the middlemen in one fashion or another, but the present system whereby members keep their production on their land and deliver it to middlemen hampers the process of breaking the patron/client relationship between the middlemen and producers. It is equally important that the cooperative be able to pick up its members' production and store it in one central place. The middlemen will pose a continued threat to the existence of the cooperative, as long as the cooperative depends on them for freight. This situation should be resolved in short order as the financing to buy the truck is scheduled to be approved in the near future.

Santa Tereza dos Chocalhos

The most recent work in the area of association and cooperative formation, which began in September of 1981, is in a community of 20 cowbell producers. In this community once again, middlemen are successfully able to force prices down. Extremely primitive methods of production are used, which have been passed down through generations. Although it is located close to a fairly large city, the community is quite isolated, with no health services, and no schools. (One mother in the community is teaching the children some basic reading skills.)

UNO's strategy in Santa Tereza dos Chocalhos was to establish a minimum price list agreed to by all producers. As the producers had no working capital and were extremely vulnerable, UNO decided the best possible action would be to finance the producers so that they could hold to the minimum prices. Aware of what the producers were attempting, the middlemen stockpiled cowbells in the hopes of starving the producers. The financings allowed the producers to continue working and accumulating their own stockpiles so that when the middlemen decreased their own stocks they would be forced to buy at the producers' prices. However, UNO was unable to include Santa Tereza in its credit program since it falls just outside of UNO's jurisdiction. For that reason, an outside source of funds had to be found.

It is too early to evaluate the impact of this strategy. The new price list was only established in January 1982 and middlemen's stocks had not run out at the time of this writing. However, the producers are optimistic and enthusiastic, and UNO feels strongly that there is real potential for them to become a strong and effective group.

UNO has acted primarily as an advisor, and has achieved a great deal of success in a short period of time. Its ability to finance the producers gave UNO credibility, as these producers were skeptical about how successful UNO could be. But UNO's credibility could crumble, as it does not understand sufficiently the market for cowbells. Raising the level of expectations of the producers could be potentially dangerous. There is uncertainty as to who the final users for this product will be (i.e., is it an antiquated product which will become extinct over time, or will there always be a growing market for it). UNO is taking steps to correct this and has established contacts with the cattle growers association in Recife in hopes of understanding their needs and selling directly to them.

As the production process is primitive, technological inputs may be quite possible on several levels once the group is functioning in a more defined manner.

Future Projects

The state government of Pernambuco recently signed an agreement with UNO whereby UNO will establish and staff a marketing cooperative in the Caruaru area to deal initially with three separate groups: the clay artisans of Alto do Moura; the cowbell producers in Santa Tereza; and the straw artisans in Fazenda Nova. The stage government will pick up the costs for the cooperative's first two years of operation.

Through its recently established office in Pesqueira, UNO is beginning to work with "rendeiras" -- women, and in some cases, men, who do very elaborate embroidery work on lace. In one small city, Pocao, there are over 1,000 women engaged in this activity. There is great potential for using a grouping system to market these products, which have very high value.

Several other activities will probably be undertaken, as UNO has excellent ties with both the state government and the Cooperative Association of Pernambuco.

Part 3: Technology

Through its agreement with UNO, ITEP (Technological Institute of the State of Pernambuco) has been working on improving technologies for approximately two years with microenterprises in Caruaru, Santa Cruz do Capibaribe, Toritama, and the Bezerros cooperative.

Founded 40 years ago, ITEP is an impressive institution. It operates as a foundation linked to the state Ministry of Industry and Commerce. Each state in Brazil has a similar entity, but ITEP is noted for its specialization in the field of alcohol and energy in general, and is amoung the top four or five institutions of its kind. It is divided into seven departments: Technological Information, Chemical Analysis, Mechanical Engineering, Chemical Engineering, Energy, Construction, Forestry and Wood Related Technologies.

The microenterprise program is a part of the Technological Information department but draws, as needed, on the resources of other departments. In the Caruaru region there are three full time professionals plus a supervisor in Recife, who now spends most of his time overseeing the work in the Caruaru program. Two of the full-time staff members are located in Caruaru and one in Santa Cruz do Capibaribe. Of these three, one has been with the program two years; the other two were hired recently. This staff has a varied background. The supervisor is a mechanical engineer, while the others are more practically oriented -- one having been trained as an industrial electrician and the others with backgrounds in equipment maintenance and repair.

The technology part of the program is still in a learning phase, in which the staff is attempting to understand the problems of microenterprises and how to help them cope with these problems. With the exception of courses given, primarily in the area of repair, most of the work has been individually oriented. To date, the staff has reached an important conclusion: that the technologies used by microentrepreneurs are for the most part adequate, and the real needs lie in the areas of maintenance and repair. In general, it was observed that microentrepreneurs tend to spend money on minor repair jobs that they were capable of doing themselves, because they were "intimidated" by their machinery. A strategy was developed to "demystify" the simple machines used and to explain the importance of maintenance, as microentrepreneurs were not found to be conscientious in this area.

Caruaru

ITEP staff have been working in the city of Caruaru for two years. Most of this time has been spent learning about a wide variety of activities. In general three areas were identified: furniture making, small scale saw mills, and textiles. In each area, the ITEP technician tried to bring together microentrepreneurs to train them in maintenance and repair of equipment, as well as how better to organize their production. ITEP found that it was difficult to get the entrepreneurs to come to courses and as a result has given only six courses which were poorly attended (of 30 invited, only 8 attended). Consequently, most work is done through individual sessions with entrepreneurs who are designated by promoters as having technology problems.

There is a real effort to learn from microentrepreneurs. For example, an ITEP technician worked one day a week for two months in an auto mechanics shop to understand how it was organized, the type of work done, and the equipment used. With this experience, he was able to recommend improvements in organizing the work and to help design a better set of tools. Other interesting examples were observing furniture making and realizing that the method for sharpening tools was inadequate or helping to design a more fashionable style of jeans to be made by pants makers.

Santa Cruz do Capibaribe/Toritama

Here a full-time ITEP technician will enroll in a training course which will make him a specialist in sewing machine repair and maintenance, and will then pass on these abilities to the vast number of microenterprises in this area. In Toritama, cost saving equipment for leather tanning has been designed.

Bezerros Cooperative

ITEP is involved in a number of projects with the cooperative. Early on in the formation of the cooperative, ITEP was consulted on how to standardize the size of roof tiles made by the cooperative's members. In addition ITEP is working with the cooperative members who are using inferior clay to bring them up to the standards of the other members. (As members are spread along the banks of the Ipojuca River, not all clay is of the same quality.)

However, the most important project ITEP is undertaking is the design and construction of a kiln which will improve the quality of the product and increase the efficiency of the producers.

At present, members of the cooperative, for the most part, use a primitive kiln with no roof, which allows heat to escape from the top. Tiles must be in the kilns 24 hours, and as the heat travels with in a vertical direction, does not circulate, and practically all of the tiles have been unevenly burned. Under-burned and over-burned tiles are unusable, and the remainder have an uneven color. Tile-makers generally lose 10-20% of production for these reasons. The new kiln, which circulates heat evenly, guarantees even burning of tiles, and therefore brings losses to a minimum.

The tile-makers are enthusiastic about the idea of a new kiln. UNO raised funds to build a pilot model on a plot of land belonging to one of the members. Two problems have arisen, however. First the cost of building the kiln has escalated significantly due to inflation and miscalculations. The cost is at present estimated at CR$500,000 or US$4,000 -- well beyond the means of the majority of members. Second, UNO requires that the member receiving the benefit of the new kiln give the cooperative rights over the land, to prevent the member from profiting by selling off his land and the kiln on it. A member was selected through a lottery, but his father, who owns the adjacent land, was skeptical about giving away part of the land to the cooperative and would not agree. This problem will probably be resolved. However, the high cost of the kiln will remain a serious problem.

During interviews with the author in February 1982, ITEP personnel did not appear well versed in the economics of the kiln. They knew the investment would not be viable based on reduction in the breakage alone but had to be considered in light of savings in fuel work also. (The new kiln would use half as much wood as the traditional kiln.) However, no cost benefit analysis was made.

Based on information gathered, the writer was able to make a rudimentary calculation of the benefits of the kiln (using February 1982 in cruzeiros prices). With the new kiln one can realize savings of Cr$5,000 per batch from reductions in the amount of fuel needed and Cr$1,000 from reduction in breakage. Annual production is four batches (12,000 tiles) per month from July through January and three per month from February through June.

Savings Calculations

July-January:

4 batches x 7 months x Cr$5,000 (wood)	= 140,000
4 batches x 7 months x Cr$3,500 (breakage)	= 98,000

February-June:

3 batches x 5 months x Cr$5,000 (wood)	= 75,000
3 batches x 5 months x Cr$3,500 (breakage)	= 52,500
Total	= 365,500
Average savings per month	= 30,500

Without considering interest costs, the kilns could pay for themselves in 17 months, which would appear viable. Unfortunately the calculation for the cost of the kiln is open to question, because the ITEP staff does not appear to be well versed in calculating these costs.

Other projects which are being worked on by ITEP include a mechanical mixer and a press, both of which would increase the quality of the tiles markedly. But again the cost of all these improvements (some Cr$310,000, or US$2,600) would also seem outside the capabilities of the majority of the cooperative members. There seems little possibility that a majority of members would have access to credit to buy these improvements. Because the cooperative will need all its credit to finance production, and UNO has already granted members sizable loans since the March flood, only five or six "elite" members of the cooperative can afford and in fact are already trying out some of these new machines.

There are some disagreements within the ITEP staff on how to proceed. One staff member believes that the proper route to follow is not to introduce a new kiln, but to experiment with interspersing bricks among the stacks of tiles to guarantee an even burn. Instead of a motorized mixer a mule-driven version may be possible. UNO staff members also have some doubts about the new kiln due to its cost.

There are many unanswered questions about what impact this technological package will actually have. Ultimately the technologies are labor saving, an issue which the cooperative has not yet faced. The general manager of the cooperative feels there is a shortage of labor and sees the issue as not very important. While it seems clear that the technologies will affect the quality of the product more than the quantity produced, it is unclear how much more the members could make if the quality of their product improved. There is, with this new technology, the possibility that tile-makers could move into a new line of production: special construction bricks. These bricks have a much higher price per unit, and, with the new kiln and motorized mixer, the bricks would be good enough to be sold to major contractors in big cities. Again, the only members who could make this move would be the five or six "elites" mentioned previously.

ITEP's work with the Bezerros cooperative has been extensive enough to show up problems in its approach. More attention must be paid to cost analysis in thinking up solutions to problems. The focus should be on projects that will benefit the great majority of members, rather than the few who are already relatively well off. Not enough attention given to the labor savings aspects of their projects.

ITEP expects to be working in new areas, notably with the clay artisans in Alto do Moura.

Part 4: Training

The UNO/Caruaru and UNO/Recife programs are in accord about training. UNO is a social program geared towards providing credit to microenterprises and training is a secondary element. Microenterprises at the level UNO deals with don't really need "business" training; they simply need certain basic useful information. The most important course UNO has is Banking Services, which consists of acquainting microentrepreneurs with how to open a bank account, how to make deposits, and how to write a check. This course illustrates the level at which UNO is working. For the most part the entrepreneurs are illiterate or semi-literate. Teaching aids consist of an oversized check, deposit slip and other banking documents, which are filled out during the two two-hour-long sessions.

The other courses taught, in addition to those in repair and maintenance discussed previously, are administration, accounting, and sales. These courses are unstructured group discussions in which UNO staff encourage entrepreneurs to share experiences with one another. UNO does not attempt to teach a system or method.

UNO leadership firmly believes that only a small minority of microentrepreneurs are destined to grow. Those that do will in fact need more sophisticated training, but they are not in UNO's target population. There are other programs sponsored by the government to fill their needs.

IV

UNO'S INFLUENCE

In close to ten years, UNO has grown from an organization of 10 members operating in one area -- Recife -- with operating costs of $77,000, to an organization of 100 members and operating costs estimated at $1,176,000 for 1982. These numbers reveal UNO's success and growth from the organizational standpoint. The question of how this growth was achieved is answered in part in Tables 9 and 10, where UNO's success in diversifying its sources of funding and decreasing unwanted dependency on one source can be seen.

The most important institution for UNO since its beginning has been CEBRAE (Centro Brasiliero de Assistencia a Pequenas e Medias Empresas, or the Brazilian Center for Assistance to Small and Medium Sized Enterprises). CEBRAE is a federal agency which has a network of agents -- one in each state -- dedicated to helping small and medium sized enterprises through training and credit. UNO convinced CEBRAE that UNO-assisted enterprises were much smaller than CEBRAE's clients and that for this reason UNO should receive agent status from CEBRAE, as its program could provide a very helpful complement to CEBRAE's own efforts.

International private voluntary agencies, due to AITEC's participation, were important in the beginning years of the organization. From 1974-77, there was a three-way partnership between international private voluntary organizations, CEBRAE, and the Brazilian private sector. As the others phased out, or proved to be unreliable, CEBRAE took up the slack.

Dependence on CEBRAE threatened UNO's autonomy, as UNO is one of the few organizations generously funded, for the most part, through the government. Some have suggested that UNO should be incorporated into the government. These suggestions are dealt with by the superintendent of UNO, a man with extensive government experience who is able to deal effectively with threats to UNO's autonomy.

Table 9

SOURCE OF UNO's OPERATING REVENUE

(In Thousands of US$)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	Total	
AITEC	14.9	1.0	.9	.7	4.5	1.7	--	--	--	--	23.7	1%
PACT/VITA	13.5	42.4	24.2	11.8	--	--	--	--	--	--	91.9	2.5%
OXFAM	18.1	9.3	26.9	21.8	20.1	--	--	--	--	--	96.2	2.5%
Canadian Embassy	3.6	7.5	8.2	--	--	5.0	--	--	--	--	24.3	1%
Catholic Relief Services	--	--	8.0	21.6	4.6	--	--	--	--	--	34.2	1%
Inter-American Foundation	--	--	--	19.2	13.0	--	--	--	--	--	32.2	1%
Merrill Foundation	--	--	--	11.1	--	--	--	--	--	--	11.1	--
A.T. International	--	--	--	--	--	--	--	28.5	36.3	5.6	70.4	2%
POLONORDESTE	--	--	--	--	--	--	90.1	208.3	388.1	512.9	1,199.4	33%
CIDADE PORTE MEDIO	--	--	--	--	--	--	--	--	--	50.0	50.0	1%
CEBRAE	25.3	44.2	44.3	56.4	74.8	132.3	165.7	170.4	211.2	211.8	1,136.4	31%
PIPMO-MT. TRAB*	--	--	--	--	--	47.8	66.4	15.1	11.0	--	140.3	4%
FIDEM*	--	--	--	--	--	--	--	--	--	188.2	188.2	5%
URB*	--	--	--	--	--	--	--	--	--	94.1	94.1	3%
URJ*	--	--	--	--	--	--	--	--	--	47.1	47.1	1%
Other	2.0	43.4	40.0	39.9	44.9	61.9	29.1	26.3	62.3	66.2	416.0	11%
TOTAL	77.4	147.8	152.5	182.5	161.9	248.7	351.3	448.6	708.9	1,175.9	3,655.5	100%

* Various state and municipal organizations and foundations located in the State of Pernambuco.

Table 10

SOURCE OF UNO's REVENUE BY SECTOR

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982 (estimate)
International private voluntary organizations	65%	40%	45%	47%	26%	3%	--	6%	5%	.5%
World Bank related	--	--	--	--	--	--	26%	46%	55%	48%
Federal government (CEBRAE)	33%	30%	30%	31%	46%	53%	47%	39%	30%	18%
State/city government	--	--	--	--	--	19%	19%	3%	2%	28%
Private sector	2%	30%	25%	22%	28%	25%	8%	6%	8%	5.5%
Total operating costs in US$	77.4	147.8	152.5	182.5	161.9	248.7	351.3	448.6	708.9	1,175.9

In 1979, dependence on the government diminished when UNO began its involvement with the World Bank. Although the Polonordeste project is co-financed by the Brazilian federal government (65%) and the World Bank (35%), UNO is not submitted to the same bureaucratic pressures that its dependency on CEBRAE entailed, since the contract guarantees four years of funding.

UNO has since diversified its sources of funding, with Polonordeste now its largest single source of funds. Funds for the Recife program have been diversified as a result of restructuring into six new field offices. UNO has been able to secure funding from state and city sources for each office.

The Banking System

The UNO credit program, by the design of its methodology and the assumptions UNO has about microenterprises, does not seek to alter the behavior or relationship of microenterprises except in attempting to bring them into the formal sector banking system. UNO's substantial experience in this area has disproved long held beliefs as to the lack of credit worthiness of microenterprises. Through its work, UNO is making a strong case for state owned banks to extend credit to microenterprises. UNO may also be able to disprove the other widely held belief of bankers that even credit-worthy loans to microenterprises are not viable, as the cost of processing these loans will never be offset by income generated from them. UNO's simplified methodology may go a long way in convincing bankers that microentrepreneurs need not be treated in the same fashion as other more sophisticated enterprises.

Traditional Sources of Credit

From 1973 to 1981, UNO granted over $3,500,000 in loans in the Recife and Caruaru regions. These funds replaced traditional sources of credit for microentrepreneurs as a vast majority had no previous access to formal sector sources of credit. The two most important traditional sources of credit for microentrepreneurs are money lenders (ranging from family members to "loan sharks") and suppliers who allow entrepreneurs to pay in installments for raw materials or supplies.

It is probably safe to say that losing those entrepreneurs who borrowed from UNO had little effect on money lenders; they found other customers willing to borrow at the same high rates of interest. It is widely believed that informal sector sources of credit are dealing with inelastic demand as money is lent in small quantities for short periods of time, so that the exorbitant rates of interest are never properly understood by microentrepreneurs. The need for capital is so great in the informal sector that microentrepreneurs or, as is more common suppliers, use money lenders. In the Recife and Caruaru areas it is estimated that there are over 100,000 microenterprises. Since UNO in its entire history has only lent to some 2,000, it is unlikely that traditional money lenders are being displaced.

It is difficult to assess the impact of the $3,500,000 loaned out by UNO on suppliers. Again, the lack of understanding of how much interest is actually being paid, combined with traditional patron/client relationships is the central problem. Suppliers build up relationships over time with microentrepreneurs and show great flexibility in "financing" them. This "financing" is extremely misleading. Suppliers include in their prices exorbitant margins so that, when microentrepreneurs buy supplies and are allowed one or two weeks, or even a month, to pay, they consider the supplier very lenient for not charging anything extra. What the microentrepreneurs usually do not understand is that in most instances when they pay in full there is no discount either. UNO has found that entrepreneurs are very conscientious about paying off their suppliers because they are the main source of financing available. Lack of working capital restricts the extent to which the microentrepreneurs can shop around for prices. They are thus dependent on their regular suppliers.

It is probable that a large part of the total loans made to microentrepreneurs benefitted suppliers tremendously, since microentrepreneurs, always wishing to impress their main source of credit, probably paid for purchases in full, thus eliminating the marginal benefit they received from buying over time. Rather than changing traditional relationships between microentrepreneurs and their suppliers, UNO's credit program reinforces them.

Middlemen

It is much too soon to analyze the effect of the UNO program in cooperatives or the relationship between microentrepreneurs and the middlemen -- on whom they are extremely dependent. However, certain indications are clear. The most successful experience overall was the Bezerros cooperative. The co-op has had an interesting "ripple" effect that can increase over time as more tile-makers become members. Its main effect on middlemen is to put them on the defensive. Middlemen are paying even higher prices than the cooperative in an effort to get members to sell outside the cooperative framework -- very clearly a short-term strategy. Middlemen are also reportedly spreading rumors that the difference between what the co-op pays its members and receives from sales is being pocketed by the general manager of the co-op -- the main villain in the middlemen's perception. If the cooperative survives its vulnerable first stages -- and the UNO staff is confident it will -- there will inevitably be a movement among the over 200 tile-makers in the area towards joining the cooperative, which would radically alter the relationships of the entire area.

Other attempts made by UNO to promote group action reveal how strong traditional relationships are in the informal sector. In Santa Cruz do Capibaribe, for example, even proving to microentrepreneurs that it was in their power to alter fundamental relationships through group action was not enough to change those relationships. However, as UNO learns through experience and becomes more successful, the potential for impact beyond the microentrepreneurs directly involved in the program is great. The Bezerros experience shows that under certain conditions positive group action can lead to a chain reaction to improve the situation of a whole group of entrepreneurs.

Influence on the Brazilian Government

There is little doubt that UNO had a major influence on the Brazilian government at the federal, state and municipal levels.

Through Research. UNO and the Federal University of Recife were the first to carry out extensive studies of the informal sector and to make the study of microenterprises an important area of research. These studies have been widely circulated and have been used extensively in making the case for the importance of the microenterprise sector to the economy.

Through Lobbying. Through its able and dynamic superintendent, UNO has been able to take its case to the highest echelons of the federal government. The government at all levels, recognizing the size of the population involved in microenterprises, has put the need for assistance to this sector on the national agenda.

Through Example. Having created a sizable program and proven beyond a doubt the credit worthiness of the microenterprise sector, UNO has removed the basic impediment to dealing with this important area of the economy.

The best overall example of UNO's impact on policy environment are declarations by the popular minister of the present government, Helio Beltrão. In 1981 Beltrao proposed legislation that would enable microenterprises to become legalized and be granted a tax free status. In addition, for those microenterprises that grow beyond the limits established, a tax holiday would be granted for a substantial period of time. Minister Beltrão has stated publicly that it was UNO who educated him about the microenterprise sector and its importance to the national economy. His praise for the program has been an important factor in helping UNO to maintain its autonomy.

In 1981, as a result of the increased attention given to the microenterprise sector, an important modification occurred in legislation governing banks, which has potential long range effects for microenterprises in Brazil. For many years, the Brazilian Central Bank required <u>all</u> banks operating in Brazil to lend up to 16% of all deposits subject to reserve requirements (100% of sight deposits and a portion of time deposits) to what were classified as small and medium sized enterprises at beneficial rates of interest established by the Central Bank. In 1981, the Central Bank expanded this requirement to microenterprises, to which the banks are now required to lend 1% of deposits subject to reserve requirements. The Central Bank defines microenterprises as those enterprises with annual sales less than or equal to roughly US$300,000 (UNO's definition of a microenterprise is maximum sales of $60,000). Although the limits are substantially higher than what UNO considers for a microenterprise, the potential impact of this legislation is great. Also, the legislation allows banks to transfer their obligations to other banks. A broker could concentrate the deposits of several banks in one bank willing to process loans of this nature.

Finally, it should be noted that Brazil's political system is undergoing an important change with the so-called redemocratization. For the first time in close to 20 years state governers will be elected. This fact, plus the fact that the majority of the Brazilian urban population is involved in microenterprises guarantees that the government will continue to take steps that will benefit organizations like UNO.

V.

THE ISSUES

The UNO program provides useful and revealing insights into the critical issues in microenterprise development.

Socio-Economic Context

As microenterprises do not exist in a vacuum but are very much a product of their environment, an analysis of this environment becomes critical for any microenterprise development program to define. UNO, particularly in its later phases of operation, provides an excellent working example of how a program learns about the environment it intends to work in. By establishing strong links with the federal university in Recife, it was able to call upon professionals to attempt a sophisticated analysis of the informal sector and the role of the microenterprises within it. Some of these studies have been published and have informed government policy-makers and many others interested in this field. In fact, UNO's credibility in the field of microenterprise development stems in part from studies carried out in Recife and Caruaru.

An analysis of the environment in the Caruaru region persuaded UNO to make important changes in its program methodology and led to the unique strategy of working through grouping mechanisms. It is too soon to evaluate the success of this strategy itself, but the fact that it was developed is proof of UNO's ability to learn from the environment it works in and use this learning to create appropriate strategies.

Balance Between Credit and Training

Several debates are going on in this relatively new field called small enterprise development, the most important of which is whether the principal need of microenterprises is credit or training. UNO is perhaps the preeminent example of a program based on credit. To UNO the principal bottleneck in creating a stable existence for microentrepreneurs and allowing them to grow is the scarcity of easily available credit at reasonable rates. According to UNO, with access to reasonable credit made available microenterprises will stabilize and even in a few cases grow.

To UNO, training is of secondary importance and only functions as a means to raise the consciousness of microenterprises as to their importance in the economy and to provide them with a forum to exchange experiences with others. UNO would not deny the importance of such management tools as bookkeeping, but would state that only a very few microenterprises have the capacity to grow to the point where these tools become important.

In general, UNO does not seek to alter the behavior of microentrepreneurs by giving them some "tool" or knowledge which will increase their productivity. Rather UNO sees itself as a social agency helping poor people involved in economic activity through credit.

It is possible that UNO is underestimating the potential of microentrepreneurs. Little data has been collected to test its assumptions. UNO has now grown to a size where the creation of a small technical evaluation unit would seem indispensable. This unit should test the effectiveness of UNO's methodologies and carry out in-depth analyses of microenterprises using random samples and tracking their performance over time. These samples should include non-participants in the program so as to have a base from which to judge the performance of participants.

Dependency and Credit

Every program should ask what would happen to its clients if (for whatever reason) it was forced to cease operating. Would the microenterprises be able to survive reverting to their former sources of credit or would they be unable to remain viable at these higher costs?

Not enough is known about how microenterprises financed themselves prior to entering the UNO program, but it is clear that either through their suppliers or money lenders they were financed in some fashion. The question then becomes what happens to the substantial savings accrued to the microenterprise as a result of the UNO loan program. It seems likely, and in interviews this was confirmed, that a large part of these savings do not accrue to the businesses but to the families. In other words, although the loan may actually be used in the way the program wishes, it may not contribute toward stabilizing the business. It may only be a one shot effect which will generate another request for financing.

The question of subsidized credit is a complex one, particularly in Brazil, where, in the formal sector, several different facilities exist with one form or another of subsidy, making the estimate of true market rates difficult. Under this program UNO is then charged a rate of interest below the subsidized credit lines established for small and medium sized enterprises in the formal sector. A case can be made for maintaining that the market rate for microenterprises should be based on the alternatives usually available to them in the informal sector. Thus, the rate charged is probably about one quarter the rate that the microenterprises effectively pay normally.

In either case it is quite clear that some level of dependency probably occurs and that an analysis of the extent and character of refinancings is important for the program to assess what the level of dependence is. UNO itself pays little or no attention to the issue of dependency. When questioned, UNO staff emphatically stated that in their view little dependency is created and that proof of this is the declining percentages of refinancings to total financings. Although this is true, there has been a tremendous growth in number of new loans granted. Between 1979 and 1981, volume of loans grew close to 500%. Growth in new loans overshadows the real proportions of refinancings. For example, if we look at Table 3, we find that refinancings to total loans decreased from 25% to 14% from 1980 to 1981. However, if we consider 1981 refinancings as a percentage of new loans granted in 1980, we find that probably over 40% of the microentrepreneurs who borrowed in 1980 returned for financing in 1981. The same analysis for refinancings in 1980 to new loans in 1979 shows an even higher rate, one close to 70%. (This analysis is not quite accurate as the program allows microentrepreneurs to return for loans up to three times and in some cases even more. The only requirement is that [illegible]% of the previous loan is paid off; thus, some refinancings referred to could date back to earlier years.)

Finally, there were cases observed where the UNO credit program may have strengthened the traditional patron-client relationships mentioned earlier in this report.

Client Selection

Since UNO's chief aim is to help stabilize microentrepreneurs by giving them credit, there was no need to differentiate between those that would be stagnant and those that would be dynamic. Also, unlike many other programs, UNO did not seek to concentrate its efforts in microenterprises involved in industry and service activities -- often considered to be the most likely to grow. Since the greatest number of microenterprises both in Recife and Caruaru were involved in commercial activities, roughly half of UNO's loan portfolio is to microenterprises engaged in one form or another of commerce.

UNO's method for client selection is very simple: first identify the enterprises and then invite the entrepreneur to attend a meeting. Unless they are larger than the limits established by the program, those that attend the meeting are all eligible for the credit program. This method is essentially one of self-selection. As the program has grown over the years, it is interesting to note that microentrepreneurs increasingly approach the program and request loans on their own initiative.

Staffing

How a program staffs itself is usually a crucial point which will determine its effectiveness, as it is the "front line" promoters who will be the point of contact between the program and the microenterprises. In UNO's case, however, the importance of staff is not great, because the methodology does not require much staff involvement with microenterprises.

The basic question for these programs is always how to attract committed people at low salaries. In Recife, UNO uses upper middle class university students who work for the program part-time. The salary paid is one minimum wage per month. In Caruaru, since part-time university students were not available, UNO hired full-time staff at two to three times the minimum wage.

In both settings the staffing has worked out well, although UNO program staff acknowledge that the Caruaru scheme has been more effective. Caruaru staff not only generate more credit proposals per promoter, but are able to work successfully in areas like cooperative and association formation.

There has been in fact a debate in the Recife program about the use of part-time staff, but no changes have been effected. Part-time staff are defended, because they are cheap and work is too monotonous to hold qualified full-time employees for very long. Defenders of the part-time formula for Recife also state that the job market in Recife is such that it is impossible for the program to offer high enough salaries to attract qualified full-time personnel. By paying a little "pocket money" to relatively efficient students, the program is able to have an effective work force, and is strengthening the awareness of these students of the informal sector.

Methodology

The methodology of UNO's credit program is based on assumptions that are somewhat controversial in the field of small enterprise development. UNO sees its role as simply to get credit to individual microentrepreneurs in need in the fastest, most efficient way.

It is assumed that all microenterprises are credit-worthy regardless of how unprofitable they may appear using conventional analysis. UNO's most sophisticated task in granting credit is to define what level of credit the enterprise can absorb. The information needed to decide this can be obtained in a very short period of time -- a one hour interview. Repayment rates of 92 to 95% show that the assumption about credit-worthiness is well founded. It is also clear that UNO staff have been accurate in measuring how much credit microenterprises can absorb.

The staff who conduct the interviews tend to be a poor match for the street-savy microentrepreneurs. The information they gather is highly unreliable as it is manipulated by the micro-entrepreneurs. In fact, UNO staff look at the loan proposals as simply meeting the bureaucratic needs of the bank, rather than providing an accurate picture of the microenterprise.

In developing a methodology for association and cooperative formation UNO has had to operate on assumptions that differ radically from assumptions on which the credit program is based. In working with groups UNO is trying to alter the behavior of microentrepreneurs in a significant fashion and involves itself actively and intimately with them. It is impossible to make a significant impact in this area in a short period of time. It will take probably well over one year of almost weekly efforts before any major benefits occur.

UNO has refrained from outlining a step-by-step methodology. Instead it relies on the dynamics between UNO's staff and the groups themselves. The staff has a creative combination of varied experiences, with an overall effect which could be called "eclectic."

UNO's work with groups of microenterprises stems from the socio-economic phenomena of the Caruaru region. It is generally believed in the Recife office that efforts to form groups in Recife would be fruitless, as microentrepreneurs are characterized by their individuality and unwillingness to cooperate with one another. Two ill-fated attempts were made in the Recife program. In the Caruaru area the phenomena of mono-production made the purpose of grouping mechanisms a lot clearer to micro-entrepreneurs and thus made UNO's work easier.

Grouping mechanisms are a logical strategy to assist large concentrations of microentrepreneurs involved in similar activities. This strategy can particularly help microentrepreneurs purchase needed materials and sell finished products at better prices. However, there are problems. To work in this area UNO staff must understand completely the traditional sales and distribution systems that affect the microentrepreneurs both in the sale of their pr ucts and the purchase of inputs. Also, since grouping mechani ns can constitute a threat to the established traditional systems, an analysis must be made of the potential risks of retaliation. Finally, the lack of adequately committed leaders capable of taking on responsibility in the group's interest is a common problem in UNO's experience.

Technology Choice and Adaptation

Perhaps the most important single contribution that UNO has made in collaboration with ITEP in this area is understanding that first of all microenterprises need to understand their existing processes and equipment better before thinking of how to adapt or change them. Thus, maintenance and repair became a priority in a program geared to the technology needs of microentrepreneurs.

Cost-Efficiency/Replicability

These two issues are interwined. No program which has not achieved some measurable level of cost efficiency can expect to be replicated. The problem, then, becomes how to create objective criteria that can give us a sensible approach to measuring cost efficiency.

The cost efficiency of a program should be measured in two distinct ways: total capital employed measured against impact of the program and, equally as important, the operating costs of the program measured against incremental benefits achieved. The first dimension is what most evaluations should ideally attempt to do. The second, however, is not always focused on properly, and as a result the efficiency of program methodologies over time in terms of operating costs vs. incremental benefits, is not always looked at sufficiently.

In UNO's case, much data is available to analyze the cost efficiency of the program over time in terms of its principal objective: to get as many loans as possible to microenterprises in a timely fashion and to prove that microenterprises are creditworthy. Leaving aside what the impact of these loans has been, we can discuss in concrete terms how a cost efficient mechanism for delivery of these loans has been put into place.

For the sake of analysis, it would appear possible to attempt a definition of efficiency through a break-even analysis. According to this analysis the incremental benefit accruing to the microentrepreneurs as a result of the program should be at least equal to the operating costs of the program. This analysis assumes a 100% repayment rate and does not take into account the opportunity cost of capital or the operating costs of the bank that processes these loans. The following sections illustrate the growth of the program and the changing ratios in cost, dividing the program into two phases as was done in Chapter 2.

Phase I

Using number of loans and employees of program as the basic units of measure, the following unit cost analysis can be made for the last year of Phase I, 1978 (see Table 3).

Cost of each loan processed:

$$\frac{\text{total cost of program}}{\text{number of loans}} \qquad \frac{\$249{,}000}{138} = \$1{,}800$$

Number of loans processed per employee:

$$\frac{\text{number of loans}}{\text{number of employees}} \qquad \frac{138}{33} = 4.2$$

Amount loaned per employee:

$$\frac{\text{total amount loaned}}{\text{number of employees}} \qquad \frac{\$199{,}000}{33} = \$6{,}030$$

Cost of program per employee:

$$\frac{\text{total cost of program}}{\text{number of employees}} \qquad \frac{\$249{,}000}{33} = \$7{,}545$$

Average loan:

$$\frac{\text{total amount loaned}}{\text{number of loans}} \qquad \frac{\$199{,}000}{138} = \$1{,}400$$

Using these five factors, it is clear that the program would have to be considered inefficient. It spent more on itself than it was able to deliver to microentrepreneurs in absolute terms. Also whatever incremental benefit* accrued to the microentrepreneur would have to be a <u>factor</u> of the loan granted. Since the average loan was $1,400 and the cost of each loan processed was $1,800, then the entrepreneurs would have to achieve a 130% incremental benefit from the loan for the program to break even. Only those microentrepreneurs that were previously dependent on money lenders could possibly have this great a benefit from the loan program. However, according to UNO surveys, such microentrepreneurs are a small minority.

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* By incremental benefit it should be understood that other factors besides changes in employment, sales and net worth should be used as well. I.e., changes in attitudes, welfare, standard of living, dependency, etc.

Productivity of the program was low, as 4.2 loans per employee demonstrates. Clearly not all employees were promoters, but in a program where a clearly defined objective like credit is identifiable, all staff can be seen as either promoters or support staff geared to the basic activity of the program.

Although these results appear dismal, it should be noted that a crippling exogenous factor was in large part responsible for the inefficiencies of the program in this phase: the inefficient credit mechanism of the bank with which UNO was forced to work. The problem is seen more clearly when one notes that 271 credit proposals were completed in 1978; if all proposals had been processed, loans per employee would have risen to 8.2, and all the ratios would have been quite different.

271 loans x average loan of $1,400

amount loaned per employee $= \frac{\$379,000}{33} = \$\ 11.485$

cost of each loan processed $= \frac{\$249,000}{271} = \$\ \ 918$

In sum, the program would have been much more efficient, as the incremental benefit necessary to reach a break-even point to match the costs of the program, would have been only 65%.

Phase II

Using the same mode of analysis we can identify the key indicators for 1981, the last year of Phase II (see Table 4).

Cost of each loan processed:

$$\frac{\text{total cost of program}}{\text{number of loans}} \qquad \frac{\$709,000}{1,004} = \$\ \ 700$$

Number of loans processed per employee:

$$\frac{\text{number of loans}}{\text{number of employees}} \qquad \frac{1,004}{93} = 10.8$$

Amount loaned per employee:

$$\frac{\text{total amount loaned}}{\text{number of employees}} \qquad \frac{\$1,552,000}{93} = \$16,688$$

Cost of program per employee:

$$\frac{\text{total cost of program}}{\text{number of employees}} \qquad \frac{\$\ 709,000}{93} = \$\ 7,623$$

Average loan = $1,500

$$\frac{\text{total amount loaned}}{\text{number of loans}} \qquad \frac{\$1,552,000}{1,004} = \$\ 1,500$$

Two exogenous factors were responsible for a good part of the increased efficiency. The federal government of Brazil became more interested and informed about the area of microenterprise development largely through UNO's work, and consequently provided major support, both in operating cost and loan capital to the program. And BANDEPE, the bank which UNO relies on exclusively, devised a streamlined centralized system which did away with the major bottle-neck in terms of processing.

However, much can be said of the program's increased efficiency on its own part. The program entered into a whole new region -- Caruaru -- and was able to increase productivity at the same time. (In Caruaru the program developed new areas of activity outlined in this report which cannot be measured in the same fashion as they are far from being exclusively credit oriented and require intensive work with a limited number of microenterprises.) That the program undertood new activities and still increased productivity demonstrates that major breakthroughs were made operationally in its methodology.

In Phase I, without the exogenous problem of the bank, the program would have produced only 8.2 loans per employee and, on an average loan base of 1,400, would have broken-even if the microentrepreneur had an incremental benefit of some 65% of their loans. By 1981, with all the new activity, 10.8 loans per employee were processed, and the incremental benefit needed for break-even purposes was only 47%.

It is interesting to note that one indicator remained fairly constant: cost of program per employee. In 1978, this factor was $7,545. By 1981 this factor was $7,623. As the program operating costs are basically salaries and benefits (roughly 80% of total operating costs) it would seem from the evolution of the program that this figure will remain constant if the program intends to expand.

The Future

It is surprising that the UNO program did prove to have the flexibility to operate in a different fashion in a new setting. As the Recife program grew and became well known as a successful venture, the temptation would have been great to create a "model" and replicate the program in Caruaru. In fact, UNO is committed to experiment even with its "successful" Recife program.

The Recife program is undergoing important changes on two levels. It is decentralizing -- creating six offices located in areas where there are high concentrations of microenterprises, and it is including a technology component in the methodology of the program. Both of these changes are due to some degree to observations made of the Caruaru program.

The 1982-83 estimates which were compiled by the program foresee doubling the amount of loans in terms of quantity and value. The increases, it is expected, will result from increased productivity in the Recife office and continued expansion in Caruaru. Using the same indicators used to analyze the effectiveness of Phases I and II, we can get a better idea of the expectations of the program. (The analysis is based on estimates for 1982-83.)

Cost of each loan processed:

$$\frac{\text{total cost of program}}{\text{number of loans}} \qquad \frac{\$1,175,811}{2,070} = \$570$$

Number of loans processed per employee:

$$\frac{\text{number of loans}}{\text{number of employees}} \qquad \frac{2,070}{165} = 12.5$$

Amount loaned per employee:

$$\frac{\text{total amount loaned}}{\text{number of employees}} \qquad \frac{\$3,047,000}{165} = \$18,466$$

Cost of program per employee:

$$\frac{\text{total cost of program}}{\text{number of employees}} \qquad \frac{\$1,175,811}{165} = \$7,126$$

Average loan:

$$\frac{\text{total amount loaned}}{\text{number of loans}} \qquad \frac{\$3,047,000}{2,070} = \$1,500$$

Credit will be by far the most important component of the program; however, it must be remembered that the cost of providing assistance in association and cooperative formation, for example, cannot be analyzed in this fashion. Still it would appear that the program's expectations are reasonable based on its past performance. The most important change is in loan productivity which is expected to increase by 20% for Recife. What the program appears to have failed to account for in these estimates is that operational costs will increase when the new Recife offices are opened.

Given the historical trends of the program to date these estimates are reasonable, and one can extrapolate further to make some preductions about the 1983-85 period. Predictions are based on several key assumptions.

1) UNO's plans show that the program expects to be processing 5,000 loans per annum by 1985.

2) Given that UNO has an efficient credit mechanism (BANDEPE) and steadily improving loan productivity figures (1978 -- 8.2 loans per employee, 1981 -- 10.8 loans per employee, 1982 (estimated) -- 12.5 loans per employee), it seems quite conceivable that in the three year period 1982-85 productivity can grow some 32% to 16.5 loans per employee.

3) Given the expected volume of loans (5,000) and the loans per employee estimate (16.5) the program staff will have to be around 300.

4) Historically the ratio of progressive operating costs to employees has been in the area of $7,500. If we assume 300 employees, expected program costs will be $2,250,000.

5) Average loans are expected to remain around $1,500 which would mean $7,500,000 in total loans granted in 1985.

Thus, the key indicators would be as follows:

Cost of each loan processed:

$$\frac{\text{total cost of program}}{\text{number of loans}} \qquad \frac{\$2,250,000}{5,000} = \$450$$

Number of loans processed per employee:

$$\frac{\text{number of loans}}{\text{number of employees}} \qquad \frac{\$5,000}{300} = 16.6$$

Amount loaned per employee:

$$\frac{\text{total amount loaned}}{\text{number of employees}} \qquad \frac{\$7,500,000}{300} = \$25,000$$

Cost of program per employee:

$$\frac{\text{total cost of program}}{\text{number of employees}} \qquad \frac{\$2,250,000}{300} = \$7,500$$

Average loan = $1,500

As UNO will probably continue to enjoy increased levels of support both for its operating costs and loan program from the World Bank and Brazilian federal government and as the credit mechanism (BANDEPE) is more than adequate to handle this volume, the 1985 estimates are quite possible.

Final Considerations

As we have seen, UNO has moved from a small organization to one of the largest in the field of microenterprise development -- one with ambitions to become substantially larger. This process of scaling-up and diversifying is accelerating. In fact, UNO can be seen as an organization in transition. This transition is a difficult one and poses problems for the organization.

Simply stated, the transition is from an organization with two "heads" Recife and Caruaru to an organization with a strong head office and a decentralized field structure. Crucial to this is the separation of the general administration from program operations in the Recife office. At present both exist in tight quarters.

For the organization to reach its ambitious goals, a strong central unit is needed for administration, control, and evaluation. Of these three only the first is really working at present, and, since it is also responsible for day-to-day operations of the Recife program, it is not as effective as it needs to be for the planned expansion.

The control function, at present, in the author's view is seriously deficient. By control what is meant is not the financial administration of UNO (that is quite adequate) but the vastly more important function of monitoring and administering the burgeoning credit portfolio. That UNO has the high repayment rates it does is a remarkable achievement. Given more vigorous control, the repayment rates could probably be much higher. Also BANDEPE functions as an appendage to the program and really cannot be expected to carry out the proper monitoring needed. A strengthening of the control function does not imply a large staff and high budgets; it does require an experienced professional and a staff of probably four. When in place this function can be of major importance in tracking the success of various field offices and flagging potential problems.

At first glance it may appear counterproductive to suggest that a program which has been becoming more cost effective take on additional operating costs which would not necessarily increase its ability to work with microenterprises. In the case of the control unit it should be emphasized that although it does not grant loans, in many ways UNO can be best characterized as a bank as it identifies, processes, approves and monitors loans. With the impressive growth in the program's ability to give access to credit for microenterprises through the BANDEPE credit mechanism comes an increased responsibility to properly supervise this portfolio. This function becomes increasingly necessary not due to repayment rates as they are adequate, but due to size.

There is the need for an independent effective evaluation unit which tests the effectiveness of the various methodologies and carry out significant longitudinal studies of the evolution of microentrepreneurs who have participated in the program (compared to non-participants). UNO has already grown to a point where this unit is not a luxury but a vital necessity if UNO is to justify its existence. Independent efforts have been made to carry out such studies of participating microentrepreneurs but all have one serious flaw: available base-line data is extremely unrealiable as it is normally collected in a one hour interview between an inexperienced college student and a usually street-wise entrepreneur. For the program accurately to measure its impact upon entrepreneurs, sample groups of microentrepreneurs should be selected and more reliable data should be collected about them.

At present much can be said about how effectively services of the program are delivered, but little can be said about what impact the services have. As the program grows it becomes crucial to understand how much benefit the microentrepreneurs receive from loans and other services UNO offers.

Finally, this unit could undertake to document the important experiences that UNO is accumulating in the field for the benefit not only of UNO but also of others in the field of small enterprise development.

PART TWO

The Micro-Industries Development Center of the Philippines

Marshall Bear & Michael Tiller

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AUTHORS' NOTE

This report examines the impact that the Micro-Industries Development Center (MIDC) and two of its component organizations -- the Micro-Industries Development Program (MIDP) and Manila Community Services, Inc. (MCSI) -- are having on participating microenterprises in the slum areas of Manila, the Philippines. The report begins by outlining the socio-economic and institutional context in which these programs exist. Their assumptions and methods are then described, followed by an analysis of the effects of each program on participating microenterprises, particularly in achieving viability and prospects for growth. The report closes by commenting on MIDC's agenda for the future in light of its first two years of experience.

Our findings and observations are based on thirteen working days in January, 1982, during which we interviewed a representative sample of program beneficiaries, particularly microentrepreneurs, as well as managers and staff members of local agencies which have used MIDC's services. Extensive interviews were conducted with the staff, management, and board members of MIDP, MCSI, and MIDC. Relevant client records and program reports were reviewed. The majority of our time was spent in the squatter settlements of Metro Manila. This analysis is limited by the absence of key data about the participating businesses and about non-participants against which to compare them, as well as by gaps in the data about program costs.

We are grateful to the leadership and staff in MIDC, MIDP, and MCSI for their cooperation and interest in this report, which we hope shows, above all, their commitment to people striving for a better life for their families and themselves.

Marshall Bear
Michael Tiller
July 1, 1982
Washington, D.C.

I

CONTEXT

When the Philippines became an independent republic in 1946 its World War II-ravaged economy was dominated by agriculture. Up to three-quarters of the post-war work force worked on farms or in food processing plants (chiefly sugar), and nearly half the net domestic product came from agricultural production and processing. In the first decade after independence, industrial rehabilitation and expansion, encouraged by government import restrictions on consumer goods to promote local production, led to considerable growth in the manufacturing sector and a proportional shift to non-agricultural activities. However, towards the end of the 1950s and throughout the 1960s the limitations of the domestic market restricted growth in the industrial sector. What growth there was came from relatively large-scale capital-intensive industries that benefitted from import-substitution restrictions and incentives and later, to a lesser extent, from export processing industries -- also large-scale and capital intensive.

During the fifties and sixties, the work force was expanding at the rate of about 3% per annum or roughly 400,000 workers each year. At first the majority of these workers found work in agriculture, but the rate declined as increases in population strained the capacity of available arable land to engage and support additional people. A limited number of new job-seekers were employed in relatively large-scale industries. But jobs in those industries became harder and harder to find and less and less desirable. The ever-growing pool of labor brought down substantially the real (adjusted) wages paid to skilled and unskilled workers in industrial establishments in the main industrial areas between the mid-1950s and the mid-1970s.

Development planners in the Philippines became increasingly concerned by the inability of the existing agricultural and industrial economic structures to create new work-places in pace with increased population. Various programs to enhance the viability of agricultural small-holdings, and to develop non-traditional export industries (furniture, clothing), were put in place as a consequence. Alongside these programs a comprehensive Small and Medium Industries (SMI) program was initiated in 1974. Planners who designed the SMI program observed (quite accurately) that manufacturing, the third largest employment sector after agriculture and commerce, took place predominantly in peoples' homes as self-employment, in small workshops, and in small factories employing fewer than ten workers. However, these small manufacturing enterprises were severely hampered from growing because it was difficult for them to obtain investment and loan capital from the organized financial sector, and no industrial extension support services existed for them. The planners hypothesized that the manufacturing sector could grow significantly in terms of employment and output if small manufacturing enterprises could be provided with such financial and extension services.

In order to implement the SMI program, the Commission for Small and Medium Industries (CSMI) was created, with representatives from key branches of the government, from parastatal organizations, statutory bodies, and the private sector. The CSMI was given responsibility for policies and programs affecting the sector. The SMI program had two basic components.

> Finance. A separate department was created in the Development Bank of the Philippines (DBP) to make direct commercial loans at prevailing interest rates to small and medium-sized industrial enterprises. The Bank's policy of granting loans on the basis of financial appraisals and character assessments, differed greatly from the collateral-based lending policies of the commercial banks. In addition, the Industrial Guarantee Loan Fund (IGLF) was created as a government-operated rediscounting facility upon which commercial banks could draw for lending projects they had identified.

Extension. The Medium and Small Industries Coordinated Action Program (MASICAP) was created to help small enterpreneurs prepare loan applications, a daunting task for most such entrepreneurs. At the same time, Small Business Advisory Centers (SBACs) were established in each of the country's twelve administrative regions to offer free production, financial, and management counseling to new enterprises in particular.

As a further incentive, small manufacturing firms with fixed assets below ₱100,000 and annual sales below ₱400,000* were given, upon registration with the National Cottage Industry Development Authority (another program arm of the CSMI), exemption from sales and other taxes and from minimum wage legislation.

In order to clarify eligibility for participation in programs of the CSMI, the government now classifies industries according to their fixed asset value.

Asset range	Designation
Less than ₱100,000	Cottage Industry
₱100,000 to ₱1,000,000	Small Industry
₱1,000,000 to ₱4,000,000	Medium Industry
Over ₱4,000,000	Large Industry

*In this report money figures will be expressed in Philippine pesos at the value obtaining at the time under discussion. For reference, the exchange rate between the peso and the U.S. dollar over time has been:

	U.S. dollar	Philippine peso
1950	1.00	2.02
1955	1.00	2.02
1960	1.00	2.02
1965	1.00	3.91
1970	1.00	6.44
1975	1.00	7.50
1980	1.00	7.59
1982	1.00	8.37

This multi-faceted program to promote growth in the manufacturing sector has grown considerably in scope and sophistication during the eight years of its existence. It has reached and benefitted a significant number of cottage, small, and medium-sized industrial enterprises and has positively affected the policies and operations of public and private financial institutions.

Not long after the SMI program got into operation, however, it became apparent that there were enterprises so small and so informal that they were beyond the reach of the SMI program. This class of enterprises came to be called the "micro"-enterprise sector. It is made up typically of family-based manufacturing, processing, vending and service businesses with extremely small fixed asset values far below the ₱100,000 maximum for designated cottage industries, capitalized by family savings and informal (often illegal) financing mechanisms, and operated with very informal planning and accounting. In rural areas these enterprises usually supplement subsistence and marginal cash-crop family farming, but in urban settings they are very often the sole economic activity of extremely poor post-War migrants resident in the slums and <u>barangays</u>, or squatter settlements.

The SMI program could not reach this large and growing sector mainly because the cost of appraising and administering credit to meet the ordinarily very small, short term capital requirements of micro-enterprises was too high in relation to the very small amounts of money the enterprises needed, and therefore the interest earnings that could derive from such loans. (The minimum IGLF loan was ₱50,000, for example.) In addition, the extremely informal nature of such enterprises made this sector relatively unattractive to institutions with mandates to promote broad-based industrial growth. (Most of the enterprises are carried on with no books in homes or workplaces or on land to which the entrepreneurs hold no title and from which they are constantly threatened with eviction. The entrepreneurs are normally not well educated and are totally unfamilar with formal business practices.)

While the SMI program could not intervene on behalf of the microentrepreneur, a number of public and private social service agencies, most notably the Ministry of Social Services and Development (MSSD), the Ministry of Industry Micro Industries Development Program (MIDP), Manila Community Services, Inc., (MCSI) and the Philippine Business for Social Progress (PBSP), began experimental small scale "livelihood" programs designed to encourage microenterprises and thereby to meet basic economic and social needs of the rural and urban poor. "Livelihood" programs normally offer very small grants or sub-commercial loans and training and advisory services to individuals who want to maintain or start what are called "subsistence businesses." Such programs are intended to assist the very poor to reach a level of family sustenance as an alternative to public assistance. In recent years, some social service agencies have tried out programs designed to assist the microentrepreneurs to reach a size and level of business management capacity to qualify for participation in the financial and advisory service programs of the SMI.

This study analyzes the programs of two of those agencies -- Manila Community Services, Inc. (MCSI), and the Micro Industries Development Program (MIDP) -- as well as the umbrella organization which MCSI and MIDP, along with others formed in 1980 -- The Micro Industries Development Center of the Philippines (MIDC). A.T. International undertook this study in order to further its interest in the field of small enterprise development and also because of its position as a provider of grant funds to MIDC. The report opens with descriptions of each program's assumptions and methods and moves to an analysis of the impact of each program on participating groups and individuals. At the end certain evaluative points and -- at the express request of program leadership and staff -- certain advisory comments are made.

Readers interested in further background material are referred to: Small Enterprises and Development Policies in the Philippines: A Case Study, World Bank Working Paper No. 468, Dennis Anderson and Farida Khambata, Washington, D.C., 1981.
Philippines Industrial Development Strategy and Policies, Barend A. de Vries, et al, The World Bank, Washington, D.C., 1980.

II

PROGRAM DESCRIPTIONS

This chapter introduces the three organizations -- MCSI, MIDP, MIDC -- that are the subjects of this analysis by looking at how they have designed and implemented programs around their assumptions of the informal sector and the needs and capacities of participating microentrepreneurs. The historical development of each organization is traced to identify the major changes and adjustments made in their efforts to achieve desired impact.

Manila Community Services, Inc.

Manila Community Services, Inc., (MCSI), is a non-stock, non-profit company that has been in operation for the past 14 years. It was founded in March 1968 by a number of church groups wishing to play an active role in redressing the social and economic problems of urbanization in the Philippines. Throughout its institutional life, MCSI has focused on generating employment opportunities for the unskilled and uneducated persons living in the burgeoning squatter settlements in Metro Manila and on promoting the gradual organization of self-reliant community structures to spread and sustain those economic gains brought about by employment. While remaining small both in size and program coverage, MCSI has tried to demonstrate that community-based programs can generate formal sector and self-employment opportunities.

MCSI's history is best traced by looking at how its programs changed over time. There are two distinct phases: the "job skills" phase and the "self-employment" phase.

The job skills phase ran from 1968-1976. During those years MCSI implemented a skills training program to prepare out-of-school youth and unemployed adults for formal sector employment opportunities. The program was based on MCSI's assessment that there were more jobs in the formal sector for skilled employees than there were skilled employees to fill them. MCSI developed non-formal training programs in a number of skill areas including automotive engine repair, shoemaking, driving, electronics, handicrafts, sewing, shirt-making, cosmetology, and other areas. These programs were implemented through community organizations in order to maximize community involvement in screening training applicants, setting up apprenticeships and on-the-job training opportunities, and placing people in jobs. While MCSI succeeded in training approximately 2,500 persons in a number of skills, its program fell short in meeting its employment objectives mainly because industry was able to employ only a limited number of trainees. Also, community organizations proved unreliable in placing MCSI graduates in what formal sector jobs there were. Therefore, in 1976, MCSI initiated the Self-Employment Program (SELP) to assist graduates who were unable to find formal employment to start and operate their own small businesses. This program is still going on.

The "self-employment" phase signified a major shift in MCSI away from non-formal skills training to microenterprise promotion and support. Since this phase began, the SELP program has been modified and streamlined, but its basic feature has not changed. In the SELP program "social credit" is extended to microentrepreneurs who are otherwise ineligible for institutional finance. These loans are supervised by volunteer community leaders, themselves engaged in business. "Social credit" is a system of financing for the basic livelihood needs of very poor people. Very small loans (between P50 and P2,000) with short maturities (one to six months) are offered without material collateral at below market rates (2% to 10% per annum, as compared to 18% for commercial loans). MCSI offers these loan recipients an introduction to business management and provides them with regular follow-up by the community leaders for loan repayment.

The SELP program is small, partially by design and partially because of limited financial resources. Since its inception, 768 beneficiaries in the barangays of Metro Manila have been served. MCSI's staff numbers just three: the executive director, the SELP program coordinator, and a secretary. It has no paid field staff -- rather it relies on a network of 27 recognized community leaders, former MCSI clients in good standing with demonstrated entrepreneurial abilities.

These community leaders carry out activities upon which the success of the program depends. They identify and screen all credit applicants; administer the credit extension and collection system; monitor all enterprises assisted and submit monthly reports on them; assist in training programs; provide business and family counselling to MCSI clients; and identify other resources which the clients and the community as a whole could utilize. While the community leaders are not paid a salary, MCSI does offer them a number of incentives, including invitational travel for workshops and seminars, priority consideration in obtaining credit for their own businesses, hospitalization insurance and reimbursement of all expenses connected with their service.

The SELP program coordinator, who is responsible for the program's implementation, supervises the community leaders and is responsible for carrying out MCSI training programs for loan recipients, community leaders, and staff and clients from other organizations.

Overall administration of MCSI rests with the executive director, who concentrates on fund raising, liaison with other institutions, future planning and board relations.

The SELP program offers a package of services -- loan assistance, self-awareness and business training, and business extension and advisory assistance -- geared to the needs and capacities of the very smallest of entrepreneurs, who, if not extended credit, would have severe difficulty in continuing their businesses. Here is how the program works.

Stage 1:

Trial Fund. MCSI opens a trial fund account for the community leaders with an opening balance of P500, loaned at 10% per annum, which they are responsible to repay. From this fund, the community leader is authorized to make loans, at her or his own discretion, not to exceed P300 (the average is P200) with very short maturities, ranging from one week to three months (the average is two months). Interest is set at 2% per month. Before credit is extended the community leader conducts a background investigation of the client to satisfy MCSI eligibility criteria (the client must be a permanent resident with positive character references, entrepreneurial motivation, and an ability to repay the loan from business earnings) and gives a one day orientation session on the goals and objectives of the SELP program. Once the credit is extended, the community leader is responsible for collecting on the loan (daily or weekly) and visiting the client twice a month to monitor the project. Loans collected are revolved through each community leader's trial fund and re-loaned to existing or new clients. A client can receive no more than three loans from the trial fund.

Stage 2:

SELP I. This level of credit assistance, which ranges between ₱300 and ₱500, is administered through the Philippine Commercial and Industrial Bank (PCI). Credit is extended at interest of 10% per annum, ordinarily with six month maturities. A person eligible for this level of credit must be a graduate of the trial fund in good standing, must be willing and able to participate in the entrepreneurship development and training program, and must have demonstrated entrepreneurial motivation. A simple project feasibility study prepared by the client and evaluated by the community leader is presented to the SELP program coordinator and then to the executive director for approval. Prior to the release of funds, each client participates in a two day intensive entrepreneurship development and training program, which seeks to give each client basic bookkeeping and business planning skills. Each client opens an account at the appropriate PCI branch and is provided with an amortization schedule. Community leaders are responsible for repayment collection and twice monthly project monitoring visits. Clients seeking a second loan must repay in full the previous loan or deduct the balance outstanding from the amount of the second loan. SELP I clients are allowed only two loans at this level, after which they will be recommended for SELP II, or to other lending programs, or are phased-out.

Stage 3:

SELP II. This level offers increased credit assistance ranging from ₱1,000 to 3,000. Eligibility requirements are basically the same as SELP I, with the notable exception that credit assistance above ₱2,000 is for business expansions that create new employment. Also, the clients must be willing to attend more advanced courses in business management geared to their particular business activity. All loans are administered through the PCI bank; ₱1,000-2,000 loans are given at an interest rate of 10% per annum, while those at ₱2,000-3,000 are given at the commercial rate of 18% per annum. Community leaders are responsible for collection of those loans up to ₱2,000, whereas clients with loans in excess of ₱2,000 make loan repayments directly to the bank.

Since its inception in 1976, the MCSI program has remained small when compared to the very large number of potential beneficiaries residing in Metro Manila. Through 1981, a total number of 768 microentrepreneurs have secured loan assistance (459 trial fund, 297 SELP I & II) totalling P262,834. The FY 82-85 operating plan developed by MCSI will concentrate on packaging the SELP program (documenting credit policies and procedures, preparing material for community leader training and business management training) for transfer to other interested agencies, action research in credit and training and follow-through with existing SELP beneficiaries. MCSI is in the process of negotiating financial assistance with a number of external donor agencies.

The Micro-Industry Development Program

The Micro-Industry Development Program (MIDP), a branch of the Ministry of Trade and Industry, has been in operation since 1978. It was set up to research, develop, and test methods for promoting the viability and expansion of microenterprises nation-wide. Since MIDP's inception, its staff and sponsors have experimented with various methods and services to respond to their changing assessment of the informal sector and the needs and capabilities of microentrepreneurs.

What is now MIDP began as a special project. In February 1978, the Ministry of Industry (which merged with the Ministry of Trade in 1981) established the Metro Manila Barangay Industries Development Program (MMBIDP), a pilot project to create self-employment opportunities for the unemployed and unskilled. The Ministry assumed that existing or prospective microenterprises, too small to benefit from its programs of support to small and medium scale industry, could benefit from direct technical assistance. MMBIDP drew its staff from the Ministry of Industry's Medium and Small Industries Coordinated Action Program (MASICAP), which had provided feasibility studies and business management and advisory services for small and medium scale industries. (MASICAP was part of the Small and Medium Industries or SMI program.)

The MMBIDP project was based on the assumption that the technical expertise developed by MASICAP could be applied in cost-effective ways to microenterprises. But, rather than dealing with them one by one, the project sought to encourage individuals to get together and form "group enterprises" of a certain type or specialty (both groups of entrepreneurs in the same type but separate enterprises and single type group-owned enterprises). It was thought that MMBIDP's direct involvement with such "groups" would result in a greater willingness on the part of public and private financial institutions to make credit available to the groups and in new market opportunities, through small and medium scale industries, for their products.

After trying to implement this project for over three years, MMBIDP found that many of its operating assumptions proved to be invalid. In spite of the direct involvement of MMBIDP, the "group concept" generally failed because group members could not work together effectively -- especially when it came to income-generating activities. The groups were not cohesive, resulting in many business failures and loan defaults. Although MMBIDP did arrange credit for many of its clients as proposed, it failed to demonstrate to financial institutions the viability of loan support to groups. According to staff, loan repayments from groups were unacceptably low*. MMBIDP staff attributed the low payback rate to a perception by the group members that subcommercial credit (ranging from interest free to 10% per annum) was, in the phrase used in the Philippines, a "dole-out" or entitlement and did not really need to be paid back.

However, part of the MMBIDP project did assist small individual private family-based microenterprises. These businesses were much more successful and had a better record in loan repayments, thus demonstrating the viability of the programs for assisting family-based microenterprises. Therefore, in April 1981 the Ministry upgraded MMBIDP from a project to a program and renamed it MIDP to denote this change in status.

Based on lessons learned in the project phase, MIDP staff redesigned its program, shifting priority from groups to family-based microenterprises. The role of credit was upgraded vis-a-vis business advisory and training services. MIDP secured greater control over client selection and terms of credit extension. Since the change in its status, MIDP has grown in staff size and program coverage and has added new features to its operating methods.

Specific MIDP interventions, designed to increase the capacity of the entrepreneur eventually to operate and expand the enterprise without further MIDP assistance, take place in three stages.

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* It was not possible to make even a rough estimate of aggregate loan repayment nor to extract specific data as to loan type at different points in the program because of large gaps in program records.

The organizational stage: Based on interviews with community leaders and neighbors, entrepreneurs are identified and screened for their dependability, production skills, attitudes, willingness to take a risk, and interest in expanding their businesses. Client profiles are developed for those businesses that show a potential to improve, expand, and create new employment.

The project planning and development stage: With the participation of the client, MIDP staff prepare a detailed project feasibility study on which MIDP bases its decision either to extend credit from available credit resources or present the proposal to another institution for financing. The study varies in complexity depending upon the credit requirement but is designed to assist clients in analyzing the management, marketing, production and financial aspects of their enterprises over time.

Prior to the release of credit, each client attends a two day business management training course given by MIDP staff. The course introduces clients to basic management and accounting principles and practices.

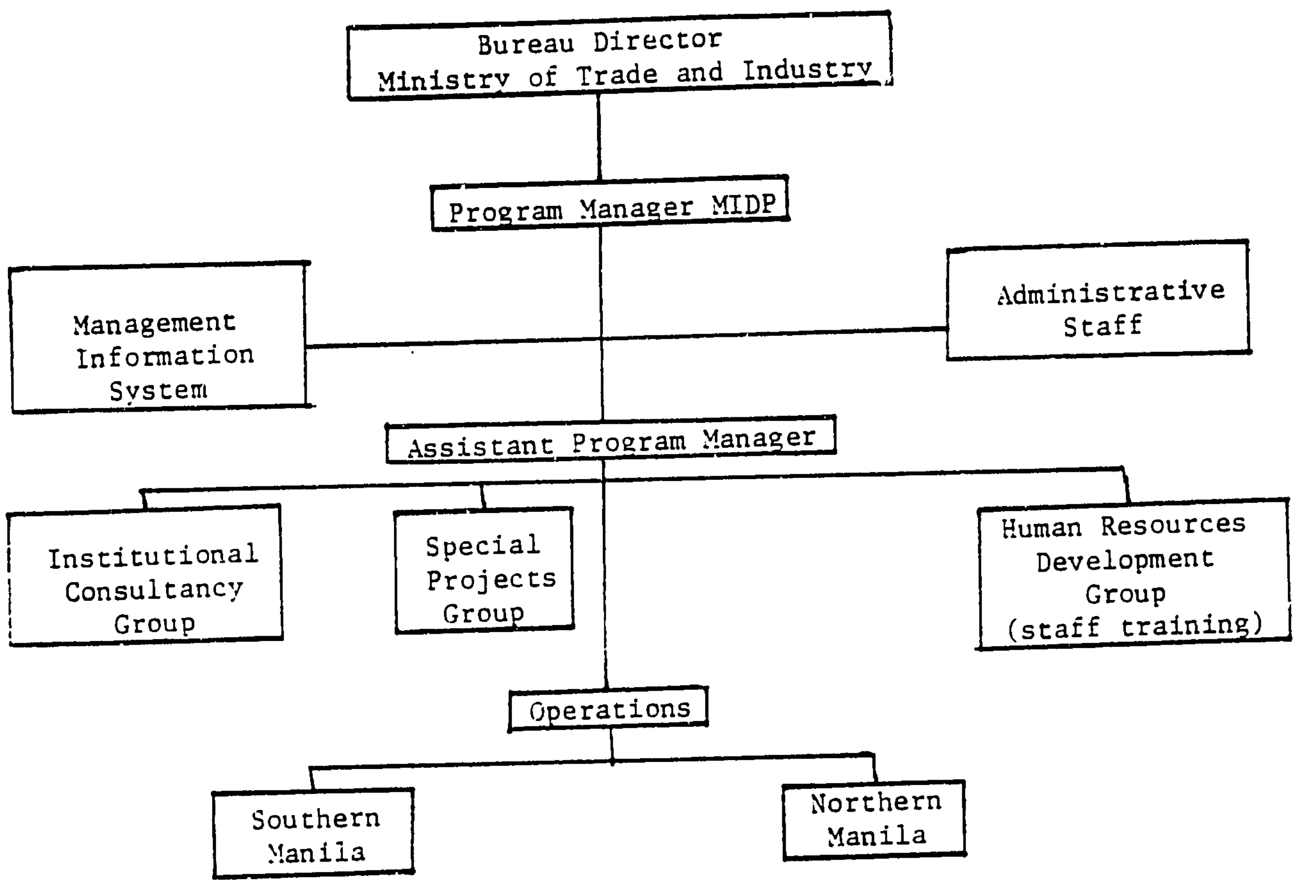
The project implementation and operation stage: This stage begins with the release of credit to the client. The amount of credit extended generally ranges between ₱2,000 to 10,000, with exceptions on both ends of the scale. Credit is used for both working capital and fixed asset purchases. Interest rates have varied in the past but currently all loans are offered at commercial interest rates (18%). Loan maturities can range from six months to five years, but the majority are of one year duration.

Funds are administered by MIDP, and repayments made directly to it. MIDP staff work with each entrepreneur in installing a simple bookkeeping system that records receipts and expenditures, Advisory services are given in marketing, raw material purchase, or production to implement the agreed upon business plan. Weekly monitoring visits are made for the first two months and reduced to once monthly until the loan is repaid.

MIDP currently comprises a staff of twenty-four: twenty-two professionals and two support persons. The professionals are college graduates with various academic backgrounds, the majority holding degrees in commerce related disciplines. Many of the original MMBIDP staff remain with the program. Twelve new recruits were brought on when MIDP became a program of the Ministry in April 1981.

MIDP's organization chart below reflects dual goals to experiment with methods and approaches to service microenterprises and to document those experiences for transfer to other institutions. This second intention has become increasingly the key element in MIDP's total effort.

Organizational Chart



Several organizational functions are involved in documenting experiences and communicating them to others. The staff of the Management Information Services (MIS) collects information and prepares documents to meet MIDP's reporting, planning and evaluation requirements. Specifically, MIS reviews and updates all client credit accounts, it prepares quarterly reports to government and donors, and it keeps statistical records required for evaluation purposes.

The Institutional Consultancy Group is set up to extend technical assistance in response to requests from institutions with projects in microenterprise development. This group has provided services including project design, economic feasibility studies, and business management training for staff and clients of such institutions as the National Housing Authority, and a number of private voluntary organizations working among the poor.

While the Operations Group is responsible for implementing the field services, the Special Projects Group conceptualizes and designs new or adapted mechanisms to be tested and evaluated for possible incorporation into MIDP's operation. To date, the Special Projects Group has experimented with alternative low cost methods of credit extension and a test to assess the dependability of credit applicants.

The 1981 MIDP budget totalled ₱600,000. It is recognized that MIDP is a costly program if measured simply by calculating the cost of the program per beneficiary. For instance, in December 1981, cost per client was more than ₱4,300. It is argued, however, that the program's potential multiplier effects justify its high costs.

Differing Assumptions

Although both MCSI and MIDP are working to assist microentrepreneurs, their assumptions regarding what this help will achieve differ markedly. MCSI assumes that its program will enable microentrepreneurs to expand their businesses and eventually to sustain them at a modest but higher level. MIDP, on the other hand, assumes that a microenterprise -- no matter how small it is -- can achieve efficiency, grow, and eventually enter the formal sector. MIDP's goal is to integrate its clients into commercial financial markets, and, correspondingly, demonstrate to financial institutions the commercial viability of the microenterprise sector. MCSI primarily seeks to stabilize its clients' businesses, and to qualify a few for participation in MIDP programs.

These basic assumptions are built on many beliefs about the microentrepreneurs and the squatter settlements in which they live. MCSI believes that microentrepreneurs are interested principally in increasing the reliability of their incomes. MIDP believes they are interested in expansion and capable of handling growing enterprises.

The two organizations are both interested in the spread effects of their programs. MIDP is actively involved in reaching out to other organizations that work in the informal sector to offer help and to promote its model of microenterprise development. MCSI assumes that its clients themselves will eventually seek collective strategies to build and sustain their economic gains and spread them to others in their communities by providing employment.

The Micro Industries Development Center

Both MIDP and MCSI were among a number of other public and private associations that organized the Micro Industries Development Center (MIDC) in May 1980. The "Center" is not a center; it is a non-profit, non-stock company giving legal identity to a group of institutions with complementary objectives and programs. Their goal is to coordinate previously scattered resources and experiences in support of microenterprise development. The organizing members of MIDC included (in addition to MIDP and MCSI) Ventures in Industry and Business Enterprise (VIBES), a private venture capital company; the Ministry of Social Service and Development, which sponsors the Self-Employment Assistance Program (SEAP); the Philippine Business for Social Progress (PBSP), a private foundation established by the business community; and the Philippine Center for Appropriate Technology and Training (PCATT), a private foundation supporting pilot projects in appropriate technology research and development.

MIDC's member institutions share the assumption that by pooling their resources and experiences they could each achieve greater efficiency and impact in the microenterprise sector. Members felt that the complementarity of the programs allowed for participating microenterprises to benefit from various programs as they grew in size and required different forms of support. MIDC expected to be able to attract and administer resources that would be difficult for each organization to obtain by itself, and that its stronger and more credible voice could speak in favor of assistance to microenterprises and obtain broad-based support in the Philippines.

MIDC was incorporated with a board of trustees comprising seven members from the public and private sectors. MIDC has no paid staff. The board appoints one of its members to serve, voluntarily, as the managing director. Office space and administrative support are contributed by the participating agencies. MIDC overhead costs are limited to paying for travel, per diems and miscellaneous expenses incurred by its board or associate members on MIDC business. MIDC's reasons for organizing itself this way are explained by a look at its operating methods and functions.

MIDC considers itself not an implementing agency, but, quoting its operating plan, a "catalyst, facilitator or broker to assure that people and programs interact to maximize their learning and the quality of their project design and implementation." In addition to acting as a clearinghouse for information and expertise, MIDC sees for itself an equally important role "brokering" suitable matches between resource suppliers and program beneficiaries. In this role, MIDC would "not be part of the resource transfer," (that is, it would not be a funding agency or competitor for funds with others) and would always seek to obtain [illegible] from other institutions." The sort of matches that MIDC wishes to make would be, for example: between international donors and public and private agencies in the Philippines; between the Philippine business and social service communities; between formal sector financial institutions and microentrepreneurs; or between small or medium sized businesses and microenterprises. In this formative stage, MIDC has defined four priority areas in which it seeks to exercise its "brokering" role: leadership development, design and testing program expansion mechanisms, technical assistance, and influencing government policies.

During its brief period of operation, MIDC has already engaged in a number of activities. MIDC gave a small grant to the Network for Small Economic Enterprise Development (SEED) to hold a workshop for both program staff and microentrepreneurs to explore the constraints to microenterprise development. MIDC has also supported an MCSI training course to prepare community leaders to become business management extension agents within the MIDP lending program. MIDC arranged a ₱100,000 line of credit from PBSP for MIDP to expand its lending program using commercial rates of interest. MIDC "brokered" funds from A.T. International to assist MCSI in raising its credit ceiling for clients with expansion and employment potential. MIDC supported with loan finance the efforts of a Filipino businessman to experiment with a successful kiosk franchising model developed in India.

In response to requests from a number of organizations, MIDC has arranged technical assistance, through MIDP and MCSI, in microenterprise program design and evaluation, in business management and planning, in socio-economic survey work, and in staff training and development. Some of the recipient organizations include the Philippine Agency for Community and Family, the YMCA, and the Tahanan Foundation.

On a policy level, officials of MIDC are working with a major national government program, the Kilusang Kabuhayan sa Kaunlavan (KKK) or "Movement for Progress through Livelihood Projects" on a plan to involve microenterprises as subcontractors to larger businesses, drawing upon a ₱250 million special government loan facility administered by the KKK. In addition, MIDC served as a consultant in the development of a large bilateral assistance program for microenterprise promotion between the government of the Philippines and the United States Agency for International Development.

III

ANALYSIS OF IMPACT

This analysis looks at what impact MIDC and two of its component organizations -- MIDP and MCSI -- are making on the microenterprises with which they have interacted and on the informal sector as a whole. Also important is the effect of project experiences on the agencies themselves and on the policy environment. (Given the brief period of MIDC's existence, the analysis examines MIDC's "potential for impact" in demonstrating the viability of microenterprise promotion as a cost-effective strategy for employment generation in the Philippines.)

Our findings and observations are based on thirteen working days during which we interviewed a representative sample of program beneficiaries, particularly microentrepreneurs, as well as managers and staff members of local agencies which have used MIDC's services. Extensive interviews were conducted with the staff, management, and board members of MIDP, MCSI, and MIDC. The majority of our time was spent in the barangays of Metro Manila. One day was spent in Cebu City interviewing the program staff of a government program which had received training and advisory assistance from MIDP, as well as a number of that program's participating microentrepreneurs.

Records kept by business operators were scanty and impossible to aggregate. Program records were much more professional, but the procedures for keeping them -- and the programs they tracked -- had changed considerably and often. The limits on an evaluation carried out under these circumstances are clear. All data that do exist were reviewed carefully, other data were brought together on the spot, and all observations arising from that data were discussed fully with program leadership and staff. Nevertheless, the depth of this analysis is limited by the absence of key data about participating businesses, the absence of a control sample against which to compare them, and the gaps in the data about program costs.

Before discussing the extent to which MIDC, MIDP, and MCSI have been able to assist microentrepreneurs, we wish to summarize briefly the histories of six representative micro-businesses participating in MIDP and MCSI assistance programs. Summaries are meant to acquaint the reader with the business and social milieu in which Manila microenterprises operate, as well as to give examples of the MIDP and MCSI program interventions described earlier.

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Client Profiles

Jofel Garments. Mr. and Mrs. A are the owners of Jofel Garments. They have three children, ages six, five, and two. They live in a makeshift two room house which serves as both garment factory and living quarters. Mrs. A began the enterprise in 1975 with one sewing machine. Prior to entering business, she worked for about ten years in a garment factory making T-shirts on a piece-work basis. She is a graduate from a vocational high school where she learned sewing and cutting skills.

Jofel Garments has basically two product lines -- corduroy and denim short pants for children and T-shirts. Recently Mrs. A has started to sew baby dresses, and on occasion she will accept private orders from family and friends. She purchases the majority of her raw materials from the Divisoria, the major wholesale market in Metro Manila, although she will occasionally purchase remnants from factories. She stocks raw materials in advance of orders, buying when materials are cheapest and paying cash.

Mrs. A sells her products on orders from middlemen and through vendors on a sale or return basis. She does not sell directly to retailers.

When Mrs. A began her business in 1975, she started with one sewing machine. She now has four sewing machines, and employs two neighbor girls, who are paid on a piece-work basis. Mr. A also works as a sewer with skills his wife taught him.

Mr. and Mrs. A began their business with family savings. They have generally financed the purchase of raw materials from sales. However, at times when cash was short or when an order had to be filled, Mrs. A borrowed from money lenders on a "5/6" basis. This system required her to repay daily ₱6 for every ₱5 borrowed for an effective interest rate of 20% per day.

Mr. and Mrs. A are clients of MIDP. In March 1981, they received ₱2,000 at 10% per annum with a seven month maturity for working capital to purchase raw materials. They repaid the loan on schedule and received another loan in December 1981, for ₱5,000 at 18% per annum with a nine month maturity for the purchase of a zig-zag sewing machine and more raw materials. In addition, they received business management training and advice in pricing finished garments.

Tambunting Binatog. Mr. and Mrs. Y are the owners of this traditional snack food business. They have six children -- one is a university student, one is in nursing school, one is a seaman and three are in elementary school.

Mr. and Mrs. Y and their school-age children live in a two-level makeshift building which houses the business on the first level and the residence on the second.

Binatog is a seasonal snack food made of maize kernels boiled in lime water and served with shredded raw coconut. Mr. and Mrs. Y decided in 1977 to start a business preparing and selling binatog with ₱300 they had saved while engaged in selling already prepared binatog.

The binatog Mr. and Mrs. Y produce is sold by vendors as a mid-day or afterschool snack for students. The vendors are assigned to different areas, where they operate on a sale or return basis. Many of the vendors are students who can earn about ₱25 per day. Mr. and Mrs. Y net about ₱50 per day between them.

Mr. and Mrs. Y are clients of MIDP. In August 1981 they received a ₱3,750 loan at 14% interest for 12 months. The purpose of the loan was to expand binatog production by purchasing maize in bulk at the cheapest possible price. Mrs. Y participated in the MIDP business management training course. The only change she made in her business was at the insistence of the MIDP staff officer who suggested she could increase the unit price of the snack from ₱7 to ₱10.

With their current facilities, Mr. and Mrs. Y can prepare, in an eight hour day, enough binatog to supply twelve vendors. Given the space limitation, the business could supply a maximum of eighteen vendors, but this would require purchase of a larger stove and more utensils.

Gingosa Buricraft. Mr. and Mrs. B began a business making rattan chairs, bookshelves, stools and folding room dividers in their two-room makeshift home in Bagong Barrio in late 1979. The items are made of buri, the long tough primary stem of the palm frond. Mr. B, who learned the trade during his seven years' employment in a large rattan factory in Cebu City, runs the production side of the business. Mrs. B, who has a high school education and had worked as a telephone operator, keeps all financial, production, and employee records and looks after purchasing and marketing.

The business was capitalized from family savings, the small size of which limited the growth of the business during its first year. Mr. and Mrs. B sought, without success, working capital financing from commercial banks to expand their business, but they avoided the "Bombays" or illegal money-lenders, calculating that the high interest rates charged (up to 20% per day) would more than offset any gains in revenue from increased production.

In the middle of 1980, the B's were recommended by neighbors to the field staff of MIDP, who analyzed their business operation and its prospects for profitable expansion. Soon thereafter MIDP gave Mr. and Mrs. B a ₱3,781 loan to finance a bulk purchase of raw buri and the initial costs of moving into a larger (and legal) rented home/factory in an adjacent suburb with electricity, water, and sewerage services. That initial loan, bearing interest, or a "technical assistance fee", at 10% per annum over eight months was fully repaid on schedule. Soon after retiring that first loan, and with the business on a sound footing, the B's saw the chance to fill a large order from a rattan exporter if they could stock up sufficient raw materials. Because of their good repayment record, MIDP gave them a ₱1,500 "emergency" loan at 10% per annum for three months so that they could stock up on buri. Again, the loan was fully repaid on schedule. In mid-1981 the B's submitted a proposal to MIDP for financing for further expansion and were extended a loan of ₱10,000 at 18% per annum over 18 months. After promptly meeting the first two monthly repayments, Mr. and Mrs. B asked for a rescheduling of that loan. They saw a chance to enter into an attractive long-term contract with the same rattan exporter and needed to purchase a very considerable quantity of raw materials. After an evaluation of this new business opportunity, MIDP granted the request on the grounds that Mr. and Mrs. B had an excellent repayment history and that the long term contract enhanced the long-term viability and growth of their business.

In January 1982 Gingosa Buricraft was employing one part-time and seven full-time workers. These were all relatives or neighbors and were mainly young school-leavers, the exception being the part-time employee, who was a student. All were trained by Mr. B. All are paid on a piece-work basis at a rate enabling the most skillful and hard-working individuals to earn ₱350 per week. Trainees average about ₱100 per week. In addition, employees are allowed to sleep in the Gingosa Buricraft home/factory (a significant fringe benefit in crowded Manila) and are given some meals. Despite these relatively attractive terms of employment there is a high rate of turnover, with workers frequently leaving and then returning after several weeks as their social interests and needs for income dictate.

Mrs. B has been given considerable business management training by three senior staff members of MIDP. She has been a willing and able pupil and now keeps excellent accounts of receipts and expenditures as well as detailed production records and individual records of employee performance. She is very interested in learning to do unit production costing and unit pricing and has been trained by MIDP in those skills. She has not yet been able to use those skills, however, to improve her business planning and operations.

Reyes Toy Manufacture. Since her husband was unable to find employment, Mrs. C decided they could earn a living together at home. Like many of their neighbors in Balic Balic, Mr. and Mrs. C began by assembling toy kits they purchased at the Divisoria, a large wholesale market. Their children sold the toys at weekend fiestas.

Mr. and Mrs. C did not have the P200 needed to start their business, so they approached the MCSI community leader, also a resident of Balic Balic, for assistance. Only a few days passed before they received P200 directly from the community leader, because she knew the Reyes and expected that they could repay the loan from business earnings as other clients who entered the toy making business had. The Cs have recently added a new product to their business -- a bamboo and plastic acrobat invented by another neighbor in the toy business. MCSI arranged a contract between a Japanese importer and another MCSI client, who in turn sub-contracted her neighbors, including the Cs, to fill the order on time.

Mr. and Mrs. C are clients in good standing, eligible for additional MCSI loan assistance if they decide to further expand their business.

Patani Cotton Candy. Mr. D is a middle-aged married man who has operated, along with members of his family, very small trading and vending businesses most of his adult life. He is known to be clever mechanically and is often asked to do simple household repairs for neighbors. At an Easter-time religious festival in 1981 he saw a commercial "cotton candy" or spun sugar machine operator doing a brisk trade. He studied the machine at length and concluded that he could fabricate a simple cotton candy spinning machine using a discarded sewing machine foot treadle.

Mr. D is a long-time neighbor of a senior MCSI community leader. He discussed his cotton candy idea with her and sought her assistance in financing the venture. He needed a small amount of funds for the treadle conversion and working capital to buy sugar and spindles. She concluded that his idea was sound on several grounds. Although cotton candy is a popular treat (especially at festivals and neighborhood celebrations), there are few cotton candy vendors around. Mr. D's plans for technological adaptation seemed in order, his skill as a vendor was well established, and, most important to MCSI, his reputation as a responsible and honest person was well known in the neighborhood. In October 1981 the community leader recommended Mr. D for a loan of P500 over five months at 10% per annum out of the SELP I fund. In January 1982 Mr. D was up-to-date with his repayments of principal and interest largely because of excellent sales at Christmas time. The money he has earned so far from the cotton candy business has enabled him to pay school fees for his children.

Mer's Figurines. For years, Mrs. E, now the mother of grown children, has supplemented the household income by retailing plaster of Paris figurines, small decorative items generally with a religious motif. Occasionally, she also fabricated figurines herself (rather than merely selling them), when she could find time and capital. Figurine making, a traditional cottage industry in this predominantly Catholic country, is a skill passed from generation to generation, as in the case of Mrs. E, who learned the skill of working with plaster of Paris from her father.

Mrs. E joined the MIDP program in its early stages, when it was working with groups of enterprises. She was grouped with three other members and received ₱5,000 at 10% per annum for 12 months to purchase raw materials needed to expand her figurine production.

Mrs. E's business venture in figurine production proved to be unsuccessful. She received her loan during the rainy season when she could not fabricate the figurines because they could not be dried. When the rainy season passed she no longer had the cash to purchase the raw materials. She had used most of it to meet an urgent family expense.

Mrs. E is once again retailing figurines to earn funds to meet day-to-day expenses and repay her loan. Although MIDP has written the loan off, Mrs. E continues to make occasional token payments because of her shame in not repaying an organization that extended her assistance. She is not interested in resuming figurine production. She would rather realize a small safe income from retailing figurines than to gamble on greatly improving her income by taking risks in a seasonal market and investing time in training workers, who often leave to set-up their own businesses after they are trained.

Participating Enterprises

The growth of participating microenterprises, seen in terms of output, profitability and employment, is the fundamental objective of the credit, training, and advisory programs of both MIDP and MCSI. Potential for significant business growth has always been a key element for individual loan application appraisals in each program and has become in recent months, in fact, a condition of qualification for MIDP financing.

Client records kept at headquarters by MIDP and MCSI have mainly to do with the extension and repayment of loans. There is very little information in their files on output, profits, and employment. Hence, statistics on the timely meeting of debt obligations are used as an indication of the success and growth of participating businesses. This can be, of course, quite misleading. Instances were seen of MIDP and MCSI borrowers repaying their loans out of a sense of obligation rather than out of any business revenues generated by the success of the loan project.

Interviews with program clients and examinations of their own records indicated that there were only a few enterprises which had realized significant, measurable, and sustained business growth through their participation in the programs. The main cause of this apparent lack of effect lies in the extremely close inter-relationship between, on the one hand, the affairs and fortunes of the enterprise and, on the other, the affairs and fortunes of the family which operates it. Typically increases in profits that result from participation in MIDP or MCSI credit programs are spent on the family -- births, deaths, marriages, medicine, schooling, consumer goods, etc. -- rather than being reinvested to expand the family's business. Program staff members report that a large number of businesses use the money to put more food on the table and in this way the children almost literally "eat up the profits". No one wants to discourage that, but the fact that the money is put into the family rather than the family business does complicate any analysis of business growth. In order to measure accurately the true marginal product to family businesses of enrollment in the MIDP and MCSI programs it would be necessary to pay as much attention to the impact upon the family -- in terms of its diet, health, education, and social life -- as to the growth of the business measured by conventional commercial indices.

The high degree of intermingling between participants' business and family affairs confuses calculations of the profitability achieved by program-assisted microenterprises. Individual businesses' records, which usually record sales volumes and values with fair accuracy, reflect the family/business muddle when it comes to recording expenses. The entrepreneurs are generally disinclined to view their businesses as separate from their families. But even a highly-trained and conscientious accountant would find it difficult to separate business and family transactions. For instance, should family food shared with relatives who often help out in the family enterprise on an informal basis during rush periods be accounted for under business expenditures as "payments in kind," or is it purely a family responsibility or social event? None of the interviewed businesses accounted for family members' contributions of labor and time in calculating their profits. (When questioned, it was clear that most entrepreneurs assigned a near zero opportunity cost to their and their families' time.)

Whatever the reasons, the books of interviewed microentrepreneurs contained figures primarily on sales and purchases of raw materials or stocks of goods. From examination of these, and from interviews, it was possible to make general observations.

What can be observed about the great majority of MIDP and MCSI clients is that, even if they have not yet realized great growth, they have become more viable: i.e., the business part of the family business has become more firmly rooted and may eventually show appreciable growth. We will discuss the matter of enhanced business viability at length below, after making what observations we can about sales, profitability, and employment.

Sales and Profits. A review of a representative sample of businesses' books in their owners' homes showed that most businesses increased their sales considerably during the life of the loan project while only a few showed clear evidence of being able to sustain those increases after the loan project. These two findings are closely related. All loan recipients have extremely simple production and/or merchandising processes. What they most frequently need is working capital to finance the purchase of larger stocks of raw material and/or wares, and consequently most MIDP and MCSI loans are extended for just that purpose. Larger stocks are sought in product areas where there is known to be an unfilled market or, in several cases, in response to specific purchase orders. In either case, staff members responsible for vetting loan applications have shown skill in assessing marketing opportunities, and the great majority of working capital loans have produced significant and fairly quick increases in sales for the enterprises which received them. However, as discussed earlier, only rarely are increased business earnings re-invested or held aside as a working capital fund to enable the maintenance of stocks at the new higher level. Once the borrowed money has been used and repaid the family may be better off in one sense or another, but sales revert to their original level.

A minority of MIDP and MCSI loans are made to improve a business' production or retailing system, typically for the purchase of production machinery (like another sewing machine) or for upgraded (often mobile) selling facilities. The recipients of such loans have a much better record of maintaining increased levels of sales. No instances were seen of new plant and equipment standing idle or of such equipment producing unmarketable goods. Each client interviewed who had purchased new equipment had been aware of the equipment for some time, had in most cases used it in former employment, knew how to maintain and repair it, and had no doubt as to how it would be used. In each case, increasing production capacity had led to proportional increases in sales, which showed every indication of being maintained.

In a few cases, enterprises achieved immediate and lasting higher rates of profitability (though not of turnover) owing to advice from program staff about materials sources, production techniques, unit costing, and/or pricing.

Only very rarely are loans applied to fixed capital assets, because so few MIDP and MCSI clients hold title or even a lease to the structures in which they live and work. They quite sensibly avoid putting their meager resources into fixed assets of which they could lose at any time. This lack of tenure, of course, is a serious inhibitor to sales and business growth. It is no surprise that one of the microenterprises showing a high level of sustained growth -- Gingosa Buricraft -- moved from a squatter settlement into legally rented quarters at about the time its business growth began.

MIDP and MCSI staff are aware of both the relative advantage of investing in production facilities and the futility of investing in fixed assets to which one has no tenure. They have therefore begun encouraging borrowers, especially re-borrowers, to use the money to purchase equipment and to negotiate some sort of tenure over their homes/businesses or to consider, in the few cases where it is feasible, moving out of squatter settlements and into legal facilities.

<u>Employment</u>. MCSI's Self Employment Program (SELP) is not intended for microentrepreneurs who employ numbers of others. As its name indicates, SELP aims to create employment for the entrepreneurs themselves. Most of the MCSI clients interviewed reported that from time to time, often regularly, close family members contributed to the running of the business and that neighbors were sometimes asked to help out in return for payment, usually by enterprises rushing to fill a specific order. But in general the MCSI program is not designed to generate employment outside the immediate families of participants.

MIDP, on the other hand, has always had employment creation as a primary program objective. Only microenterprises which show potential for significant generation of employment may qualify for MIDP loans. In January 1982 an analysis of employment in each MIDP-assisted enterprise was prepared. Because of constantly fluctuating employment levels in those businesses, the number of full-time jobs were calculated by totalling up the person-days employed per year by each. Business owners and members of the family who worked most of the time in the business were included. The analysis showed that:

- In the 246 businesses assisted by MIDP, 658 people were employed, for an average rate of 2.7 per business.
- In the 153 vending and trading businesses (mostly food stalls, rag pickers, and junkshops), 243 people were employed for an average rate of 1.6 per business.
- In the 88 manufacturing and processing businesses (mostly garments, footwear, furniture, handicraft, and recycling) 385 people were employed, for an average rate of 4.4 per business.
- In the 5 service businesses (small restaurants and a snack maker) 30 people were employed for an average rate of 6.0 per business.

Further comparisons were made between the size of the loan, the purpose of the loan, and the timeliness of repayment and each factor's effect on employment levels. However, from available information, no perceptible pattern in these areas emerged among MIDP borrowers.

The above figures show that the average client engaged in vending and trading provided employment for less than one (0.6) full-time person other than the business owner. Even those few vendors interviewed who had very considerably increased their sales had taken on few extra workers. Instead they simply turned over more stock by putting in longer hours themselves.

The employment picture among manufacturing, processing, and service businesses was more attractive, as seen in the above figures. Those such businesses which had achieved increased production capacity, throughput and sales showed proportional increases in numbers employed.

During client interviews, entrepreneurs and their employees were asked about conditions of employment. What emerged was a clear picture of low wages or piece rates. Vendors only rarely employ others for payment, and none interviewed could estimate the consideration paid to relatives or friends who helped them from time to time. Nearly all manufacturing and processing enterprises paid workers on a piece rate, which meant that individual employees' earnings varied considerably according to skill and industriousness. Trainee and unskilled production workers could expect to earn between ₱60 and ₱100 per week, or ₱240 to ₱400 per month in a business with steady production. Skilled workers ranged from ₱150 to a maximum of ₱350 per week, (seen in one case only) or a possible ₱600 to ₱1400 per month. In practice, few workers were engaged steadily for extended periods, and the great majority of non-owners earned well under the Philippine minimum wage of ₱600 per month for formal sector employment. Interviews also revealed that seasonal and other fluctuations in microenterprises with very short planning cycles meant that individual business' labor requirements change weekly or even daily. Business owners also reported very high turnover even in jobs that were relatively steady, due in part, no doubt, to the relatively unattractive earnings and other conditions of employment. In sum, most of the jobs generated by interviewed businesses could be characterized as "casual", with workers filling them only in the hope that something better might come along. Business owners reported no shortage of available labor, however, and the implication must be that something better came along only rarely.

Employment generation by MIDP businesses has not been great but it has been even less among MCSI participants. What jobs that have been created have tended to be low-paying and ephemeral. Nevertheless, they have been created by relatively little additional capital employed in the businesses. During the 1970s the ratio of capital invested in the formal manufacturing sector in the Philippines to new jobs in those industries was about ₱240,000 per job at present value. As of December 1981 MIDP had released a total of ₱292,000 in loans since the beginning of its credit program in March 1980. If only one-quarter of the 658 jobs in the businesses of MIDP borrowers were created by that new capital, the equivalent ratio would be ₱1,776 per job. Even if, <u>ad extremum</u>, only <u>two</u> of those 658 jobs were "created" by MIDP loans, the ratio would still be ₱146,000 per job, or nearly ₱100,000 less per job than in the formal manufacturing sector. In reality it is impossible to gauge what number of casual, almost informal, jobs were generated by MIDP's loans. It is also quite misleading to compare an occasional low-paying job holding little prospect for advancement in a Manila barangay microenterprise with a secure job at industrial wages carrying health and pension programs in a modern Philippine factory. What can be said is that MIDP businesses have contributed modestly towards providing employment and family incomes for the ever expanding number of Metro Manilans without land, education, or likely prospects for formal employment and that they have done so at relatively low cost.

Progress of the Entrepreneurs

The client profiles described the types and nature of the microenterprises assisted by MIDP and MCSI. Most of the clients have had previous enterprise experience, usually starting with trying to produce or sell something. That experience and the absolute necessity to earn a living has kept these entrepreneurs going. They are motivated to secure their businesses but have almost no control over the factors that inhibit their growth to a level of stability or beyond. They typically face a lack of capital, limited sources of raw materials, and a lack of markets. They tend to be too lenient in extending credit to customers and to divert business capital to meet either family or personal needs. Finally, their business management practices are often based on simple "rules of thumb."

Because of these limiting factors, the majority of the businesses operate on very short-term business plans; that is, the time in which they are reasonably confident that they can realize revenue through sales from the purchase of raw materials or stocks. The business planning period for Jofel Garments, for example, is around three to four weeks, which is based on Mrs. A's best estimate of return on sales. The Reyes toy-making business makes week-long business plans: toys sold in the weekend fiesta market are produced each week from raw materials purchased out of sales from the previous weekend. This constant "start-stop" nature of business operations, coupled with regular use of meager accumulated business earnings to meet urgent family expenses is the major inhibition to longer-term planning for investment and growth.

The first objective of participating businesses is to increase their production and/or sales volumes. In order to sustain higher levels of sales, business operations often need to make longer-range plans to achieve a smooth flow of procurement, production and marketing. MIDP and MCSI seek to assist their clients to do this not only by providing the necessary working capital but also by offering planning guidance and advice. How fast and how much the planning cycles can be leng enterprise, depending on type, the interest and motivation of the entrepreneur, and the complexity of the enterprises' factor prices. In the case of Jofel Garments, the planning cycles could be lengthened in a number of ways: by purchasing raw materials in larger quantitities, by extending and diversifying product lines and market outlets, or by employing more people. In the case of the toy-maker, the opportunity to lengthen the planning cycle is limited. Reyes Toy Manufacture depends on a single source of supply; the cost of its inventory is not affected by bulk purchase; and the product has a limited market range.

MIDP and MCSI have developed different tools -- MIDP's "package assistance," MCSI's "social credit" program -- to increase the capacity of the entrepreneur to gain a greater measure of control over the factors that inhibit business viability and growth. While the starting points may differ for MIDP and MCSI clients, the impact of both programs can be judged by how effective they are in increasing the capacity of the entrepreneurs to operate their enterprises at desired levels on a self-sustaining basis without further special inputs from MIDP or MCSI.

The majority of clients are at least more confident than they were before participation in the MCSI and MIDP programs simply because they made a somewhat longer term plan and, in most cases, acted on it successfully.

Inputs of credit on flexible terms has had a direct effect on the microentrepreneurs' capacity to plan and willingness to take risks. Clients, many of whom previously depended on the "₱5/6" system of credit, would borrow up to the amount that they were absolutely sure they could repay, keeping risk-taking to a minimum. They made daily, weekly, or monthly plans at best. MIDP and MCSI credit extended on flexible terms -- specifically longer maturities (3 to 12 months) -- permitted clients to increase and/or diversify stocks and encouraged them to gamble on increasing sales in the long term.

Mr. and Mrs. A, owners of Jofel Garments, illustrate this observation. In just one year, they revised upward their expected revenue through sales by accepting a second MIDP loan for ₱5,000 at 18% per annum with a nine month maturity. Their first loan was ₱2,000 at 10% per annum over seven months. Taking on the risks of repaying a second, larger and more expensive loan was based on the

the money lender to finance business expansion. [...] on her own calculation that she simply could not afford their usurious rates of interest and still meet expansion production estimates. By this calculation, she demonstrated an increased capacity to use available information (her accounting records) to determine her financing requirements.

The added confidence has translated, in some clients, into an increased awareness of the need to separate business and family affairs. An anecdote can be used to illustrate this observation. While interviewing the owners of the toymaking business, a visitor asked for a sample of a whirlybird-like toy they were assembling for sale. Mr. C, who does not look after the business end, was about to give away a sample as a social courtesy when Mrs. C, smiling, asked for P3 to complete the sale.

Most clients have temporarily transferred unwanted dependencies, specifically in the area of credit, from "5/6" lenders to more reliable and sympathetic sources provided by MIDP and MCSI. (It was reported that people who are able to secure financing from "wanted" dependency relationships -- i.e., family, friends and patrons -- are not attracted to participate in the programs.) The methods employed by both programs require a period of dependency to enable clients to establish good credit ratings and to learn needed business skills. During this "temporary" dependency the clients are supposed to save increased profits to secure and expand the enterprise either by reinvesting them or using them as collateral for obtaining commercial credit. If the concept of "pass-up" is to be proven valid, the capacity to save is key. ("Pass-up" refers to client progress through credit and advisory services of MIDP and MCSI designed to move clients step-by-step up the investment ladder to a point where they enter commercial financial markets and further special program inputs are no longer required.)

Our observations confirm the findings of MCSI's 1980 evaluation of the SELP program that "savings either for capital formation or for unforeseen need is very negligible... thus continuing dependence on loan assistance for business capital." While many MCSI clients have graduated from the trial fund to the SELP level, none has gone further. MCSI recently attempted to graduate clients in good standing to MIDP-type financing (P3,000, 18%, one year maturities) but with no success. There were very few takers largely because they did not want to be exposed to the risk of paying back P3,000. Those few clients who did accept loans are in arrears. Among MIDP clients, we did not find one client who graduated or "passed-up" to commercial financing. While there is little evidence that the "pass-up" concept is working, this does not necessarily mean that the concept is invalid. It may take two or three loans to develop both the enterprises and the entrepreneurs to the point where they can approach financial institutions as qualified credit risks. This process requires more time than the period of program implementation on which our observations are based.

In addition to depending on MIDP or MCSI for credit, the majority of the clients are dependent in varying degrees on MIDP staff and MCSI community leaders for help in managing their businesses. Clients have have attended courses in business management, but the credit proposals are prepared by staff or community leaders. The project feasibility studies are seen as a learning tool, but there were few cases where the clients could complete their own. There was little evidence of expanded business skills in unit costing, budgeting, etc. While many clients keep books, few could use the information in them for planning purposes. MIDP or MCSI staff often completed monthly records for clients.

This lack of skills in formal business management only partially accounts for the limited movement of the program's clients towards eligibility for commercial finance. Our interviews revealed that clients generally are not interested in expansion. The majority are interested in stabilizing family income so that they can meet basic family needs. Many also hope to earn enough to enable their children to finish their schooling in skilled professions. Success for them means accumulating enough money to help their children to escape the barangays.

Squatter settlers without title cannot realistically expand their businesses. Most manufacturers operate from the home where severe spatial limitations prohibit expansion. The uncertainty of tenure also inhibits growth, and there are very few options for them to relocate and still remain in close proximity to their markets. There are, then, indications of increased viability, but very limited indications of sustained growth. Even those microentrepreneurs who eventually internalize the required capacities for growth will always face very competitive situations, owing to the limits of the competitive marketplace and the economies of scale available to larger formal sector enterprises.

Effectiveness of the Implementing Orga izations

The first job of an organization seeking to aid microenterprises is to establish its effectiveness -- to demonstrate that it can achieve what it intends to achieve. After that it strives for efficiency and then attempts to expand, extending coverage to more beneficiaries. According to this schema, MIDP is still learning to be effective. This is not surprising, since it is a young organization that in its four years of existence has undergone a basic shift in emphasis from working with groups of enterprises to supporting individual family-based enterprises.

MIDP's present methodology and service mix calls for sizeable investments of staff time and funds in business management training and client monitoring to assure repayments of risky loans (without collateral) and to increase the basic business skills which the program assumes its clients need if they are to grow. While this heavy investment of time and money has led to a reasonable rate of loan repayment, experience to date suggests that it has had a minimal effect in increasing business skills. Indeed it could be argued that many of MIDP's clients, specifically the vendor group, cannot benefit at all from business training because of the nature of their businesses. Training and advisory services included in MIDP's package assistance -- unit costing, budgeting, pricing, marketing -- do not, for example, affect the vendor who has no control over the cost price he pays for inventory or the market price at which he sells it.

Before MIDP can claim it has developed an effective methodology in promoting microenterprise, it must put itself in a position to be able to answer a number of questions. For instance, how would loan repayments be affected if MIDP increased its ability to assess loan applications and select clients, and reduced project monitoring to a minimum? If business management training became optional instead of a requirement for credit, how many clients would seek training on a voluntary basis? What increased business capacities do the clients develop on their own by virtue of expanding their business with loan assistance? Answering these and similar questions will inform MIDP in choosing a methods and service mix best suited to meet client needs.

As far as MCSI is concerned, over the past six year of implementing the SELP program, it has demonstrated an effective methodology in extending credit to the smallest of microentrepreneurs. The community leader network basically accounts for the effectiveness of MCSI's methodology. The trial fund for small loans, administered by community leaders, has been an effective screening device for MCSI to evaluate clients and their enterprises for larger amounts of credit at the SELP I and SELP II levels. In effect, this system reduces costs of client evaluation because the trial funds are revolved by the community leaders without head office overheads. In addition, having the community leaders collect loan repayments at the SELP I and II levels was a major breakthrough in reducing dramatically the rate of arrears from 70% (when clients repaid loans directly to the MCSI office) to 16% (all loans repaid directly to community leaders) and eliminating defaults altogether. The effectiveness of the community leader network can be attributed to MCSI's capacity to select, train and support them at a reasonable cost. A 1979 study showed that overhead to loan value was at a ratio of about 1:15. If MCSI had more credit sources available to it, this ratio could be improved because the community leaders are capable of reaching out to more clients without additional expense to MCSI.

As will be described later in this chapter, MCSI has demonstrated a cost efficient loan assistance program geared to the smallest of existing family-based businesses. The evidence is less favorable as to MCSI's impact in assisting its clients to operate self-sustaining enterprises without further dependence on MCSI. However, MCSI has great potential to expand both in terms of broadening its program (increased client coverage) and extending its involvement (experimenting with new activities). MCSI plans to expand its coverage indirectly, by packaging the SELP methodology and transferring it to other organizations. MCSI could also expand its own program by increasing the trial funds of the community leaders to enable MCSI to evaluate a larger number of clients who show potential for growth. MCSI intends to continue to experiment with ways to assist clients to graduate to commercial financing (SELP III) or develop community mechanisms to sustain their enterprises.

These general remarks having been made, the rest of this section will look in depth at specific aspects of the two agencies' operations.

Staffing. MCSI has achieved a very good fit between its objectives and the development of a network of community leaders to pursue them in the barangays. The community leaders are "insiders" of the communities in which they serve, themselves entrepreneurs, knowledgeable of business opportunities and appropriate business practices and acknowledged informal leaders in their communities.

Equally important is the ability of MCSI leadership to develop the community leaders into a network characterized by cooperation and mutual support. Interviews with community leaders uncovered numerous examples of this cooperative spirit. (For example, one community leaders posed as a bank officer to assist her colleague in a distant barangay in dealing with a client with a poor repayment history.) MCSI encourages this spirit by conducting workshops where community leaders learn from each other, by allowing new community leaders to increase their client loads gradually under the guidance of more experienced leaders, and by providing staff back-up in difficult cases.

MCSI's community leader network has demonstrated its effectiveness in extending credit and ensuring its repayment; however, MCSI has not yet demonstrated the effectiveness of this network to spin-off community-based structures, such as savings clubs or credit unions. Nor has the network been able to "pass-up" clients to MIDP or banks.

MCSI is mindful of some of the pitfalls associated with the use of community leaders in program implementation. Its own 1980 evaluation report points out that clients often depend too heavily on the community leaders, perhaps even deloping a "personality cult." Also, the whole social credit scheme raises in clients the unrealistic expectation that all organizations will deal with them as informally and as sympathetically as community leaders.

MIDP has sought a good fit between its program objectives and the employment of college graduates to implement them in the field. However, it bears repeating here that MIDP staff's professional capacity is underutilized, and may not be understood by many clients. The advantage in staffing the program with college graduates is that their educational background enables them to assist clients in key commercial areas -- production, planning, pricing, marketing -- that are supposed (at least in theory) to assist them expand their enterprises and "pass-up" to commercial financing arrangements. These skills alone will not be useful unless the staff can adapt them to the environment of their clients. Interviews showed the staff members to be dedicated and enthusiastic in pursuing their jobs, but in some cases lacking an understanding of the harsh realities of doing business in the barangays. In order to be effective staff members must achieve a proper balance between social and commercial considerations in their interactions with their clients. Among MIDP staff the balance is tipped somewhat towards social considerations.

One MIDP staff remarked about loan collection, "we have to be gentle because our clients are poor." It may be that the clients would be served better by firmness and commercial discipline more in line with their milieu, particularly in anticipation of the time when they must stand on their own.

Client Selection. What fit is there between the clients selected and the objectives and resources of each of the programs? In the case of MIDP there is not a good fit. MIDP selects as clients a significant number of vending enterprises (62% of total MIDP clients) that show very little prospects for "bankability", i.e. eligibility for commercial bank or SMI program finance, or employment generation, the two basic characteristics currently sought in clients of MIDP. If the selection criteria were applied more rigorously, MIDP's portfolio would show a higher concentration of manufacturing and service enterprises (currently 38% of the portfolio), which have shown a capacity to benefit from MIDP resources. Greater selectivity should result in a more efficient use of MIDP resources, specifically credit and staff.

The client selection process is skewed too much towards presenting the application for MIDP credit assistance rather than making a rigorous assessment of the enterprise and the entrepreneur. MIDP currently uses a project feasibility format which presents information, specifically, detailed costings and cash flow analyses, beyond the needs of the enterprise and the reach of the entrepreneur. While appraising the likelihood of payback is essential in maintaining character loans, this exercise tends to dominate staff time. MIDP staff should be learning how to assess client needs (credit, training, management) and to "pick winners". The current selection, review, and feasibility study processes de-emphasize this in favor of setting the stage for very intensive client follow-up. The ability to "pick winners" quickly and often is key to increasing the efficiency and impact of the program and should be encouraged by shifting emphasis towards improved client selection at each program stage.

The early years of intensive client monitoring were very instrumental in developing staff expertise about the particular conditions of microenterprises in the barangays of Metro Manila. But it is now necessary to apply that expertise more quickly and with less extensive and costly staff follow-up. In January 1982, MIDP's Special Projects Department was developing a "dependability test" based on staff experience to be applied to new clients. It is hoped that this test will measure applicants' potential for sustained business and employment growth rather than the simple likelihood of their repaying loans. Appendix I to this report suggests further measures for tracking clients' progress and selecting them for entrance into later program stages.

When MCSI delegated trial loan making to the community leaders it achieved a very good fit between the clients selected and MCSI objectives and resources. The community leaders, themselves microentrepreneurs, are capable of making rapid assessments and taking risks (they are responsible for the trial funds) because of their knowledge of the people and the businesses in which they are engaged. MCSI client selection has achieved a proper mix between the social and commercial considerations in extending character loans to subsistence enterprises. The delegation of client selection to the community leaders enables MCSI to reach the very smallest enterprise at minimal cost.

The Balance Between Credit and Training. Both MIDP and MCSI offer their clients what they call "package assistance," with the package including loans, short courses given in the head office, management skills training in the workplaces, and regular counseling in procurement, production systems, marketing, compliance with regulations, and dealing with police and other public authorities. The package is tailored for each client and varies considerably. Nevertheless, there is supposed to be a balance between the financial and non-financial parts of the package or between credit on the one hand and training -- short courses, skills development, and counseling -- on the other.

There is no doubt that access to credit is what attracts microentrepreneurs to participation in the programs. When asked what they had derived from the programs, participants invariably mentioned credit first. Nevertheless, both programs have devoted, over the years and still today, a great part of their institutional resources -- particularly staff time -- to activities other than administration of credit.

Of MIDP's 22 professional staff, 14 are assigned to "operations" for the supervision of loan projects. In January 1982, 246 businesses were served by operations. However, grouping of these businesses reduced the number of loan accounts to an even 100 (for instance, one vendor's association is made up of 96 independent businesses but is treated as a single loan project.) The total of the principal amounts of those active loans was ₱288,685. Therefore, the average MIDP operations staff member was administering about seven loan projects with a total principal value to those seven of slightly over ₱20,000.

MCSI's 27 community leaders served 63 SELP I and II clients, plus approximately 250 trial fund beneficiaries. The total principal value of SELP loans stood at ₱41,500 in January 1982. Trial funds are completely in the hands of community leaders and centralized records relating to their use are not kept. Each community leader started with a trial fund of ₱500 and rolled the principal and interest repayments back into the fund. One senior leader's fund had reached nearly ₱4,000, but the average appeared to be about ₱800, or a total of about ₱21,600. The average MCSI community leader, then, was administering about twelve loan projects with a total principal value to those twelve of about ₱2,500.

For the purposes of comparison it should be remembered that MCSI community leaders are unpaid volunteers and are active business operators themselves, while MIDP "project coordinators" (as they are called) are full-time professionals. The point is, however, that in neither program is the operations staff fully or even mostly engaged in the administration of credit. A very considerable proportion of their time and energy is taken up in providing those various services referred to loosely as <u>training</u>.

To a large extent this emphasis on training has not been so much a matter of choice as a result of very limited financial resources. MIDP, as a department of government, is not allowed under civil service law to administer loan funds directly. Previous efforts to recommend borrowers to the Development Bank of the Philippines and the Philippine Center for Appropriate Training and Technology were not fruitful, and it was only after the creation of MIDC that loan funds derived from Philippine Business for Social Progress and A.T. International came under the control of MIDP's staff. Those funds were extended fully to borrowers within months of their availability, and, by January 1982, MIDP could only make new loans out of the revenues from earlier loans that had matured and been repaid. The same situation obtained for MCSI community leaders, whose SELP I, II and trial fund moneys were completely committed. There is no doubt that both programs could process and monitor considerably more loans, but neither has had the financial resources to do so. What the upper limits might be on these programs' ability to administer loans is, therefore, open to speculation.

Staff members have used the time left to them by their relatively light loan case loads to provide other services to their borrowers. In the case of MIDP, with its staff of young university graduates, these services are characterized by efforts to teach clients standard techniques of business planning and management. MCSI's cadre of entrepreneurial community leaders, on the other hand, have emphasized seminars and counseling sessions intended to heighten the self-confidence and motivation of clients, and very down-to-earth practical tips on how to operate tiny businesses in the milieu of the barangays of Manila.

The feasibility study prepared by MIDP operations staff for each loan applicant is supposed to be done in conjunction with the entrepreneurs and is intended to be a learning experience for them. Feasibility study formats vary somewhat in length and complexity according to the size of the proposed loan, but even the simplest format includes detailed procurement, production and marketing schedules; unit price calculations; as well as detailed gross profit, net profit, and cash flow projections. Somewhat larger loans require feasibility studies that analyze alternative marketing strategies, technical specifications of all machinery, demographic and economic characteristics of the community, projected net marginal income effects for direct and indirect beneficiaries, and that set out a critical path of implementation schedule.

Given that format, it should be no surprise that the feasibility studies are prepared entirely by operations staff. The writing-up of the studies alone requires between one and two weeks of staff time for each. It was clear from client interviews that the scope and complexity of the studies is quite beyond the needs and abilities of the great majority of MIDP borrowers. They participate only peripherally in the studies' preparation, and do not use them as a tool for tracking their own business' viability or growth. As existing business operators, they have developed their own informal "rules of thumb" for business monitoring and planning, and they continue to rely upon these in preference to the feasibility studies.

It is worth noting here that the performance of MIDP staff members is evaluated for the purposes of promotion and salary adjustment according to a points system. Points are given for professional work on feasibility studies, but no account is taken of the business or repayment performance of a staff member's loan portfolio.

The rest of the MIDP training package is intended as a follow-up to the initial feasibility study, and is comprised of training in bookkeeping, reconciliation of accounts, and preparation of trial balances. This training appears not to be very interesting for the majority of clients. There were even reports of a certain reluctance among microentrepreneurs to keep close business records for fear that such information might fall into the hands of tax collectors, neighbors, relatives, or competitors and somehow be used against them.

In general, MIDP's assistance package is weighted unnecessarily and unproductively on the side of training as opposed to credit administration. To some extent this imbalance results from the very limited funds available to the program to administer as credit. MIDP has worked rigorously over the years to secure access to more loan capital -- a major reason for the creation of MIDC was to further this effort -- and the top of every interviewed staff member's "wish list" was more loan finance.

Too much emphasis on training reflects a lack of fit between the program objective of making enterprises appear "bankable" and the need most clients feel for short-term working capital. MIDP program staff, motivated by their professional biases and interests, attempt to accelerate the growth of potential of an enterprise by establishing the entrepreneur as a credit worthy applicant for commercial financing faster than desired or absorbed by the client. This fact has implications for MIDP's intentions with regard to program replicability, as will be discussed later.

MIDP could achieve a better balance by gradually phasing in training services and phasing out credit as its clients' interests change and as the enterprise grows. Such a program could be organized in three phases.

Phase I: <u>Credit-worthiness</u>. Provide a small amount of short-term credit for working capital or fixed assets or both to evaluate the entrepreneur's credit worthiness and interests in expanding the enterprise.

Phase II: <u>Entrepreneurship</u>. Provide credit at increased amounts earmarked for business expansion and phase in advisory services (stock control, merchandizing, new design for the market) tailored to the needs of the business.

Phase III: Business management. De-emphasize credit and phase in the provision of business management services (basic bookkeeping, budgeting, pricing, marketing) to prepare the entrepreneur to qualify for and manage commercial financing.

The phasing of credit and training services would also provide a way to screen clients, thus enabling MIDP to maximize the use of staff and credit resources.

MCSI's assistance package is much less formal. Loans are made by community leaders out of their trial funds solely on the basis of the leader's personal knowledge of the clients and their particular business prospects. No feasibility study is prepared. Applicants for SELP I loans must be successful former trial fund borrowers, and applicants for SELP II must be those who have repaid SELP I loans on time. A simple descriptive document accompanies these SELP loan applications, but the two main bases for approval are the recommendations of the community leaders and the applicants' growing records of timely repayment.

None of MCSI's selection procedures are intended as devices for training clients. Training takes place in two ways. First, all new borrowers attend a two-day orientation seminar where they are introduced to MCSI objectives, policies, and procedures. Here they are encouraged to make an active personal commitment to full participation in the MCSI program, of which the credit program is only a part. Broader social goals of constructive community action underlie the SELP program. Second, training and guidance towards improved business performance is offered to clients by community leaders on a simple as-needed basis, with the needs being defined by the clients themselves. In a few cases this includes instruction in standard bookkeeping, costing, and stock-control procedures. But the great bulk of this guidance takes the form of advice about sources of supply, improved production techniques, more attractive merchandising, or avoidance of harrassment. Community leaders are also able to advise on personal and family matters, particularly when these bear upon the success of the business.

Grouping Mechanisms. Microenterprise promotion programs use grouping mechanisms to help entrepreneurs gain a greater control over the factors that inhibit the development of their enterprises. These factors include lack of access to credit, lack of bargaining power in the marketplace, lack of purchasing power for raw materials, and lack of leverage to enter into favorable relationships with suppliers, retailers, regulators and others.

The MIDP program began by organizing groups of enterprises as the most efficient means to extend credit and tap resources of financial institutions more likely to respond favorably to a request for one P5,000 loan than 10 requests for P500 loans. In fact, this proved inefficient because of the many business failures and loan defaults. Lack of shared accountability leading to poor management were the reasons given by MIDP to explain the poor showing of the groups. The notion that a newly formed group of enterprises supported by outside assistance would gel around the opportunity of receiving credit was perhaps an unrealistic expectation for clients with very individualistic attitudes about earning an income in the very competitive markets of the microentrepreneur. The MIDP experiment does not prove that a grouping mechanism for credit is invalid, but it certainly suggests that grouping is not the best way to begin working with microentrepreneurs in the barangays of Metro Manila.

Further development of a planned "service center" project may lead MIDP to experiment with another type of grouping mechanism. Initially, the service center would operate as a private company providing a number of services to the microentrepreneur, including bulk purchase of raw materials, sub-contracting opportunities, quality control and other technical assistance. If the company proved to be commercially viable, its ownership could gradually devolve to the participating entrepreneurs. The service center could assist the entrepreneur in gaining greater control over the factors that inhibit growth. MIDC will play a critical role in translating the concept into a project if discussions prove successful with the KKK.

The issue of continuity is important to both programs: How will MCSI and MIDP clients sustain their economic gains after program services are withdrawn? Savings and re-investment is one option, but there is little evidence so far to suggest that clients, without the outside pressure of program personnel, will defer immediate consumption needs to reinvest in their enterprises. Whereas some MIDP clients may be able to sustain the growth of their enterprises by qualifying for commercial financing, this option is basically foreclosed for the majority of MCSI clients whose enterprises will remain "unbankable." In the case of MCSI, devising effective client grouping mechanisms, specifically for obtaining short term capital, is one realistic option to sustain economic gains. Worthy of mention here is the effort of one community leader who is trying to organize a group of her clients representing a mixture of enterprises, into an imputan, or "savings club." The purpose of the savings club would be to establish, in effect, an MCSI trial fund, capitalized from the savings of its members. The community leader sees the club as an important first step in stimulating the formation of community structures to sustain the economic gains brought about through MCSI. In addition to developing a short-term loan making capacity, the group could explore bulk-buying arrangements, new business opportunities, community counseling, and other services currently provided them by community leaders. This experiment should be encouraged and monitored by MCSI.

Role of technology choice and adaptation. All interviewed clients were questioned at length about how they had developed their systems of production, how they selected and acquired the machines and tools necessary to operate it, how they had acquired the necessary skills, and about what role technology might play in their future plans. (In this instance "technology" was taken to refer only to the hardware and production systems of the participating microenterprises.)

What emerged was a remarkably uniform picture. The great majority of barangay microentrepreneurs had entered a line of trade on the basis of familiarity with it or skills acquired through some prior experience: shoemaking learned at a father's knee: ability to construct rattan furniture acquired from previous employment in a large factory; or appreciation of the imperative to "buy cheap and sell dear" gained from being raised by a mother who hawked vegetables door to door. From these experiences and based upon these skills, microentrepreneurs had gone into business, adapting their skills and production systems to fit the scale of operations imposed upon them by the limits of their available capital. If their tiny enterprises prospered, or when they were able to secure financing, they seem to have had no doubts about where best to apply funds to rationalize their business system. It has already been noted that most participating entrepreneurs have used infusions of money to increase their stocks of raw materials or wares. But, where entrepreneurs chose to invest in expanded plant and machinery, they reported no doubts about what particular pieces of equipment were appropriate for their needs. The primary basis for choice was familiarity, that is, what the entrepreneurs or their families knew how to operate and maintain. In the absence of a comprehensive program of technological training and follow-up, choice on the basis of familiarity is almost certainly correct. What was clearly the case was that the average entrepreneur was much more expert than program staff when it came to questions of technology and production system choice. A staff member might advise a T-shirt maker that business growth would be enhanced by securing long-term sales contracts, but it was the shirt maker who knew that a particular type of overlocking sewing machine was necessary to achieve the standard of finish required by the department stores. Even if program staff had been much more expert as regards technology choice, it is doubtful that such expertise would have produced significant benefit. The great majority of microenterpreneurs were sufficiently knowledgeable about their particular line of business and the technologies applicable to it to make adequate choices through several stages of expansion and growth. The quality of technology choice was a very much <u>less</u> limiting factor than the availability of finance, the constraints of the competitive market, the insecurity of tenure over places of production, or the degree of determination of the microentrepreneurs themselves to expand.

unit of program cost is necessarily and rightly a [illegible] of MIDP and MCSI, as it is for any institution which relies on public and/or donated funds for its existence. What is not clear here is what exactly is the proper measure of program output or what the programs must be able to demonstrate their efficiency at doing. A review of MIDP and MCSI literature suggests a number of intended "products" which might be compared with costs. The most important of these are creating work places, increasing the security of family subsistence commercial activity, administering loan funds, developing and disseminating expertise in microenterprise promotion, and helping microenterprises to become "bankable." Looking at how efficiently (in terms of cost) MIDP and MCSI deliver these products is difficult because of a general paucity of data. However, a few tentative observations can be made regarding work places, increased security of family businesses, and the administration of loan funds.

(i) Creation of work places. An earlier section on the subject of employment showed that MCSI aims at self-employment and that its participating microentrepreneurs only occasionally engage the services of others. In January 1982, MCSI's 313 business owners probably did not provide the equivalent of full-time jobs for more than 400, including themselves. Even though the loan funds supporting those work places are quite modest (₱63,000), it would be inaccurate to conclude that they had been "created" by those funds or to calculate a cost per job ratio based on the value of the loans. The majority of those work places were in existence before the loans were made, and other program costs besides loans would have to be considered in computing cost per job.

MIDP borrowers were also existing businesses, and because the program records no systematic baseline data about employment in enterprises which apply for loans, it is unable to track the number of jobs that may have resulted from each loan project. The earlier section on employment concluded that participating MIDP businesses were themselves relatively efficient creators of employment when that efficiency was measured as a function of total capital employed in the businesses set against total work places. However, the efficiency of the program in creating jobs is less attractive.

At the end of 1981 there were 658 people employed in MIDP businesses. The capital employed by the program in support of those jobs was a loan portfolio with a principal value of ₱288,685 plus an annual overhead budget for MIDP of exactly ₱600,000 made up of staff salaries, travel, and office expenses, for a total of ₱888,685. During interviews with MIDP clients it was estimated that a maximum of one-quarter of the total workplaces (or roughly 165 jobs) had come into existence during 1981 as a consequence of the loan projects. This would imply a ratio of roughly ₱5,400 of capital employed by MIDP for each job created. The same interviews suggested that at least one-tenth of existing workplaces (or 66 jobs) had opened during 1981, whereby the program cost per job would be about ₱13,500. The fair conclusion, then, is that MIDP requires currently between ₱5,400 and ₱13,500 of program costs (overheads and loans) to create one full-time job. Set against the value of those jobs to their holders this ratio is rather high. The great majority of employees in MIDP businesses earn less than the Philippine minimum wage of ₱7,200 per year and might prefer simply to be "paid" a relevant share of program costs directly. However, compared with the costs of alternative strategies to create jobs, MIDP's ratio is quite favorable; it has already been seen that the ratio of capital invested in the formal manufacturing sector in the Philippines to new jobs in those industries was about ₱240,000 per job.

(ii) Increased security of family subsistence commercial activity. Greater viability -- as opposed to growth -- of existing family microenterprises has been shown to be both the intention and the result of MCSI lending programs, and the major result (although not the stated intention) of MIDP's interventions with its clients. The degree of heightened viability is, of course, very difficult to measure. The observation that participating microenterprises are, in fact, on a more secure footing is based upon the regularity with which they described themselves that way, and the evidence they themselves put forward. They had been freed from dependence upon usurious "5/6" money-lenders; they had established reliable, fair, sources of supply: or they had maintained a more regular production and marketing flow.

To try to compute the cost of some "unit" of increased viability would be futile based on existing data, and that data would be very expensive to accumulate in any case. What can be said is that MCSI has achieved those gains with a very lean program operated at minimal cost. There is also very little wasted effort in this regard. Each element in the MCSI program -- lending, training, advising, even counseling on personal and family matters -- contributes to the greater security and viability of the family and its enterprise.

MIDP has set itself the more difficult task of promoting the growth leading to "bankability" -- in terms of employment, sales, and profitability -- of the enterprises it assists. Consequently a very great part of MIDP program resources and costs are expanded in the effort to promote business growth. At the same time the capabilities and interests of participating microentrepreneurs are in a majority of cases limited to achieving gains in security and viability of the family and, as a part of that, its enterprise. The costs of promoting growth, then, have in many instances been wasted. Considerable cost efficiencies could be achieved by MIDP streamlining and sequencing its package of assistance and tailoring it to fit the needs, abilities and interests of its clients as they evolve over time.

(iii) Administration of loan funds. MCSI has an outstanding record of putting out loans to microentrepreneurs and having them repaid at minimal cost. Its network of 27 unpaid community leaders administered loans totalling over ₱63,000 in January 1982 with a low rate of arrears (16% over 30 days) and no defaults. Total program costs were not made available but are known to be limited to two professional and one secretarial salaries, modest office rent and expenses, and local travel costs on public transport.

MIDP does not describe itself primarily as a lending institution, and would not be seen in a favorable light if evaluated on those terms. The total principal value of loans released in 1981 was ₱212,014 against program overheads for that period (staff, office and travel) of ₱600,000. It has already been noted that MIDP has had limited funds available to it for making loans, and this fact helps to explain the poor overhead cost/loan ratio. Nevertheless, even the loans that MIDP has been able to make have not had a good repayment history. At the end of 1981, about 24% of loan repayments due to MIDP were more than 30 days in arrears. During 1981 a further 17% had fallen into arrears and had their loan accounts "restructured," that is, either rescheduled or refinanced to eliminate accumulated arrears. Another 13% had defaulted and been declared "inactive."

(iv) Increased marginal production and profitability of participating microenterprises. Nothing at all can be said about MIDP's efficiency in making enterprises "bankable" or in developing and disseminating expertise about microenterprise promotion. At this point in its development, it has not been able to do the first, and has just begun to do the second.

Both MIDP and MCSI must find some way to bring focus into their descriptions of their goals and to develop some practical ways to develop cost efficiency data. It is clear that those who support MIDP and MCSI programs (government, domestic and international donors, dedicated volunteers) are concerned primarily with the conditions of the poor in the barangays of Manila. Their motivations are social and are directed at relieving the poverty and lack of opportunities of the growing numbers of landless unemployed. Therefore, in order to continue to attract support, both MIDP and MCSI (and, in fact, all MIDC members organizations) must be able to demonstrate that a unit of money or time invested in them leads directly and reliably to an increase in the family incomes of participating businesses greater in value than the unit invested.

Not only would such a demonstration encourage continued support for the programs, but data derived from its calculation would help the programs to focus their efforts on achieving the fundamental objective of program supporters and beneficiaries alike: sustained increases in family incomes.

Calculations based on this index of cost efficiency are not possible from existing records. It would not be advisable to track with great precision individual marginal gains in production and profitability. To record too much detail would by itself skew unfavorably the ratio of overhead costs to benefits. Nevertheless, it is incumbent upon MIDC programs to incorporate into their client selection and monitoring procedures a simple but reasonably accurate system of recording such gains. Informed estimates would have to be used, but these could be tested against the performance of a more closely-monitored small but representative sample group. Estimates of family business income for loan applicants could be based on their own statements as modified by the observations of the relevant case worker. Such estimates, not at present made or recorded, would provide acceptable base line data. Increases in income during the period of the loan project could be derived from the profit and loss accounts prepared by MIDP project coordinators and from the informed estimates of the remarkably shrewd MCSI community leaders. Such simple procedures would not burden field staff unduly and would be of great benefit in streamlining and sequencing program components to fit more effectively the needs and capacities of clients. The data derived would also provide valuable information about performance on the other indices of program output listed above.

IV

MIDC AND ACHIEVING MAXIMUM IMPACT

MIDC's Record

Recognition of some of the program weaknesses described in the preceding section was a major reason why MIDP and MCSI led the way in creating MIDC. The pooling of institutional experience and resources is intended to assist participating programs to review their performance and effect sensible adjustments.

MIDC, still in an early stage of development, has so far experimented with a number of projects designed to enhance MIDP's and MCSI's effectiveness, as well as to become an effective "brokering" mechanism in support of other microenterprise promotion programs. The MIDC projects have enabled MIDP and MCSI to experiment with their methods by adding cost-efficiencies (MIDP's community leaders training and supervised money-lenders system) or expanding client outreach (MCSI SELP III). MIDC has also brokered funds for MIDP and MCSI from Philippine Business for Social Progress and A.T. International. MIDC has played a helpful role, and hopes in future to demonstrate that it can be an effective vehicle for spreading the lessons learned by its member agencies.

MIDC's own program plan points out that "the impact of brokering is difficult to assess since it involves the direct involvement of minimal resources compared with those provided by institutions. Causal connections are difficult to identify. The impact of brokering is most easily assessed in terms of the value attached to it by those who have had contact with the brokers." MIDC leadership has realized that the most reliable indication that parties attach value to this "brokering" would be the willingness of those parties to pay for the service. For that reason the Institutional Consultancy Group of MIDC has been projected as a fee-earning service. Perhaps over time the only valid means of establishing MIDC's cost efficiency at developing and disseminating expertise will be seen in the ability of that program element to pay its own way.

Discussions are underway between MIDC and the government-sponsored Kilusang Kabuhayan sa Kaunlaran (KKK) program that could enable MIDC to develop as an effective broker in expanding opportunities for microentrepreneurs through its members. These discussions have centered on MIDC brokering relationships between small and medium scale industry and microentrepreneurs through sub-contracts. MIDP and MCSI would play key roles in a number

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of ways: in identifying potential sub-contractors, in providing a channel for raw material purchase and marketing, and in providing advisory assistance for improved productivity and quality control.

Should MIDC be successful in its negotiations with the KKK it would be on a solid track in learning how to be an effective broker and how to reach out to the informal sector beyond its relatively small client groups. Success on this initiative would undoubtedly result in a quantum leap towards achieving MIDC's program objectives.

Nevertheless, the impact to date of MIDC, its member agencies, and their participating microenterprises upon the informal sector as a whole has been minimal. The scale of the sector is, of course, quite beyond MIDC. In the Philippines in 1975, there were, for instance, about 900,000 people working in their own homes on manufacturing activities alone. But even in the immediate neighborhoods of client microenterprises there was surprisingly little evidence of any spin-off commercial activity. For example, few MIDP and MCSI clients had entered into lasting business relationships with others in the sector, and fewer still had spawned new enterprises. Nearly all client businesses bought raw materials and/or stocks from large wholesale suppliers and sold directly to the public in highly competitive markets.

An important function that MIDC has set for itself is that of using its participating programs as a "laboratory" for testing the effectiveness and results of various techniques of microenterprise promotion. MIDC intends to bring the expertise gained in that "laboratory" to bear, not only upon other similar programs, but also upon the policies and procedures of local and national government, financial institutions, and larger formal businesses. If successful in the government sphere, these efforts might produce changes favoring microenterprises in legislation concerning taxation, licensing, regulatory laws, and public procurement. With banks, changes might be seen in a relaxation of their lending policies as regards minimum size, collateral, or treatment of arrearages. Larger businesses might be induced to give greater consideration to microenterprises as subcontractors or component suppliers when developing business opportunities.

The progress of MIDC in affecting policy is minimal. The upgrading of MIDP from project to program status is evidence of the government's seriousness about the microenterprise sector and its recognition of MIDP as an important agent in furthering its objectives there. The positive indications from early discussions on the KKK initiative show that MIDC's voice is being heard, and in time MIDC may become an important source of guidance to the government in the formation of policy as results from the "laboratory" become available. But to date the impact of MIDC upon official policy has been limited primarily to establishing the credibility of the program and opening the channels of communication.

Little success can be noted in getting commercial banks to extend credit to microenterprises. The Philippine Commercial and Industrial Bank has agreed to serve as administering agent of MIDP loan accounts but has not yet been willing to assume ordinary commercial risk on those accounts.

The Philippine Business for Social Progress (PBSP) organization extended to MIDC in 1981 a P100,000 line of credit to enable lending at commercial rates to forty established MIDP clients. PBSP's major interest is to test MIDC's ability to select and support borrowers, and the main index of success in the project will be the record of repayment of those loans. PBSP's assessment of the project will affect its own future programming, as well as the expectations and plans of the large private business houses of which PBSP is composed. Similarly, the performance of microenterprises that may participate in the KKK initiative will influence larger businesses' perceptions of opportunities for collaboration with such microenterprises. But these impacts are ones that may be seen in the future. Alterations in the behavior of larger businesses as a result of MIDC's work are, to date, negligible.

MIDC's Agenda

MIDC expects to achieve impact by developing and transferring to other agencies program methods and services in microenterprise development proven cost-efficient by its member agencies. Both MIDP and MCSI have geared their programs, which deliberately have remained limited in scope, to the design of what they call "program technology." In the case of MCSI this refers to the use of community leaders to extend social credit to stabilize the enterprises of the poorest of the microentrepreneurs; whereas program technology for MIDP refers to the use of young professional civil servents to extend credit and support services to expand and formalize the enterprises of microentrepreneurs.

MIDC has responsibility to advise agencies interested in replicating various programs of their costs and benefits. What are some of the questions MIDC should ask in assessing the replicability of the MIDP and MCSI programs?

(i) Have cost efficiencies been achieved in delivering services proven effective in meeting client needs and capacities?

(ii) Can the program be applied to a similar though larger client group without changing elements that have made it successful?

(iii) Can the program's components be evaluated on their own?

(iv) Does basic documentation exist that shows the costs and benefits of the program and its components?

For example, the MCSI community leader approach has very good expansion potential for a number of reasons: the low costs in evaluating many clients because the community leaders reside in the target areas; the business experience of the community leader is sufficient to meet client need, thus reducing staff training costs; the community leader network is basically self-monitoring and requires very little support from headquarters. MCSI has been able to expand client loads by adding assistant community leaders to the network (one senior community leader has eleven assistants) without sacrificing its personal and informal approach and without adding supervisory staff. Through this mechanism, the senior community leaders can expand their own client loads. The program appears to have achieved efficiencies in costs as it expanded, although this is difficult to document due to lack of overhead information available for this report.

The primary components of the MCSI methodology -- credit and community leader training -- can be evaluated on their own and, therefore, can be adjusted to suit the particular requirements of any interested agency. The credit component with its staggered approach (trial fund, SELP I and SELP II) allows the agency to evaluate the credit-worthiness of the client. It also offers access to credit without unacceptable risk or cost to the client. Loan collection procedures have proven to be very effective. The community leader training component is a refined and coherent six day training module that could be applied by organizations interested in leadership training for small business promotion or other types of income-generating projects. The comprehensive nature of the module, which covers community organization, self-awareness/attitudinal training and small business management, offers the community leaders the background and tools required for their role.

Before transferring its member organizations' methodologies to other institutions, MIDC must first produce clear operational descriptions of those various program elements which can be interpreted and adapted by others. It must also produce basic documentation which shows the costs and benefits of the programs and their components. The lack of such documentation of both

MIDP and MIDC programs made this analysis difficult. Neither kept systematic, updated statistical and/or narrative records on their clients or on cost of program elements. The information that did exist was aimed at tracking the use of outside financial resources rather than providing useable data to assess program cost and benefits. MCSI and MIDP staff recognize that this information gap inhibits both their ability to make program adjustments in order to increase its efficiency, and their ability to transfer their methodology. The question they asked was: What are realistic measures of program cost-efficiency and can they be assessed at an acceptable cost without overburdening the program and distorting its potential for replicability?

In an earlier section, this report suggested that among all the possible measures of program cost-efficiency, the one that MIDC must establish at the end of the day is a calculation of the marginal product accruing to participating microenterprises set against program costs. The chart outlined in Appendix II suggests measures of cost-efficiency and the minimum documentation requirements at the various stages of a program with "bankability" as its primary objective.

(i) Credit-worthiness Stage: This is the stage in the program when the clients' credit-worthiness should be evaluated at the least possible cost. Program effectiveness depends upon the skill of program staff in judging client character and determining the short-term capital requirements of a feasible enterprise. Efficiencies can be achieved by streamlining loan processing procedures, simplifying loan collection procedures and minimizing staff monitoring to ensure timely loan repayments. The formulation of program cost-efficiency is made up of low transaction costs and maximum repayment rates set against minimum feasible staff time and other overhead. The information needs here are records of staff time and other overhead costs incurred to process and monitor loans and records of repayments arrearages and defaults.

(ii) Entrepreneurial Stage. This stage requires staff to make an evaluation of the client's attitudes and entrepreneurial capacities to stabilize and/or expand the enterprise. Program effectiveness depends upon the skill of staff in selecting clients who can benefit from these services and in guiding them, through credit and business advice, in making adjustments or changes in their businesses geared to increasing sales. At this stage, efficiencies could be achieved by increasing staff specialization, in particular lines of business in terms of production, merchandizing, marketing techniques, stock control and other entrepreneurial tips. Loan transaction costs could be reduced because of the demonstrated credit-worthiness of the client. The suggested measure of program efficiency for this stage is documentation of changes in family net worth and disposable income set against staff time, and other overhead costs including any loan defaults. The minimum information required includes: records of changes in income aggregated by tracking sales, household expenses, all capital purchases (family/business), inventory purchases and extraneous income to the family; records of staff time and other overhead costs to process/collect loans and provide on-site business advisory services; and records of loan repayments, arrearages and defaults.

(iii) Business Management Stage: Microentrepreneurs selected for this stage of the program would have demonstrated their capacity to translate program services (credit and advice) into increased sales. Program effectiveness would depend upon staff skills to select clients who can benefit from a package of training services and to design and implement training curricula. Cost efficiencies could be achieved through careful client selection and streamlining course work to prepare clients to meet commercial bank requirements in terms of business management -- record keeping, unit costing, and business planning. The measure of cost-efficiency would be essentially the same as the entrepreneurial stage with the addition of tracking the progress towards being "bankable" of family net worth. This refers to business and/or family real assets that would meet bank requirements for loan collateral. The information requirements would be the same as in the earlier stage.

The suggested measures of program cost-efficiency would permit program managers and others interested in adapting parts of that program to assess costs and benefits of various program stages with different types of services and staff inputs. Of course, in this process of interpretation and adaption MIDC must pay close attention to the similarities and differences between, on the one hand, the operational contexts of particular institutions seeking to adapt methodologies, and on the other, the context of its own institution's programs in the barangays of Metro Manila. Appendix III suggests an outline of key contextual factors that should be considered by MIDC during the transfer endeavor.

In order to assess overall program performance it would be erroneous to assess overall program costs against only these clients who ultimately have achieved "bankability." It is implied that clients who do not "pass-up" and leave the program would at least have been assisted to stabilize their enterprises at a higher level of profitability without further program inputs.

MIDC might track a representative sample of clients who have left the program, and perhaps even a sample of non-participants, to see if they have been able to sustain social and economic gains on their own.

When MIDC is positioned to document clearly the elements of its members' programs, the conditions and contexts in which they were developed, and the relative costs and benefits of each it will be much more able to perform its main intermediary function of disseminating or transferring program methods, proven cost-effective, to other institutions.

APPENDIX I

ANALYTICAL TOOL FOR SELECTING CLIENTS FOR "PASS-UP"

MIDC is set up to test the feasibility of its basic assumption that microenterprises can grow, in both size and required capacities, to qualify for financing from larger institutions. Enterprise "bankability," the term MIDC uses to define this assumption, is the principal intended output of the programs it supports. Even very rudimentary businesses are expected to "pass-up" through successive program arms until they are eligible for commercial finance. Microenterprises that become "bankable" are expected to generate, in turn, sustainable employment opportunities for others.

There were no instances of participants who became "bankable" in the MIDC supported programs. The foregoing analysis did not conclude, however, that the "bankability" assumption was invalid. Rather it noted that the expectations and experimental methods being developed by MIDC and its members require much better focus to permit a reliable test of the "bankability" and "pass-up" concepts. The report identified four key areas where changes in focus seemed particularly important. These areas were:

- Revision downward of MIDC's expectation of the percentage of clients selected who will eventually become "bankable."
- Sequencing the package of program services to permit better tailoring of service delivery in line with the changing needs and capacities of the microentrepreneur.
- Ensuring that as clients grow in entrepreneurial capacity they reduce their dependency upon the staff and credit services of the program.
- Development of a system for selecting clients to move through the sequential stages of the program, i.e., "pass-up."

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Thus, client selection is the primary task before MIDC in bringing "bankability" to a reliable test; that is, to determine which clients to work with; which package of services to offer each; and how long to work with each before he/she is either "passed-up" or phased out of the program. MIDC is aware of the importance of client selection and is in the early stages of devising what it calls a "dependability test." The purpose of this test will be to assess objectively the dependability of individual applicants for timely repayment of first-time loans. It is understood that the dependability test will put into a more formal system those techniques of client selection already practiced by more experienced field staff of MIDC-supported programs. Because of the very informal nature of the businesses of initial loan applicants, those techniques center around making a character assessment of the applicant and are based upon impressions gained from interviews cross-checked against the applicant's reputation in the community. Assessment of potential for business growth at the initial stage is very difficult, and, as discussed earlier, the effort expended by program staff on preparing very detailed business plans and feasibility studies is often wasted. To the extent that the dependability test streamlines, simplifies, and regularizes the procedures for initial selection it should be of significant benefit.

However, if sustained business growth leading towards "bankability" is the ultimate objective of the program, then indicators of dependability other than personal integrity become increasingly important as individual clients grow in business size and management capacity. These indicators include client attitudes towards business growth, and toward themselves as entrepreneurs, as well as the development of their skills in production, marketing, and management. It must be understood that growth towards bankability is a step-by-step process, and that client selection is critical at each stage.

MIDC's programs can be looked at as a four stages process -- each stage with its own goal. In the first stage it is the client's credit-worthiness that is being nurtured and tested. In the second it is their entrepreneurial capacities. The third stage assumes that a creditworthy, entrepreneurial client can develop and benefit from more formal business management skills, and the fourth that a client is fully eligible for financing from the normal commercial channels, or is "bankable". Each of these program stages requires the same high quality of client selection as does the initial point of entry into the program. A more careful screening of clients at each stage should ensure that the efforts and costs of training in each stage are directed at those clients most able to absorb that training and apply it with greatest effect to their businesses, even if many of those do not "pass-up" again.

This appendix suggests an analytical tool designed to enable better client selection at each stage succeeding the initial entry to the program, where clients would continue to be chosen according to MIDC's dependability test of character. The tool is essentially a profile of a particular microenterpreneur at a particular time as he/she is characterized by certain indicators of performance, attitudes, motivations, and skills. The profile could be constructed as a questionnaire to be completed by a program staff member. (See Sample 1 attached.) If this form were filled out for potential clients applying to the program for the first time, few of the questions would be answered in the affirmative, and the client would still have to be selected on the basis of character and reputation.

Four sample profiles are attached to this text, showing how the profile could be used to tell just how far given entrepreneurs had progressed towards the ultimate goal -- bankability.

Sample Profile 2: Participating clients such as Mr. and Mrs. A, the garment manufacturers described in the client profile section, who had already established their credit-worthiness and who had clear inclinations towards business growth and development of entrepreneurial capacities would be prime candidates for entrance into the second "entrepreneurship" stage of the program. They would be likely, not only to repay a further infusion of credit, but also to benefit from a package of program assistance designed to encourage and further their capacity. As shown in the profile, Mr. and Mrs. A were able to take a calculated risk, defer short-term consumption, sustain increases in production/sales, enter new markets, increase their bargaining skills, and lengthen their planning cycles. Such a client would be considered as eligible to remain in the program and ready to "pass-up" to a more sophisticated regimen of program assistance designed to enhance entrepreneurship.

Sample Profile 3: On the other hand Mr. D, the cotton candy maker, had a satisfactory repayment history but showed little or no inclination to become more entrepreneurial.

Clients like Mr. D would have [illegible] in repaying their debts, but would probably have reached the upper limits on their motivation towards business growth and entrepreneurial development. Such a client would not be likely to "pass-up" to "bankability," but would instead remain dependent indefinitely upon subcommercial program credit. Following the logic of a program like MIDC's, such a client should perhaps not be selected for entrance into the entrepreneurship stage.

Sample Profile 4: A few of the MIDC clients interviewed during this study seemed clearly ready for entrance into the third program stage of business management skill development. A case in point would be Mrs. B, the buricraft manufacturer described in the main report. Her microentrepreneur profile would probably show her as a developing entrepreneur with an expanding business. The profile would also highlight those additional elements of business management that she needs in order to continue to grow, as shown by the "no" answers in the table, i.e., accurate calculation of profitability, unit costing, administration of sub-contracting arrangements and long-term financial planning for growth. This simple observation might help program staff to tailor a package of assistance best suited to her capacities and needs.

Sample Profile 5: On the other hand, a client who would be unlikely to benefit from entrance into the third "business management" stage would be one like Mr. and Mrs. Y, the binatog makers. They have demonstrated considerable entrepreneurial capability. However, they have not separated their business and family affairs; do not seek business assistance; do not use raw materials or production equipment to capacity; do not keep or understand records of profitability and unit costing; and do not have regular employees or sub-contractors. All those factors indicate that they have reached the limits of their entrepreneurial growth and that they would not profit from instruction in business management techniques and should not enter the third stage of the program.

As stated repeatedly, no MIDP or MCSI clients had "passed-up" through the first three program stages all the way to fully-fledged "bankability." Nevertheless, a client who was adjudged to be ready for introduction to a commercial bank as a qualified borrower would have to have virtually all of the characteristics suggested on the microentrepreneur profile. The absence of only one would give pause to a commercial loan officer. On the other hand, a credit applicant with all the characteristics outlined would probably be considered a good risk.

This microenterprise profile is a tool that would have to be used by program staff with considerable flexibility and good judgement. It does not present firm rules to be applied to each client without exception, and it does not offer a fool-proof formula for guiding clients towards "bankability." What the profile could do is simply to organize and guide staff evaluations of clients' performance, motivation, and capacity. That kind of organized approach would permit better selection and de-selection of clients as they move through the sequential stages of the program, better tailoring of the package of program services offered to particular clients, and an indication of whether or not clients are reducing their dependency on program staff services and credit.

SAMPLE 1

Micro-Enterprise Profile	YES	NO
ADMINISTRATION OF CREDIT		
1. Has received and repaid credit on a timely basis to program		
2. Has received and repaid credit on a timely basis to bank		
3. Has applied credit for purposes of working capital		
4. Has applied credit for purposes of increased production capacity		
5. Has applied credit for purposes of combination of 3 and 4		
6. Has applied credit for purposes of business expansion		
7. Amount of loan received approaches bank minimum		
MOTIVATION FOR BUSINESS GROWTH		
8. Has assumed calculated risks in stocking-up, diversifying product		
9. Has shown willingness to defer short-term consumption wishes		
10. Has shown discipline in separating business and family affairs		
11. Actively seeks different types of business assistance		
PRODUCTION SKILLS		
12. Produces marketable wares		
13. Uses raw materials to maximum		
14. Uses existing production equipment to capacity		
15. Has incorporated new production technology		
16. Has sustained increased levels of production/sales		
MARKETING SKILLS		
17. Sells all production		
18. Has delivered products on time		
19. Has adjusted product to suit market		
20. Has succeeded in entering new neighborhood markets		
21. Has succeeded in entering new city markets		
22. Has succeeded in entering new national markets		
23. Has succeeded in entering new export markets		
MANAGEMENT SKILLS		
24. Knows business receipts and expenditures		
25. Knows business profitability		
26. Records business receipts and expenditures		
27. Records business profitability		
28. Calculates unit costs		
29. Hires people to fill specific orders		
30. Hires, trains and retains employees		
31. Uses sub-contractors		
32. Has shown increased bargaining skills with suppliers and customers		
33. Uses profits to meet urgent family needs		
34. Uses profits to sustain increased cash flow of business operation		
35. Uses profits to reinvest in business expansion		
36. Has acted on daily/weekly business plans		
37. Has acted on monthly business plans		
38. Has acted on yearly business plans		