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A SMALL ENTERPRISE DEVELOPMENT PROGRAM FOR ECUADOR:  
STRATEGY PAPER

under the  
SMALL BUSINESS CAPACITY DEVELOPMENT PROJECT  
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## EXECUTIVE SUMMARY

### A. The Role of Small Enterprise

Small enterprise has a vital role to play in Ecuador given its contribution to national development, growth of the economy, employment creation and thereby improved living standards. The importance of the small enterprise sector must be viewed in light of recent economic trends, in particular the petroleum based boom of the 1970's and the recession of the 1980's. The 1970's was a decade of widespread advance in Ecuador-- in output, incomes, urbanization, education levels, and, no doubt, aspirations for the Ecuadorian people. The early 1980's however witnessed a slowdown of GDP growth and in 1983 an actual decline. The growth pattern of the 1970's is unlikely to be repeated in the future. Small enterprise is now considered an essential element for a development strategy which can allow the country to achieve a satisfactory rate of growth and a satisfactory pace of employment creation so as to prevent increased poverty and accentuated inequality.

The economic growth of the 1970's was accompanied by an equally unprecedented expansion of the role of the central government. Ecuador grew not only in economic terms but also in terms of the complexity of its social and institutional relations. Dozens of public and private institutions established specifically to support, represent or assist the small enterprise sector organized in the last decade with the support of the central government, their financing made possible by the oil resources. The importance of small enterprise in Ecuador's economy makes it essential that specific policies directed toward it be well designed and executed, that the selection of macroeconomic policies take into account the likely impacts of small enterprise, and that services and institutional means to assist the small enterprise sector be further developed.

Recognizing the role small enterprise has to play in Ecuador's future growth, the U.S. Agency for International Development commissioned this small enterprise sector analysis in anticipation of future program development in this area. USAID/Quito, Private Sector Office contracted Partnership for Productivity/International through the Small Business Capacity Development Contract to conduct this sector assessment. Over a two month period, the consulting team conducted field research including: interview surveys of over 30 key public and private sector leaders who influence both policy and programs affecting the small enterprise sector; questionnaire survey of 200 small manufacturing enterprises in Quito and Guayaquil; further statistical analysis of data collected by the Instituto Nacional de Estadística y el Censo; and, an institutional assessment of organizations assisting the small business sector. This data, together with a review of the existing literature on the small

enterprise sector of Ecuador has served as the basis for three papers:

Strategy Paper: A Small Enterprise Development Program for Ecuador

Background Paper: The Small Business Sector in Ecuador: Economic Aspects

Background Paper: Policy and Institutional Background Paper

Team members included: Dr. Albert Berry, Team Leader; James Hochschwender; Gino Lofredo; Miguel Maldonado; Dr. Jorge Sanguinety; Augusto de la Torre; Liza Valenzuela. Special attention in this study was given to small manufacturing enterprises, with 1-20 employees given their potential to generate employment and to contribute to economic growth.

A principal finding of this study is that for the small enterprise sector to develop its full potential, two broad conditions must be satisfied. One is a business environment supportive of the growth of existing enterprises and the creation of new ones. The other is the promotion of entrepreneurial skills and the provision of central services. Thus both policy and program initiatives are called for. Achievement of both initiatives requires adequate representation by the sector before government in order to: (1) make its views known and to suggest policy options; and (2) push for high quality services to support small enterprise growth.

#### B. Overview of Constraints to Small Enterprise Growth

In its analysis the team identified a series of needs and constraints which should be addressed in order to effectively support enterprises.

- 1) The need for systematically applied rules and regulations. The Ecuadorian economy is laden with laws, regulations, guidelines or procedures which may work at cross purposes to small enterprise growth.
- 2) The need for complementarity between public and private sectors. Too often the relationship between the public and private sector involves one way communication, distrust or hostility. To contribute efficiently to private sector development it is necessary to diagnose its needs, which involves much listening and discourse rather than a top-down process of providing assistance.
- 3) The need to encourage and assist in the development of entrepreneurship. The entrepreneur who is able to generate employment for others without requiring undue amounts of

capital or other scarce resources in the process is perhaps the central figure in whatever success the Ecuadorean economy may have in the next decade.

- 4) The need to encourage firm growth, especially in terms of employment. In Ecuador, many elements of the institutional setting discourage or impede firm growth, especially in terms of employment. Various benefits prescribed in the Artisan Defense Law, Small Industry and Artisan Development Law and the Labor code serve as a disincentive to the increase in firm size.
- 5) The need for decentralization of institutions and services. Small business in secondary cities is inadequately serviced by existing institutions due to their excessively centralized structure. Ecuador's two dominant cities, Quito and Guayaquil have achieved higher levels of development of public and private business services than the secondary cities. Yet, there is clear evidence that the secondary cities can show a good deal of economic dynamism.
- 6) The need to enhance opportunities for women and to incorporate them productively into the economy. The rate of participation of women in the Ecuadorian labor force is low by comparison, for example, with that of other Latin American countries at similar levels of development and those who do participate earn much less than their male counterparts.
- 7) The need for better information to assist small enterprise and to improve formulation of policy related to it. Major informational gaps are identified in the body of this report which can be filled without costly financial or human resources.
- 8) The need for better coordination among public sector services to small enterprise. Coordination problems are the norm rather than the exception in the case of government services. The need for effective coordination between the credit and technical assistance institutions is probably the most urgent for small enterprise in Ecuador.
- 9) The need for representation commensurate with small enterprise's role in the economy. Many of the deficiencies in the present situation of small enterprise in Ecuador and in the public policy toward it can be at least partially explained by its near absence from the key decisionmaking processes and the public debate on macroeconomic and sectoral issues.

### C. Components of the Small Enterprise Assistance Strategy.

To address these needs the research team is proposing a series of policies and institutional interventions. When combined, these offer a comprehensive strategy for promoting the small enterprise sector. Included are recommendations for:

- \* Economic Policy
- \* Representational Organizations
- \* Service Organizations
- \* Credit System Improvements

#### 1. Economic Policy

The best service delivery system for the small enterprise sector is unlikely to yield positive results if overall economic policy is prejudicial to it. The key elements of an economic policy package which would complement a strong service program are:

- a) **Balanced trade policy:** A balanced trade policy which avoids negative rates of effective protection on the goods produced by small industry, avoids unduly sudden changes in the level of protection, and facilitates export activities.
- b) **Balanced monetary policy:** A monetary policy which does not victimize this sector in terms of the overall credit made available. The likelihood that the needs of small enterprise sector will be considered in the formulation of monetary policy would be greatly enhanced by formal representation on the Junta Monetaria.
- c) **Allocation of government expenditures:** The government should be encouraged to allocate resources to an efficient system of services for small enterprises, one which is well planned and user oriented. A technical assistance system for the small enterprise sector cost relatively little while achieving a very high benefit/cost ratio.
- d) **Labor market policy:** A labor market policy should be encouraged which provides stability. It should avoid sharp increases or decreases in the real minimum wage, focus on new directions that can benefit both labor and business, and promote a constructive dialogue between labor and management toward their mutual benefit.

Section D of the Strategy Paper presents a more detailed overview of recommended policy modifications. Until policy issues and contexts are understood and modified, there remains a great risk that serious errors in this area will inadvertently diminish the improvements achieved on the service provision front of this strategy.

## 2. Representational Networks

The service strategy proposed here would utilize a network of representational institutions for two purposes. First, these organizations from small industry, artisanry and the small merchant sector would work together to increase the beneficiaries' influence on policy decisions and on the behavior of the public sector institutions intended to serve them, and thereby promote the policy package described above. Second, the network of these organizations would serve to provide services tailored to the needs of the sector and to broker services performed by a variety of service organizations.

In Ecuador key representative networks include:

1. Small Industry: Provincial chambers, County Cells, and their Federation, the National Federation of Small Industry (FENAPI).
2. Trade or Sector Associations: Such as the woodworkers association, leatherworkers association, etc.
3. Artisan Associations: The National Council for the Defense of Artisans (JNDA).
4. Small Merchants. Local small merchants associations and their National Federation of Small Merchants (FENACOMI).

The local chambers, associations, and cells seem to be the most appropriate institutions for providing or brokering services for small enterprise:

- \* Information on policy, legal matters, markets, supplies, technology;
- \* Brokering technical and management assistance from private and public institutions;
- \* Credit Access, through autonomous institutions such as cooperatives and credit guarantee corporations through referrals and other assistance; and
- \* Joint services such as bulk purchasing schemes, shared production facilities, storage and transportation.

In order for representational networks to affect policy and to service their small business constituencies, they will need to be strengthened. For instance, INSOTEC and Creative Associates have helped to support the small industry associations and federations, and this can serve as an example for similar future initiatives. Programs should emphasize organizational and motivational training among national and

local network leaders and members, and aim to improve their capacity to serve their constituents. This capacity is limited by the lack of adequate salaries or training for technical and professional staff. However, the experience of larger chambers suggests that once the service mechanisms are operational, various fee schemes may gradually reduce the need for outside subsidy. In principle, each service contemplated has the potential to increase user incomes. For the representational networks, service delivery capabilities are expected to grow with future increases in overall membership and fees.

### 3. Service Organizations

Despite the number of service organizations listed in the institutional analysis paper, it appears that there are real gaps in the service delivery particularly in smaller cities and among women, and among the smaller of the enterprises under consideration. The many institutions which exist generally assist only a few entrepreneurs or offer services which are ineffective for the small enterprise sector.

In the team's assessment, "technical assistance" is one of the most requested services among the small enterprise sector in Ecuador. Demand for it far exceeds supply. In particular, technical assistance needs of women appear to be inadequately satisfied. The kinds of technical assistance demanded by the small entrepreneurs can be grouped into four broad categories: 1) planning; 2) financial analysis; 3) production; and 4) marketing. In addition to technical assistance, training is also regarded as a means of upgrading skills and improving business performance. It should include topics such as: management techniques; marketing; credit access and management; production; importing and exporting among others. The growth of the small business sector is also stifled by lack of information and research. Both should be increased at the microeconomic level, to aid small businessmen, and at the macroeconomic level to facilitate government policy formulation. A final service area includes joint mechanisms such as bulk purchasing.

To better meet the needs of small enterprises the team recommends that private sector initiate or expand programs of technical assistance, training, joint mechanism promotion and information and research. In addition, these organizations could have the following functions:

- \* Identifying and training a local technical assistance "cadre";
- \* Developing plans for the "Service Function" of each of the local representational units;
- \* Interfacing with public institutions to encourage more user oriented programs in technical assistance, credit, training, information and research;

- \* Project development, supervision, and evaluation of decentralized assistance projects financed by international institutions;
- \* Research and information projects on the small industry, artisan and micro-enterprise sectors;
- \* Development of information centers in the chambers and associations.

The research team believes that the representational network can serve as the institutional core through which many of these services can be provided directly or brokered to the private sector. There are, in addition, a range of private and public service intermediary organizations whose specialized expertise, technical capability and institutional form allow them to provide services to the representational networks or to the small businesses directly.

Two organizational models for service organizations merit particular attention. The relationship of INSOTEC, the Instituto de Investigacion Socioeconomicas, with the small industry network is a unique model, worth supporting and perhaps replicating. INSOTEC provides a range of services for FENAPI and its members, from organizational and motivational training to industrial extension services to brokering of services from other public and private organizations. INSOTEC's activities constitute a valuable complement to the activities of the representational networks.

A second model of interest is that of governmental organizations such as Fundacion Ecuatoriana de Desarrollo, PRODEM and Fundacion Espejo/PROCREDEM which promote the micro-enterprise sector. Both provide services and lobbying for their constituencies, although they are not formally guilds or membership organizations. These hybrid institutions can be supported much like the representation networks listed earlier.

#### 4. Credit System Improvements

In our survey of the needs of small enterprises, 55% of the firms interviewed had received credit from commercial banks or from the National Development Bank (BNF). However, for firms located in secondary cities and for very small enterprises the lack of credit appears severe. As of 1984 institutions providing credit to firms at the bottom of the small enterprise spectrum probably accounted for only 2-5% of all small business credit outstanding.

The research team concluded that lack of financial assistance continues to afflict a considerable part of the small enterprise sector and that a strategy to provide it should include:

a) Increasing the availability of credit by: promoting Credit Guarantee Corporations; extending the discount mechanisms of Fondos Financieros and FOPINAR to savings and loan cooperatives; encouraging and assisting new and existing savings and loans; and extending the AITEC credit model to secondary cities.

b) Improving borrowers' ability to access credit through: short training courses and credit information; and graduation of "credit subjects" into other programs.

c) Improved lender efficiency in servicing small loan applicants through simplified and automated the application processes.

d) Rational interest rates policies which help avoid lending irregularities and make more funds available.

#### D. Concluding Remarks

Given Ecuador's stage of development and the current macroeconomic and balance of payments conditions, expansion of the small enterprise sector will be a key to growth of employment and output over the coming years. For the sector's potential to be attained, better representation will be important, both in influencing overall policy making and in brokering a better service system. That improved service system, with technical assistance, training and credit, among its central components, and a satisfactory policy setting are the major proximate needs of the sector.

## A. Introduction

### A.1 Purpose of Report

This strategy paper, together with two background papers focussing on institutions and economic aspects, has been undertaken by a team commissioned by Partnership for Productivity as part of its Small Business Capacity Development program, on contract with A.I.D. <sup>1/</sup> The team visited Ecuador during the months of April and May, 1985. The report and accompanying background documents respond to the terms of reference provided by A.I.D., requesting inter alia identification of a small enterprise policy and program agenda (with alternatives) for the government of Ecuador, and small business program and project profiles for USAID-Ecuador.

The team undertook a large number of interviews in the process of reviewing the institutional setting for small enterprise in Ecuador and the public policy formation process. Data were gathered and analysed and earlier studies consulted, views sought, in order to assess the economic characteristics and setting of small enterprise.

Partly in view of the serious lag in data availability on small enterprise, and partly to collect evidence on small business expectations and views on the institutions designed to support the sector, a survey of 200 small manufacturing enterprises in Quito and Guayaquil was undertaken. Special data tabulations were obtained from INEC, Ecuador's central statistical office. The report draws on all of these materials.

Two briefings were held in Quito during the Mission's visit, one for USAID-Quito personnel, a second for members of public and private Ecuadorean agencies particularly involved with the small enterprise sector.

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<sup>1/</sup> Team members included Albert Berry (overall team leader), Gino Lofredo (primary responsibility for the background paper on institutions and for analysis of institutions in the Strategy Paper), Jorge Sanguinety (primary responsibility for the economic background paper), James Hochschwender (small business policy and institutions), Miguel Maldonado (small business institutions), Rodrigo Albuja (technology issues), Augusto de la Torre (economic background paper), Liza Valenzuela (institutional background paper and Strategy Paper). Members of the team spent varying periods of time in Quito. The Mission benefitted from facilities provided by Stern, Naranjo & Co., including interviewers and analysts who assisted in the survey undertaken.

## A.2 Scope of Report

For purposes of this study, we have limited the discussion of small and medium businesses to those economic activities which are non-agricultural and primarily urban-based. Agro-industry is covered only in so far as it falls under the category "small industry." The main focus of this strategy paper is small manufacturing enterprise, although attention is given to small scale commerce and services as well. Although more employment is created in small commerce and service enterprises, small manufacturing (including artisanry) warrants greater attention both because its contribution to economic growth is almost certainly greater and because whether it develops successfully depends more on the economic setting and on government policy than appears to be the case with the service sector.

Defining "small" enterprise in Ecuador is problematic since definitions differ from institution to institution. Some differentiate size on the basis of the number of employees, others according to the amount of their fixed assets. Still others attempt to combine several factors, such as number of employees and gross value added. To complicate matters further, several terms may be used to describe a given size category, "Artisan," "micro-enterprise" and "informal sector" are used interchangeably by some institutions. And some institutions limit their definition to a particular type of activity, such as "industry," and ignore others. (For further details see the Institutional Background Paper.)

We have not chosen among these alternatives, and although we considered developing a new definitional framework, we opted not to do so for two reasons: first, because the task would have been time-consuming and second, because we would have had a statistical problem attempting to fit the existing numbers on sector sizes into the new framework.

In this paper we utilize three main terms to describe the small enterprise sector. They are: 1) "micro-enterprise" (activities of the informal sector, especially retail); 2) "artisan" (mainly industrial activities in which manual labor is predominant over capital, where fixed assets excluding land and buildings are generally less than S/725,000) and 3) "small industry, commerce and services" (where fixed assets excluding land and buildings are less than S/19 million and the number of employees is less than 20). These terms are necessarily used in a somewhat flexible way, since it is often the case that statistical information on a sub-sector under discussion is imprecise.

## B. The Potential Contribution of Small Enterprise to Ecuador's Development

### B.1 The Urgent Need for Growth in the Small Enterprise Sector at This Time

The 1970s were a decade of widespread economic advance in Ecuador--in output, in incomes, in urbanization, in levels of education, and no doubt in levels of expectations and aspirations. The early 1980s have witnessed a slowdown of G.D.P. growth and 1983 an actual decline. The growth pattern of the 1970s is unlikely to be repeated in the future. The probable new scenario involves the need to shift to a quite different pattern of growth. If the challenge is not successfully met, Ecuador's labor market is likely to be the scene of turmoil, unsatisfied aspirations, and inefficiency in the coming years. Growth will be limited and inadequate to reduce poverty in a significant way.

Small enterprise's potential contribution over the coming years is highlighted by the abrupt switch from the petroleum-based boom of the 1970s to the recession of the 1980s. The boom brought rapid income growth and structural change to the Ecuadorean economy; both output and employment growth were particularly fast in the public sector, in construction and in certain services. The boom left the country with an income level swelled by the "easy rents" provided by petroleum and well above what could be sustained by the level of productive capacity in other sectors of the economy, and with a public sector whose administrative capacity would not permit it to be a strong force for growth. As a result, unless the oil bonanza returns, it will be difficult for the country to achieve a good rate of growth; a satisfactory pace of employment creation such as to prevent worsening poverty and accentuating inequality will be even more elusive. Disequilibrium in the labor market is likely to become aggravated as a reduction of growth on the demand side of that market coincides with a probably increasing rate of growth of the labor factor force; that growth was somewhat curtailed in the 1970s by the rapid increase in educational attainment and by a still low rate of female labor force participation. Neither of these factors is likely to retain its dampening impact during the decade to come.

The economy has now achieved a degree of recovery from its stagnation/decline of 1982-84. The Central Bank's trimestral sample of mainly large firms indicates that their output grew significantly in 1984, with a modest growth of 2-3% predicted for 1985. If this prognosis is accurate, the large scale manufacturing sector will make little contribution to employment growth in the near future. Nor, presumably will the public sector. Construction, which is also in the midst of recovery especially due to public investment in roads in the coastal area, should make a greater contribution. Agro-industry, a focus of the current administration's economic policy, while

having good growth potential is unlikely to contribute much on the employment front, judging from the experience of other countries. This combination of circumstances places a greater than usual importance on Ecuador's achieving and supporting a dynamic small enterprise sector. The historical record suggests that this should be possible, as long as the sector is provided with a reasonable context for growth and a modest level of support.

## B.2 The Present Role of Small Enterprise in Ecuador's Non-Agricultural Sector

Most urban workers in Ecuador are currently employed in small establishments. A recent study classified about 55 percent of the 1980 urban force as falling in the informal sector, whose major activities, judged by the level of employment, were personal services, retail trade, and manufacturing. According to the 1980 Economic Census, which covered most urban establishments in mining, manufacturing, commerce, restaurants and hotels, financial, business and personal services, nearly two thirds of the persons employed in these sectors worked in establishments of less than ten workers, while only 25 percent were employed in large establishments of 50 workers or more.

The formal sector grew rapidly during the 1970s on the basis of fast growth of government employment, construction, larger scale establishments in manufacturing, commerce, and to a lesser degree services. Though Ecuador's urban economy has thus moved toward the formal end of the spectrum, small enterprise remains very important. In commerce the employment share of establishments of less than 10 workers was 80 percent in 1980, and the output share close to 45 percent. In manufacturing, although small establishments of under 10 workers dominate employment somewhat less than in sectors like commerce, they still account for a significant majority of total employment, about 60 percent of the total as of 1982.

### Dynamism During the 1970s

During the boom period of the 1970s manufacturing employment rose fastest in the large scale sector (plants of 50 workers or more). But growth of total employment in small industry (however defined) was also considerable, and the rate of growth of the typical small firm may well have exceeded that of large firms; part of small firm growth is unreflected in the sector's total employment since fast growing small firms move out of that category, whereas employment in the large-size category is swelled by firms moving into it from lower size categories.

The small industry sector was achieving both good profit rates and a high rate of investment (in relation to output or value added). Over the decade the average seems to have been about the same in small as in large industry, around 30 percent. No doubt it has dropped markedly since 1980 but the investment performance of the 1970s reveals the potential dynamism of the sector.

Artisan employment seems to have been roughly constant, at least during the late 1970s. While there are no good statistics on the growth of artisan output, and it was probably modest.

## Economy in the Use of Capital and Imports

Small enterprise is more labor intensive than large enterprise; this is evident both for the economy as a whole and in each individual sector. For the sectors covered by the 1980 Economic Census, for example, the amount of capital (fixed plus inventories) per worker was over 30 times higher in the establishments of above 10 workers than in those with less than 10 workers. For manufacturing, it appears that small industry is about a quarter or a fifth as capital intensive as large industry, while artisanry is, in turn, about a third as capital intensive as small industry.

Associated with these wide gaps in capital per worker are marked but less wide gaps in value added per worker and in wages. Average earnings of blue collar workers in small manufacturing establishments of less than 10 workers were, in 1980, about 50 percent as high as in large establishments of 50 workers and up. Although less than what this modern manufacturing sector could pay, wages in small industry were well above those in agriculture. Both the labor productivity and the wage gaps between small and large manufacturing firms appear to have been narrowing over time. Between 1965 and 1980, for example, the average real wage in small plants with under 10 workers rose by about 60 percent over this period as compared with 34.3 percent for the largest plants of 100 or more workers. Labor productivity also rose substantially faster in the small plants.

Small industry tends to use less imported inputs than large industry; as of 1980 the ratio of imports to value added was about one third to one half as high in the former as in the latter.

## Regional Dispersion

Smaller scale manufacturing, less capital- and import-intensive than its large scale counterpart, is disproportionately located in secondary cities and smaller urban areas. Whereas in Quito and Guayaquil over 70 percent of recorded manufacturing employment in 1980 was in establishments of 10 or more workers, in the intermediate cities of Ambato, Cuenca, Portoviejo, Manta and Machala (taken together), the corresponding figure was 50 percent and in the rest of the country 32 percent. The increasing weight of larger scale manufacturing over time has been associated with an increasing regional concentration of manufacturing, especially in Pichincha and Guayas.

### B.3 The Institutional Setting For Small Enterprise

The economic growth of the 1970s was accompanied by an equally unprecedented expansion of the role of central government. Dozens of public sector agencies emerged during this period, their financing made possible by the oil resources. Ecuador grew not only in economic terms but also in the complexity of its social and institutional relations.

The majority of the institutions examined in our Institutional Background Paper did not exist in the 1960s. Even the Camaras, Asociaciones and Nucleos de Pequeños Industriales, the principal representational organizations of the small scale manufacturing sector, have been organized only in the last decade and with the support of the central government. Moreover, both public and private sector institutions relevant to small scale enterprises emerged in a rapidly changing environment to which they had to adjust, often with insufficient resources. Changes in the context of small enterprise, and especially of small manufacturing, have been particularly frequent and abrupt in the last few years with the economic slowdown of most of the 1980s, the doubling of the minimum wage in 1980, the burst of inflation since 1982, and the significant shifts of economic policy now being effected by the Febres Cordero administration.

The importance of small enterprise in Ecuador's economy makes it essential both that specific policies directed towards it be well designed and executed, and that the selection of macroeconomic policies take into account the likely impacts on small enterprise. Achievement of these goals calls both for an adequate level of representation by the sector before government to make its views known and to suggest policy options, and a good level of performance by the government in terms of useful services provided to the sector.

The next section discusses briefly the more likely macroeconomic scenarios in which small enterprise is likely to find itself in the coming decade or so.

#### B.4 Probable Macroeconomic and Policy Settings For Future Small Enterprise Development

The context for small enterprise during most of the 1970s was essentially one of a fast growing economy, a varied level of effective protection against imports, and a modest amount of support from the public sector. Both the macroeconomic setting and certain important aspects of public policy are quite different at this time.

##### Slower Growth

Since 1982, Ecuador's economy has been stagnant. It is now recovering from the agricultural crisis produced by the floods in 1983 and from the decreased capacity to import resulting from the slowdown in the growth of oil revenues and the increased international debt burden. But a return to the fast growth of the 1970s is very unlikely. At the optimistic end of the spectrum, an average growth of 4 or 5 percent per year is possible, but per capita income growth will in that case be modest by comparison with the 1970s, and the structural shift toward the more modern sector of the economy will be gradual. If not all goes well, growth could be a percentage point or so lower, leaving very little margin for improvement in per capita income given the still rapid rate of population growth, and nearly eliminating the chance for a significant increase in the share of persons employed in the large scale sector. Under either of these scenarios, small scale activities will of necessity remain very important for decades. Whether or not they are able to expand, to raise their productivity and to modernize will be a major determinant of the rate of creation of productive employment and the income levels of a majority of the labor force.

##### Outward Orientation

The end of the oil bonanza and the balance of payments/debt problems and recession of the 1980s have contributed to the current re-orientation of economic policy by the Febres Cordero administration. The basic shift is from the previous heavy orientation towards import substitution, pursued in varying degrees from the 1970s to the present, to a more export oriented approach involving less protection for domestic industry. Changes in the system of tariffs are to be announced soon. It is assumed, and policy steps consistent with this assumption are being taken, that the primary sector and especially agro-industry will become a major source of exports when appropriately stimulated.

##### Austerity

A second major change is toward an austerity program, taking mainly the form of a restrictive monetary policy, in order to curb inflation and alleviate the balance of payments

problem. This policy will presumably be transitory, to resolve a hopefully short run problem, whereas the shift in trade policy will be lasting. Finally, the present administration is oriented toward the private sector and the usefulness of market mechanisms.

### Opportunities for Small Enterprise

These shifts create both problems and potential for small-scale enterprise. Some small scale industries fostered by the high protection will be put at risk, and may collapse if the effective protection is reduced too quickly and they are unable to reduce costs enough to regain competitiveness in the domestic market. Others should be able to capitalize on the new directions of policy. Although parts of the primary sector are expected to be the main source of new international competitiveness, a number of small scale and low cost, the small producer faces special obstacles to exportation, including the cost of getting information about the process, bureaucratic red tape, the need for quality control, and the need for cooperation to achieve large enough supplies to be able to move into the international market. The foreign exchange bonanza of the 1970s both reduced the international competitiveness of such lines of manufacturing, and dampened any interest by the public sector in promoting them. In short, the industries in which the small-scale sector predominated are likely to have a high degree of actual or potential competitiveness in production, but not in marketing and distribution.

To the extent that these labor intensive industries can enter world markets (and hold on to domestic ones) the benefits should go disproportionately to workers, as has occurred in cases like Taiwan and Korea. If it is possible to facilitate the export process of small firms, they may eventually do better under an export oriented regime than under an import substituting one, since the latter type of regime tends to be (and appears in the Ecuadorean case to have been) designed to aid the larger, higher profile and better connected firms. Small industry benefits less from low priced machinery and raw material imports since it uses less of them. It is less likely to reap the high monopoly profits possible to the large firm which has high protection against imports, since it competes against itself.

An austerity program also may be less damaging to the more self contained small enterprise than to the larger one. Small firms tend to receive less credit and other forms of assistance than do larger ones. While not condoning this as good practice, one can note that it may imply a greater resilience. Again, however, that resilience may be helped along by certain complementary interventions; facilitating the organization of savings and loan cooperatives is one way, providing modest amounts of off :ial-sector credit another.

The present administration's market orientation should on balance benefit small enterprise, as long as it is applied in an even-handed way. Because it is so seldom strongly supported, led alone coddled by government, most of this sector is accustomed to a competitive setting. Often the greatest threat to it is the protection and subsidization government provides to the large scale sector.

When policy shifts are abrupt, as the introduction of the austerity program has been and the trade control changes may be, it is particularly important that small enterprise have the capacity to respond quickly to the change of setting, and also have the capacity to make its voice felt in government.

## B.5 Experience of Other Countries With Small Enterprise

The potential benefits of a vigorous small enterprise sector have been amply demonstrated in other developing countries. Small enterprise typically plays a more important role in economics in the early and middle stages of growth, because of its capacity to use relatively large amounts of labor with less of the still scarce resources -- capital, imports, and sophisticated organizational and managerial capacity than larger scale enterprise employs. This capacity makes much small enterprise economically efficient.

### Role in The Economic Development Success Stories

The powerful economic logic which underlies the importance and the economic efficiency of small enterprise in developing countries is corroborated by the important role played by this sector in many of the most outstanding success stories of development. In fact, to achieve both fast growth on the one side and high employment creation and poverty eradication on the other, a flourishing small scale sector is a very key ingredient, perhaps even a necessary condition. This is well illustrated by the case of Taiwan where in both rural and urban sectors small industry and small enterprise in general have flourished over the last two decades and more. Not only has Taiwan's growth rate been one of the fastest in the world, but employment creation has been rapid, unemployment low, and income distribution more equal with the passage of time. All socio-economic groups have been major beneficiaries during this process. When a country achieves rapid overall growth without a large and dynamic small enterprise sector, as has Brazil, the fruits of growth are usually highly concentrated, with the problems of poverty and underemployment remaining as sources of social strife.

### Contributions to Savings and Technology Improvement

A closer look at small enterprise reveals other advantages besides its ability to adapt to a country's abundance of labor and scarcity of capital. In most countries small enterprise is mainly self financed; in offering a productive outlet for the savings of the entrepreneur (and often his/her family and friends as well), it contributes to raising the country's rate of savings. Alternative outlets are often unattractive (cash and financial assets tend to offer low or negative real rates of return) or socially unproductive (e.g. investment in real estate). And, although small enterprise's contribution to technological advance may at first glance appear less striking than that of larger firms, it has in many countries been shown to be considerable. Further, the improvements which emerge from experimentation and the urge to do things better in small enterprise tend to be socially productive improvements; they contribute "appropriate technology."

### Competition and Complementarity

Small enterprises are, by their very smallness, more likely to be part of a competitive sector than are large firms; this is especially so in a small country like Ecuador where, if well protected from the outside, one fairly large firm can readily become a monopoly. One of the important contributions of the smaller firms is to weaken monopolistic positions, to provide inducement to greater efficiency on the part of larger firms and in perhaps the most positive outcome of all, observed in Colombia's agricultural machinery industry in the 1970s, push the larger firms into the export market.

Small enterprise not only competes with larger firms; it also collaborates productively with them through subcontracting arrangements, and contributes to the efficiency of large enterprise by providing a training ground for workers, who then move to large firms, attracted by the usually higher wages available there. Very important also, some small firms grow into large ones. Put another way, most large firms in any developing country started small. An efficient and dynamic small scale sector thus not only yields current benefits to a developing economy, but also provides the base for the larger establishments of the future.

### An Alternative to Public Sector Employment

A final point, of special relevance to Ecuador at this time, involves the role of government in the economy and in employment creation. It has been commonly observed that countries in the midst of mineral bonanzas, as was Ecuador in the 1970s, become service-oriented economies as far as employment is concerned, with the government sector playing a large role in employment creation and with commerce and other services also absorbing large numbers of workers. This is a result of the facts that: (a) the mining sector itself usually creates an insignificant number of jobs; (b) money is relatively easily available to create public sector jobs and people clamour to get them; and (c) other productive sectors, especially agriculture and manufacturing, are put at a relative disadvantage both by the country's ready access to imports and by its lack of attention to their development.

Where the private sector does not provide reasonable employment options, the expanding middle class will naturally pressure the government to create jobs. The large scale sector has only a limited potential to create jobs because of its capital intensity. A prosperous small scale sector may be the only safety valve to relieve the pressure towards an overstuffed public sector.

When it is not there to perform this function, one may see the extremes observed in countries like Malaysia, where relatively educated youth often remain unemployed for one to two

years before getting their first job; their range of vision is the public and modern (large scale) private sectors, because the small scale sector is not of adequate size to provide an alternative. Since the large scale private sector cannot satisfy the public sector jobs, or relegating people to the unemployment pool.

An overstaffed public sector implies a number of problems above and beyond the excessive cost that it implies. For those so inclined, it provides a setting conducive to bad working habits. For those anxious to do something, it may be a temptation towards the taking on of responsibilities which might better be performed in the private sector, or which may even hamper that sector's effective functioning.

## C. Broad Objectives and Themes Relating to the Small Enterprise Sector

Before presenting our detailed analysis and recommendations in the next three sections of the report, a number of general issues pertinent to the development of small enterprise warrant discussion. Some bear on specific recommendations made below; others relate to the general setting for small enterprise in Ecuador.

### C.1 Lack of Adherence to Laws and Regulations

In many respects which bear on small enterprise, the Ecuadorean economy is laden with laws, regulations, and guidelines or procedures which are frequently avoided or sabotaged. This situation has two main costs: On the one hand rules which are erratically applied raise the uncertainty involved in doing business; the entrepreneur may not be able to predict whether he will wind up bearing a certain cost or not. Secondly, non-systematic application of rules implies corruption, with its counterproductive incentive to the bureaucrat to profit from the corruption; its costs are often harder for the small entrepreneur to bear than the larger one.

It is clear that the framing of impractical rules contributes much to their widespread neglect and circumvention. An ill-designed rule pushes the person who would prefer to abide by the law into an untenable position and ultimately makes him/her deprecate the system of rules. Disregard for one rule tends then to breed disregard for other ones.

A systematically applied set of rules within which small enterprise, for example, could work most productively would exclude those which are unenforceable or create such an incentive to break them that it is unrealistic to assume they will be obeyed. Rules which try to substitute for the laws of supply and demand, e.g. disequilibrium exchange rates, interest rates or wage rates fall in this category. While it would be going too far to conclude that intervention which produces disequilibrium is never appropriate, each time that such intervention is contemplated the costs need to be carefully weighed against the benefits, and an attempt made to minimize the payoffs (i.e. incentives) to breaking rules, for example by trying to avoid excessive gaps between the official and the uncontrolled exchange rate, by making the labor code more feasible to fulfill, by avoiding excessively low interest rates on credit, etc. Having less rules in the first place, together with serious, forceful administration of those rules which are in fact important to the efficient functioning of the economy and the society, is the essential recipe for success.

## C.2 Ineffective Public Sector - Private Sector Interaction

A general problem in Ecuador, and perhaps especially in its small enterprise sector, involves the nature of the relationship between public and private sectors. What should be a highly complementary relationship with smooth communication in both directions tends too often to involve one way communication, distrust, or hostility. One root of the problem lies in an insufficient recognition that for much of the public sector the *raison d'être* is to assist and implement the development of the private sector. A second is the inadequate recognition that to contribute efficiently to private sector development it is necessary to accurately diagnose its needs, and that especially in a varied and changing world this involves much listening and discourse rather than an essentially top-down process of providing assistance. Especially in the case of small enterprise, a third factor is the uneasy relationship between the bureaucrat and the frequently less educated small business person.

Both the structure and the (related) procedures of many public sector agencies which interface with small enterprise reflect these various problems. Of most immediate relevance to a number of our recommendations is the need for a more bottom up flow of communication with respect to priorities, needs and how they should be met. The major government institutions dealing with small enterprise need to become more accountable to and dependent on small enterprise, so that their programs will reflect much more closely than at present the needs of that sector.

### C.3 Assisting the Development of Entrepreneurship

The entrepreneur who is able to generate employment for others will be central to the success of the Ecuadorean economy in the next decade or so. A country where it is absent can only progress rapidly if lucky enough to be able to live off its natural resources. In many countries at least half of net employment growth comes from newly created firms.

The creation of new firms depends on a positive business environment and on which reflects the participation of more individuals in the search for and exploitation of economic opportunities. A common group of environmental constraints results from a misguided conception of the functions of government that is generally reflected in inadequate legislation, excessive intervention in factor and output markets and poor administration of government affairs. This is often accompanied by a poor human resource base that limits the number of highly productive individuals. Under these circumstances the pervasive notion that opportunities are limited with its corollary that one person's gain is another person's loss, often sets in, and contributes to a continuous struggle for economic gain or for survival. In this atmosphere of distrust, the possibilities of finding collaborative arrangements become narrow and contractual relationships, an indispensable ingredient of economic and social development, become difficult and unstable.

The present situation in Ecuador, given a modest further improvement in the overall performance of the economy, could be a good setting for the creation of many new enterprises. In the past small industrialists, a key group among small entrepreneurs, have come in significant numbers from commerce (often persons who previously imported or distributed a good, then decided to produce it themselves), from the professions, from white collar workers and from artisans. The recent marked decline in real wages (probably on the order of 25 percent from many groups between the peak in 1980 and the current level) is likely to encourage many job holders to try to set up a business either as a side line or as a full time activity, in order to avoid such a sharp income cut. (A similar income drop for both blue and white collar workers preceded the burst of small industry growth in the 1970s in Colombia). Another group, unable to find work in the difficult labor market of today, will be induced to do the same.

At present, unfortunately, a number of features of the economic setting in Ecuador discourage either the creation or the growth of small enterprise. These are discussed further below, and recommendations are made about some of them.

#### C.4 Encouraging Firm Growth, Especially in Terms of Employment

Related to the preceding point, it is of great importance to provide a setting propitious for firms' growth. Many large establishments reach a point where they grow no further, at least in terms of employment, so employment creation depends primarily on the creation of new firms and the growth of small and medium sized ones.

In Ecuador several elements of the institutional setting discourage or impede firms' growth. The various benefits written into the Artisan Defense Law and the Small Industry and Artisanry Development Law, and the advantages provided to smallness by the Labor Code all work in this direction. The complexities of graduation from one source of credit to another appear to constitute a barrier to growth for some firms, especially those towards the lower end of the size range. Ecuador's class system diminishes mobility between certain layers of the economic hierarchy. Additional disincentives to growth include the weaknesses in the system of transportation, communication and market information, which tend to restrict the perceived market of many firms, especially those in secondary cities. Finally, general labor problems (as distinct from those particularly pertinent to small enterprise) leading to the perception that overall labor cost is high, and fiscal and other incentives to capital investment encourage growth via intensification of capital rather than expansion of employment.

In the face of these considerable negative factors affecting firm's incentive to grow and to generate jobs, some of them not easily attacked in the short run, there is a premium on dealing with those which are amenable to policy and on designing incentives to growth which may help to offset the disincentives.

#### C.5 The Need for Decentralization of Institutions and of Services

Ecuador's two dominant cities, Quito and Guayaquil, have achieved a considerably higher level of development of public and private business services than the other secondary cities; Cuenca is at an intermediate level. Quito and Guayaquil have about half of the country's urban population, and each is facing certain diseconomies of size, suggesting the desirability of balanced economic growth across the other urban centers of the country.

Further, there has been clear evidence that the secondary cities can show a good deal of economic dynamism. Their performance over the last two decades has in several respects allowed them to narrow the economic gap between themselves and the two metropolitan areas despite a rate of population growth which was on average just as high. This dynamism suggests that a number of these centers can be fertile ground for further growth.

The intermediate cities are on average already more specialized than Quito and Guayaquil in the less capital intensive small scale activities on which Ecuador must now place increased emphasis in order to get maximum output and employment growth. Small industry, in particular, is more decentralized than large industry. Whereas about 70 percent of large industry is located in the two principal cities, they have only about 45 percent of that small industry and artisanry which is located in urban areas. Finally, it is relevant that income levels remain lower and employment difficulties in general greater in the secondary cities and towns.

The setting, therefore, is one in which government policy should take account both of the potential and the need for economic advance in these areas. The most obvious sector to contribute to this process is small industry. At present, however, its needs are not adequately served by existing institutions, due to their activities according to the stated needs of potential clients but according to their own internal criteria. Correction of this latter bias would automatically produce a greater decentralization; decentralization would also tend to diminish the bias.

C.6 The Need to Enhance Opportunities for Women and to Incorporate Them Productively into the Economy

The rate of participation of women in the Ecuadorean labor force is low by comparison with that of other Latin American countries at similar levels of development. In 1982, it was 20.2 percent for all women 15 and up and 26.7 percent for urban women in that age range, the latter figure being a very marginal increase from the 25.4 percent in 1974. Of women participating in the urban labor force 51 percent were in (commercial, personal or social) services, about 22 percent in commerce, restaurants and hotels and 14 percent in manufacturing. As of 1979, for employed persons the average earnings of women were 50 percent as high as those of men in Quito and 59 percent as high as Guayaquil. While part of these differentials is due to lower average levels of education and of work experience for females than for males, another part is due to labor market discrimination of various types and, more directly relevant here, discrimination in access to services for women who are running businesses, as discussed below. There is thus a general need for the society to make a concerted attempt to better incorporate women into productive activities, both for their own benefit and to promote a more efficient economy.

C.7 Better Information to Assist Small Enterprises and to Improve Relevant Policy Formulation

Ecuador's rapid growth and structural change during the 1960s and especially the 1970s seems to have seriously outrun its system of information. While the costs of this gap may not have been too serious during the easy 1970s, this is unlikely to continue to be the case in the more complex conditions under which both business and government now make their decisions. Major informational gaps are identified in Section E.5 of this report. Provision of many types of information either are the responsibility of government or can be facilitated by government. Frequently such provision is not very expensive in either financial or human resources. With its large supply of university trained people, Ecuador should be able to effect major improvements on this front.

#### C.8 Better Coordination Among Public Sector Services to Small Enterprise

Coordination problems are the norm rather than the exception in the case of government services. The problems reflect in part a sometimes inadequately instilled spirit of service towards the clients; in part institutional rivalries for terrain which may in turn be the product of a lack of a clear delineation of responsibilities among public agencies; in part lack of energy; and in part striving for personal or political aggrandisement. Coordination is probably also less developed when many institutions are relatively new and the context for their activities is changing quickly, as has been the case in Ecuador.

The costs of inadequate institutional coordination are severe in the case of small scale manufacturing. Many firms have a range of needs, often not well identified by themselves, but inadequate knowledge of how to satisfy such needs. It is unlikely that the small entrepreneur can substitute for the missing coordination of and put together the appropriate combination of services. The need for effective coordination between the credit and technical assistance institutions is probably the most serious one in the context of small enterprise in Ecuador.

### C.9 The Need for Representation Commensurate With Small Enterprise's Role in the Economy

Many of the deficiencies in the present situation of small enterprise in Ecuador and in the public policy towards it can be at least partly explained by its near absence from the key decision making processes and the public debate on macroeconomic and sectoral issues. The essential contrast between small enterprise and large is the relatively atomistic character of the former -- many small units among which cohesion does not come as easily or as naturally as among large enterprises. The resulting anomaly is a sectoral influence which bears no relation to its important role in the economy, especially in employment creation. In this report we have placed great emphasis on the need for strong and well informed representation for the sector. Both influence and competence are very important since either without the other is unlikely to bring many benefits for the sector or for the economy as a whole.

D. The Setting for Small Enterprise: The Labor Market, Macroeconomic Policy and Other Government Policy

D.1 The Labor Market

D.1.1 Issues

An essential advantage of small enterprise is its capacity to contribute to growth with equity, by matching high levels of labor inputs with limited amounts of such usually scarce resources as capital and imports, and thus using those scarce resources in an economically efficient way. An unavoidable dilemma revolves around the fact that the more small enterprise has to pay for labor the less will be hired. While this proposition holds also for large enterprise, the issue matters less there since many fewer workers are involved (given the limited employment generation in large enterprise) and employment is likely to be less sensitive to wages in larger, more capitalized businesses. It is precisely those sectors where labor intensive technology is most sensitive to labor costs. A firm that due to its technological and administrative characteristics can easily substitute capital for labor, will hire less labor and rely on more capital if the level of wages increases relative to the cost of capital. Firms with less flexibility will either pay more wages or go out of business. A monopolistic enterprise is usually able to absorb higher labor costs partly by raising its prices, but it too may replace labor with capital. Minimum wages typically have the effect of increasing wage rates above their equilibrium levels. Fringe benefits and other costs of hiring and training workers further raise the cost of labor, and inability to predict how productive the workers will be creates uncertainty for the employer as to how much he will wind up paying for a given task. When labor legislation makes it difficult or costly to fire a worker who does not perform well, or where labor relations are unstable or hostile, the perceived or expected cost of labor is even higher.

None of the above is to say that unions, minimum wages, or other elements of labor legislation are undesirable per se. Given the degree of poverty and income inequality which exists in Ecuador, any institution which can help lower income groups without having offsetting costs is obviously desirable.

Worrisome Evidence

But there is a real possibility that these institutions are having serious negative effects both on growth and, via their effects on employment, on the income levels of the poor.

This fear is based partly on the comments and complaints of small entrepreneurs (which must, of course, be viewed with some skepticism, but at the same time not be disregarded) and partly on a variety of other types of information, including the following:

(i) The observation that, when the various fringe benefits above the basic wage are taken into account, the minimum wage has over recent years been high relative to the potential productivity of most workers. Thus in 1979, according to INEC's household survey, about a third of manufacturing workers in Quito were receiving less than the minimum wage (with fringe benefits) and in Guayaquil 27 percent were. In secondary cities these figures would be higher. (Wage figures reported to INEC by firms do not indicate a high share of workers with remuneration below the minimum wage but this may reflect a bias in their reporting).

(ii) The irregular path of the minimum wage over time. Whatever the merits of higher or lower levels, the sudden changes in the minimum wage in recent years and especially the abrupt doubling in 1980, cannot but make business difficult for complying entrepreneurs and, equally - damaging, make them worry that such erratic movements will recur in the future.

(iii) The considerable evidence that firms are taking deliberate steps to avoid reaching the level of 15 permanent employees at which the workers have the right to organize a union (Comite de Empresa), or more generally the evidence that they are keeping their permanent staff low in order to avoid labor problems. In part this is achieved by choosing more capital intensive technologies than they otherwise would have, in part by using temporary workers who are let go after three months to avoid their having the status of permanent staff. Several cases have been noted where medium sized enterprises have split up into several smaller "firms" in order to avoid the obligation of dealing with a union.

(iv) It is generally accepted and is certainly consistent with the evidence for Ecuador, that laws which inhibit firing workers also inhibit their hiring; most studies in other countries have found the final net effect of such laws on paid employment to be negative.

In Colombia during the 1970s employment in manufacturing establishments of 5-50 workers grew at an annual rate of 8-10 percent (well above the 5-6 percent in large establishments) and helped to absorb the rapidly increasing supply of workers during Colombia's peak period of labor force expansion. Under labor laws which seriously discouraged the firing of workers by small firms one would presume that such an explosive growth of small and medium industry would not have occurred. One of the striking features of the establishments sampled, whose aggregate employment growth was as noted extremely high, was the marked fluctuations over the years in the employment and output levels of specific firms. Had they not been able to retrench when

their economic niche became less profitable, many of the firms would presumably have been forced to close. Others would never have started operations in the first place, or would not have expanded employment so rapidly in their good times.

Our survey of small manufacturers in Quito and Guayaquil suggests a reluctance to hire workers when sales improve. More than 44 percent of the 200 interviewees indicated that they would not expand the number of permanent jobs if their sales "grew a lot", but would instead create temporary jobs, increase overtime, or subcontract. Of those indicating they would not increase labor inputs, 45 percent mentioned the high level of minimum wages as the main reason, 20 percent pointed to problems of labor quality and 16 percent were concerned to prevent the creation of a labor union.

### Aggregate Effects Unclear

A view of the labor market as dominated by unrealistic labor legislation and powerful and unbending unions would, however, be much too simple. While there is no doubt that there have been negative effects from excessively high wages and labor conflicts (some firms have been forced out of business by one or the other of these), and that jobs have been lost as firms shy away from growing into the size range where the minimum wage is higher and unions have the right to form, it is not clear how great the aggregate impact of these phenomena has been.

(i) It is widely known that many firms avoid the force of labor legislation by hiring many workers on a temporary basis and at rates below the minimum wage. This is not surprising since even wages well below the legislated minimum level will often be an improvement on the alternatives many workers face. It is probable that with the passage of time, small entrepreneurs as a group have been learning how to avoid the pitfalls of labor legislation. Also, judging from our sample of firms in Quito and Guayaquil, many firms of above 15 workers do not have Comites de Empresas. Of 33 such firms in our sample, only 7 reported having a comite.

(ii) Whatever the impact that legislation and unions may have on the level of wages, that level is flexible downward, at least under the conditions of inflation and recession which have characterized the 1980s. Since its sudden jump in 1980, the real minimum wage has by May 1985 fallen by about 23 percent. Reported wages of blue collar workers in both large and small scale manufacturing have fallen by a similar proportion.

On balance, one may conclude that in the sectors where they are operative, the labor market institutions under discussion have benefited the favored workers in terms of wages, working conditions, and stability of employment. Also undoubtedly,

there has been some loss of employment due to the incentive to the use of labor displacing technologies and to the disincentive to creation and growth of firms. Finally, there is some loss of employment and income stability of unprotected workers as firms avoid hiring them on a permanent basis. Due to lack of detailed and current information, and to the absence of careful studies of this issue, it is hard to guess at the magnitude of these negative impacts. The chance that they are large cannot be discounted. Accordingly, it is necessary to search for means to minimize them, and to create as conducive a labor market setting for small enterprise growth as possible with a minimum of loss to the currently protected workers.

### D.1.2 Strategy Options

A more conducive setting for growth and employment creation in the small scale sector would be aided by either an increase in the productivity of labor and/or a decrease in the costs and risks associated with employing workers. The first approach obviously has much to be said for it in principle, since it enables wages to be high without being above potential productivity and thereby discouraging employment creation. A more detailed discussion is undertaken in Section E.4 below.

Among the other possible ways to improve the functioning of the labor market are the following:

1. A simpler system of legislated minimum wages: The present system distinguishes minima for nearly a hundred separate job categories. Whereas the logic of a minimum wage is to provide a floor below which no worker's earnings are allowed to fall, there is no comparable welfare argument for setting the wages of some job categories above those of other categories. The wage structure would more effectively reflect relative scarcities of different skills if it were market determined. This change could result in losses for some groups of workers and gains for others.
2. A more stable minimum wage system: Some constraint is needed on the existing process of negotiation and determination of the minimum wage. There could be a built in regulation against either increases or decreases of more than a given percent (e.g. 10 percent) per year. This would provide greater security for labor against sharp decrease and for business against sharp increases.
3. A minimum wage tied to a market wage: e.g. that of a certain type of unskilled workers. This would avoid most of the negative effects of an above equilibrium wage system as discussed above, while still avoiding monopsonistic or other exploitation of workers in the form of below equilibrium wages. But it would reduce incomes of workers currently protected by an above equilibrium wage.
4. A system of unemployment insurance: high while retaining the worker security aspect of the current legislation which requires payment of a year's salary in case of dismissal without warning, would reduce the burden of risk on the employer which this legislation implies. Such a system would have to be designed so that between the employer and the worker they would on average pay the cost of the unemployment benefits; otherwise it would be subject to abuse and would not meet its objectives. Unfortunately, such a system appears to be administratively complicated enough to make it hard to apply in the context of small industry.

5. A system of profit sharing: reaching further down the size hierarchy of firms. Profit sharing is already part of the institutional setting in Ecuador. It might be possible for it to make a more significant contribution to the efficiency of manufacturing or other sectors. The basic problem of business in guaranteeing a high level of total labor remuneration is that in bad times paying that level may seriously damage its viability; the basic objective of labor should be to share in the high rents accruing to a given sector or firm when they exist without driving the firm to the wall when such rents do not exist. Profit sharing should raise worker incentive and create a communality of interest between labor and capital which can ease their relationship, while also reducing the risk-adjusted cost to the firm of paying a high average remuneration to labor over a period of years. Unfortunately, such a system is probably too complicated to be feasible in small industry; what primarily warrants consideration is its more extensive use in middle sized establishments. Were the practice thus extended it could lower the current disincentives to firms' growing into that middle size range.

6. An increase in the minimum number of workers required to form a Comite de Empresa: e.g. to somewhere between 25 and 50 workers. This step would encourage firms to grow and especially to raise the number of permanent employees. But it would be viewed as an attack on a position already won by labor.

7. Introduction of regional differentials into the minimum wage system: to provide lower minima in the secondary cities than in the two metropolitan areas. The present system distinguishes only small industry and artisanry (conceding to them lower minima than the "general" one). Regional differentials would encourage the growth of small enterprise employment in the secondary cities, where the potential appears to be particularly strong. The current minimum wage legislation in fact discriminates against these cities in the sense that, since the purchasing power of a given nominal minimum wage is higher in most of these cities than in the metropolitan areas due to a lower cost of living, the real minimum wage is actually higher.

A disadvantage of such differentials is that they would constitute an additional complication. There is also a possibility that they would encourage migration to the metropolitan areas with higher minima, though we doubt that. This is a significant factor in migration decisions.

8. A wage-subsidy incentive system to replace the current fiscal incentives to small (and large) industry: which take the form of incentives to the use of capital (e.g. exonerations on tariffs for importation of capital equipment). As long as the level of incentives is set so as to have the same fiscal "cost" as the present system of subsidies to the use of capital, its only effect should, in principle, be to induce greater labor intensity. It would, however, be more difficult to administer

than the present system of incentives, perhaps rendering it impractical.

9. Information and legal assistance in labor relations: to small entrepreneurs so that they will understand the options open to them and not suffer from unfounded fears with respect to their labor force. While reducing the uncertainty of firms, this could in some cases give them too much power over workers.

10. Dialogue between labor and small enterprise: could be encouraged to help each comprehend the others problems and positions. Hopefully this would reduce tension between the two groups.

11. Improvement in the general level of understanding in Ecuador on employment and labor market issues: The government and/or others could contribute to such understanding by increasing the information available on the state of the labor market and on small enterprise's contribution to employment creation, and by explaining some of the economic mechanisms at work in this market. This should have the effect eventually of reducing the level of demagoguery in the debates on these issues. But it is a slow process, perhaps incapable even in the medium run of much effect.

### D.1.3 Recommendtions

In this very complex area it would be unwise for the government to undertake major changes without more in depth analysis of the issues than has been undertaken to date. We recommend several cautious policy steps, and studies to assess the desirability of other possible steps.

#### Policy Steps

1. A simplification of the labor code to eliminate distinctions among occupational categories, leaving the basic minimum wage and the differentials in that wage according to sector as they now exist.
2. A guideline limiting changes in the real minimum wage in either direction to 10 percent per year. With the current and probable future inflation rate in Ecuador, the implementation of such a guideline would not be very complicated.
3. Provision of more information on the state of the labor market (unemployment wage patterns and trends, etc.) on a current basis, so that policy and debate may be based on a solid foundation of information.
4. A program to raise the level of understanding and debate on labor market issues via the media, research, and other mechanisms.

#### Studies

1. An evaluation of the feasibility of some form of unemployment insurance scheme to remove the immediate costs of firing workers from the employer;
2. An evaluation of the feasibility of extending and improving the profit sharing mechanism so that it could become part of labor contracts as far down the size heirarchy of firms as possible;
3. An analysis of the merits of introducing a regional differential in the minimum wage;
4. An assessment of the desirability and feasibility of changing as many as possible of the incentive systems designed to promote firm growth from inducements to the use of capital to inducements to the use of labor (e.g. a subsidy to bear, over a given period, a part of the cost of hiring additional workers);
5. An evaluation of the desirability of raising the minimum number of permanent employees necessary for workers to have the right to organize a comite de empresa from 15 to 25 or higher.

## D.2 The Sectoral Impact of Macroeconomic Policy

### D.2.1 Issues

Macroeconomic policy aims at simultaneously achieving "internal" and "external" balance in the overall economy. Internal macroeconomic balance is generally understood as the maintenance of as high a level of aggregate demand as is consistent with an "acceptable" rate of inflation. External balance refers to equilibrium in the balance of payments which, in countries like Ecuador where nominal exchange rates are fixed or float in a managed fashion, boils down to having a "comfortable" level of foreign exchange reserves in the Central Bank. Fiscal, monetary, and exchange-rate policies are the macroeconomic policies par excellence. In Ecuador, fiscal policy falls under the sphere of action of the Ministry of Finance. Monetary and exchange-rate policies come within the domain of the Monetary Board and the Central Bank.

Broadly speaking, macroeconomic policy deals with short-term stabilization problems (such as inflation, balance of payments disequilibria, etc.), while sectoral policy is concerned with the performance of given sectors and the overall sectoral structure of the economy; as such, it tends to have more of a medium and sectoral structure of the economy; as such, it tends to have more of a medium and long-run time horizon.

Sectoral policy in its most general sense is at least formally the responsibility of the planning institution (CONADE) and the sector-specific ministries. Policies particularly concerned with small-scale enterprises are a subset of general sectoral policies and, at least with regard to policies originated in public-sector institutions, are constrained and guided by the overall development plan adopted by the incumbent administration. The vast array of institutions, both public and private, that have a more or less direct pre-occupation with the small-enterprise area is described at length in the background paper on institutions.

### Need for Representation in Macroeconomic Decision-Making

It is important to note that the small enterprise sector in Ecuador has no direct representation on the relevant bodies charged with the formulation of macroeconomic policy. In situations of balance of payments crises such as the one affecting Ecuador since the early 1980s, the two most important organizations in the formulation of macroeconomic policy are the Monetary Board and the IMF. They jointly negotiate the "stabilization package" which, once approved, opens normalization of foreign-debt negotiations with international private banks. It would be surprising if the fact that certain sectors and/or social classes are represented on the Monetary Board while others are not had no influence on the specifics of the stabilization programs and on the particular combination of

policy instruments selected to achieve, say, balance of payments adjustment. At the same time, the characteristics of a stabilization program are also affected by the larger political arena so the way real income cuts typically implicit in an IMF conditionality package are distributed among social groups depends on the characteristics of the administration's constituency, the degree of democratic openness in the society, and the relative political strength of the various interest groups.

Tariffs and quantitative restrictions on imports provide another example. These policy tools have macroeconomic dimensions (e.g. as inflationary instruments or, in the case of tariffs, as a revenue raising instrument) and may thus be manipulated in part for macroeconomic purposes; at the same time they are used as devices to protect or stimulate certain productive sectors over others. The structure of trade controls can obviously have quite differential effects on small industrialists vis a vis, large ones, or on small commerce as opposed to its large scale counterpart. The forthcoming publication of numerous reforms to the tariff law has heightened small industrialists' pre-occupation with the topic. But small enterprise lacks the political visibility, the degree of institutionalization and coherence that characterize such other groups as the chambers of commerce and large scale industry and the unionized workers. In sum, neither in the sphere of the Monetary Board nor in the larger national political arena do small entrepreneurs have significant representation and influence.

#### Unintended Sectoral Impacts of Macroeconomic Policy

A probably significant proportion of the differential sectoral impacts of macroeconomic policy are unintended. Thus the pursuit of a reduction in the government's budget deficit and of discipline in the credit-creation process that has characterized recent Ecuadorean stabilization programs has aimed mainly at restoring overall economic equilibrium without a deliberate goal of affecting the relative performance of given sectors. Nevertheless, unintended sectoral effects of macroeconomic policy may be more significant for small enterprise than for larger firms, as three recent events illustrate: (i) a tight monetary policy expressed in a general contraction in credit availability; (ii) a decision based partly on macroeconomic considerations to raise the minimum wage sharply in 1980; and (iii) a major overhauling and liberation of financial markets via interest rate reform.

Under the tight monetary policy small enterprises are likely to suffer disproportionately because of their more limited access to those credit lines not specifically directed to the sector, their relatively low "collateral", their being less important clients of banks, and the absence in their case of the sort of symbiosis often characterizing the relation

between banks and large enterprises. In case (ii), assuming that minimum wage hikes have an effect on the overall level of wages, small industries producing wage goods might benefit as much or more than other firms from the resulting aggregate demand effect but such benefits are likely to be overwhelmed by the supply-side effects, since for smaller firms labor costs loom large in total costs.

Finally, the Monetary Board's Regulation No. 214-84 of December, 1984 introduced profound changes in the interest-rate system, raising the ceilings for all interest rates and allowing floating interest rates for two types of financial instruments, the Polizas de Acumulacion (issued by commercial banks) and the Certificados Financieros (issued by financial corporations). The main ostensible goal of this macroeconomic policy was to bring into the formal financial market a sizable volume of credit which was being intermediated through the "curb" market (mercado extrabancario) and to raise the aggregate level of domestic savings. However, given that a wide dispersion among interest rates has remained, unintended sectoral effects have begun to take place. For the small entrepreneur experiencing lower rates of return from his/her firm, an attractive possibility has been opened for shifting out of productive assets into financial assets. Furthermore, a strong incentive for credit diversion is implied in this macro policy. It has become profitable for many entrepreneurs to borrow from, say, the Banco de Fomento at an (as of yet) fixed nominal interest rate of 18 percent annually, and to put all or part of the borrowed funds in a Poliza de Acumulacion which now pays a yearly interest rate of about 33 percent.

In the case of intended sectoral effects of macroeconomic policy, small enterprise needs representation to defend its interest in policy making bodies and in the national debate. In the case of unintended effects, it needs also the capacity to assess those effects on a continuing basis, and to do so quickly enough to participate in the discussion before policy formulation has gone too far.

### D.2.2 Recommendations

1. In the short run, a narrowing of the currently wide range of interest rates which exist on various financial assets and categories of loans, at a level neither significantly negative nor too high in the positive range.
2. As soon as possible, a study of the several interfaces between the small entrepreneur and the financial market, but especially the least understood aspects of that relationship, i.e. how significant the real return on financial assets is in contributing to the potential entrepreneur's buildup of initial capital, and the extent to which that return may induce the individual to switch from financial to directly productive assets (if it is low) or in the opposite direction (if it is high).

### D.3 International Trade Policy

#### D.3.1 Issues

Ecuador's current shift towards a more outward oriented trade regime is wise since the country needs to generate new exports to reduce its dependence on oil, and since the level of protection previously given to some industries was excessive. Both for the economy as a whole and for branches of the small scale sector, it is to be hoped that the shift is not so brusque as to weaken industries which either are already close to being competitive or would already be competitive were they not facing distorted factor prices. We presume here that the new trade regime will be reasonably coherent and will not be introduced in an unduly jerky fashion. A good approach to tariff reduction, always bearing in mind that the level of effective protection is the main consideration, would be to phase major tariff cuts over a matter of several years to allow business a reasonable period of time to adjust. The new trade regime should also retain some reasonable anti-dumping safeguards, since for some products a small market like Ecuador's can be flooded readily.

A more outward oriented approach should not harm small industry, especially if some assistance is available for those sectors which must adjust to the new setting (including information on market opportunities, alternative products, etc.) and provided that factor market imperfections do not prevent small enterprise from realizing its true competitive capacity. A decrease in the degree of intervention in international trade, so that the market can play a greater role in the allocation of resources, is most likely to achieve the hoped for effects when other markets are also as free of imperfections as possible. But a combination of import liberalization, above equilibrium minimum wages and weak access to credit could easily sink industrial branches which, in true economic terms, are quite efficient. Thus policy co-ordination is very important at this time. Further improvements in credit access and steps to facilitate a smoother functioning of the labor market become very important, as does careful combining of tariff and exchange rate policy. As trade is liberalized and protection cut back, it is important that an overvalued currency not produce under-priced imports, i.e. a negative rate of protection. A properly valued exchange rate also discourages capital flight and contraband.

In our survey of small manufacturers in Quito and Guayaquil, 21 percent of 200 firms cited "less imports" as one of the three main factors which would help their firm to increase its sales; this response was concentrated in the clothing sector (45 percent of firms) and in metal products (32.5 percent), a pattern consistent with our general impressions. Clothing is the largest generator of employment among three digit industries in Ecuador, the great majority of workers being located in the small industry and artisanry size

range. The metal industry is of considerable size already and has shown promise of dynamism. It appears that neither clothing nor the main employment generating parts of the metal working industry have been receiving significant levels of effective protection, in contrast to many other branches of industry. Accordingly careful attention should be given to any changes in tariffs or other restrictions on the importation of such sectors. More generally, there is a great need for a careful study of the existing effective protection of the major branches of small manufacturing, and that which will be implicit in the about to be announced tariff structure.

With respect to exports, small industry has reasonable prospects, provided bureaucratic and other impediments can be reduced. In our survey of five industrial branches, metal products was the most export oriented; 13 of the 20 firms in Guayaquil were doing some exporting and three were exporting more than 40 percent of their output. Only in the construction materials industry was no firm exporting. While the total magnitude of manufactured exports from the small scale sector is unlikely to become really large in the short run, it is nonetheless worth encouraging. The employment created is likely to be greater than in many export oriented branches of agro-industry (e.g. shrimps) and in the longer-run it could prove to be the first step towards manufacture's exporting on a large scale.

One of the major possible boons to small manufacturing (and some other small scale activities) is a good market for second hand machinery. Such a market played an important role in the dramatic expansion of small industry in Colombia during the 1970s. It especially aids the new investor with limited funds, since prices are often a quarter or a third those of the comparable new machine. It appears that this market is of limited scope in Ecuador, perhaps partly because the larger firms which in some countries sell their used machinery to smaller producers, here tend to use them until they have little further productive value. Due to the lack of a domestic supply of used machinery, imports become important; absence of tariff and other barriers on these imports is particularly important, and a service to assist the information flow to the small producer particularly useful.

Steering a wise course between the advantages of easy importation of machinery, especially second hand machinery, and the need to stimulate the promising domestic metal products industry is not easy. The cheapest possible machinery is a necessary condition for some small firms to get their start, and if the imported variety is the cheapest, it should be encouraged. For large enterprise, second hand imports are also often desirable since they usually entail a more appropriate technology than does the latest machinery. In either case, second hand machinery tends to generate repair capacity which then often evolves into production capacity. In short, this

Issue is important but the relationships are often subtle, so a careful study should precede any major policy steps.

### D.3.2 Recommendations

1. Simplification of the administrative steps involved in exporting should be undertaken so that internationally competitive small firms, of which there are quite a number, will be induced to take the step into the market.
2. In the short run care is needed to avoid sharp changes in the levels of protection on such major tradeable goods as clothing and metal products, where small enterprise is heavily involved. It appears that these sectors are not highly protected now, but it is important to avoid the accidental creation of negative rates of effective protection.
3. As soon as possible, it is urgent that the MICEI-University of Boston study of levels of effective protection and of efficiency at the four digit level be extended to deal specifically with small enterprise, taking account of the different levels of fiscal and other subsidies characterizing small and large industry.
4. An integrated system of information, credit and technical assistance should be developed for industries and firms with export potential.

#### D.4 Fiscal Incentives

Most fiscal incentives in Ecuador, as in most countries, are designed to stimulate modern, larger scale activities. And because most also have the effect of encouraging the utilization of capital rather than that labor, their value is particularly dubious in countries where the opposite effect is needed. Although we do not have sufficient data to judge whether this is still the case, studies undertaken in Quito and Guayaquil as of the mid 1970s indicated that tariff exonerations received by small industry were modest in relation to the imports of the sector, consistent with the fact that a substantial proportion of small industrialists do not take advantage of the Small Industry and Artisanry Development Law. (Only 25 percent of the 200 firms in our sample reported having received benefits from MICEI, the ministry responsible for the application of that law). Such exonerations are no doubt much more important for large scale industry (through no figures are available) since it is much more capital intensive and probably imports a higher share of its equipment from abroad.

## D.5 Basic Legislation

### D.5.1 Issues

The two prominent pieces of legislation pertaining to artisanry and small industry in Ecuador are the Artisanry Defense Law (Ley de Defensa del Artesano) of 1953, and the Small Industry and Artisanry Development Law (Ley de Fomento a la Artesania y Pequena Industria) decreed in 1965, modified in 1972. Each defines a variety of benefits available to establishments which apply for them and which qualify under the specifications of the respective laws. There is a partial contradiction between the two laws, and each creates a perhaps inevitable but nonetheless worrisome pattern of incentives against growth of firms coming within its domain. The second law has in fact been a useful instrument for small industry, especially for those firms towards the upper end of the size range, but has had virtually no impact on artisanry, which has essentially remained under the Artisanry Development Law.

That law, much debated and discussed in the year before its passage<sup>4</sup>, in effect protects an "artisan elite" of persons who are titulados in their specialty, providing them with tax benefits and credit access (though few are able to take advantage of these), while absolving them from many of the obligations to their workers which characterize other employers. In the view of some it provides a way around the Labor Code not only for genuine artisans but also for some small industrialists and even some tradesmen, (all of whom contribute to a pressure group against any alteration of the law or its unification with the (Ley de Fomento), while leaving the great majority of workers in this sector unassisted and undefended. Given the need for employment creation, these "defects" in the Ley de Defensa probably deserve less comment than its undeniable flaw--its failure to provide incentives for increased productivity, introduction of new techniques, and growth. Its escape clauses on treatment of labor have the effect of inhibiting expansion into small manufacturing. It is a law which, as its name implies, "defends" a certain group, while not presuming the group to have the potential to move ahead.

The Ley de Fomento shares, at least in part, the basic defect of the Ley de Defensa del Artesano. Although it does not discourage technological progress for example, and indeed encourages importation of capital via its tariff exonerations, its set of benefits do constitute a discentive to growth of employment and of capital above a certain size.

### D.5.2 Strategy Options

1. One approach to dealing with the problem of the disincentive to growth would be to unify as much as possible the legislated benefits for manufacturing establishments regardless of size. This would also simplify administration of the benefits. But it would remove some probably desirable features of the distinctions across size categories, e.g. the minimum wage differential and the minimum size requirement before creation of a comite de empresa becomes a right.

2. At a second level would be unification of the legislation now applying to small industry and artisanry. A less extensive modification than the alternative just cited, this would provide more administrative uniformity for the two size categories of direct concern to us here, since the administration would become the responsibility of one ministry. Artisanry (at least some parts of it) and small industry do have more commonality of needs than either has with large industry. The disadvantage of such unification is that artisanry probably does need more special benefits in the area of labor obligations than does small industry.

3. Provision of especially designed incentives to growth (especially of employment) which would have the effect offsetting the current disincentives to growth. For example, any fiscal incentives to investment could be contingent on the investment's raising output and/or employment levels; or the fiscal incentive could be directly related to meet employment creation. Here the problem would be administrative complexity.

4. A greater access to the benefits of the Artisan Protection Law so that a broader range of producers in the size range used to define "artisanry" would be eligible. There is no apparent economic defense for the exclusivity of the law. This step would also probably reduce the current disincentive to graduation from the artisan category to the small industry one, since that disincentive is based partly on the very low cost of labor to the master artisan, but that cost would rise as other artisans have direct access to the benefits of the Law. Opposition from the artesanos titulados might lead to some disorganization in the sector, and there would be somewhat greater administrative cost to the government as the number of beneficiaries of the Law increased.

### D.5.3 Recommendation

1. A widening of access to the benefits of the Artisanry Law beyond the present narrow group of master artisans. Having a "titulo" as an artesano should not be necessary to have access to the benefits of the Law.

## D.6 Quality Standards

### D.6.1 Issues

Small industry sometimes produces low quality products and sometimes products of uneven quality; it probably does so much frequently than its large scale counterpart. Under some circumstances this may call for intervention (provided the intervention can be efficient), either to assist in quality improvement or to legally force it.

Under other circumstances, a push toward quality maintenance would be counterproductive. Thus any organization charged with ruling on quality issues needs to exercise careful judgement in determining when intervention is desirable. When low quality of a product is a result of low cost production, when the low quality is recognizable as such by the buyer, and when the product hence fetches a lower price, there is no reason for intervention to force an improvement in quality. If the buyer in question desired a higher quality and were able and willing to pay for it, they would usually be doing so already and suppliers would have responded to their needs. To force quality up could cut such (usually poor) buyers out of the market; it could also block the progress of small firms who get their start using simple technologies and unskilled workers, but have the capacity over time to grow and to raise quality on their own.

New techniques and approaches which can raise quality without raising costs are desirable but they do not, of course, require legal interventions but rather dissemination of information. Quality control needed to facilitate entry into foreign markets should result mainly from market pressures, from traders or from the producers themselves. Qualified purveyors of information on how to raise quality are of course useful and may be an effective instrument.

Where low quality presents dangers that the buyer cannot easily detect, there are grounds for intervention. But in general a public sector like Ecuador's would be best to refrain from intervention except in quite clear cut cases, both because efficient intervention is more easily conceptualized than carried out, and because businessmen tend to resent it.

## D.7 Minimization of Bureaucratic Harassment

### D.7.1 Issues

Many regulations in Ecuador seem, de facto, to have the effects of (i) bothering or harassing business, (ii) creating unproductive employment in the public sector, and (iii) creating situations which induce corruption. The government of Ecuador's concern with this problem is well-founded, and the recent World Bank loan to study how unnecessary bureaucratization can be reduced is a worthwhile initiative. Unnecessary bureaucracy creates certain costs for all types of business, but often they are greatest for the small businessperson who has less education and experience, can less afford the time involved in meeting bureaucratic requirements, and who may be less able to bear the cost of bribery to avoid a regulation which is without valid purpose.

### D.7.2 Recommendations

A thorough reconsideration of which regulations are really necessary and capable of implementation is clearly a high priority matter for the government. Removing resources from those areas which do not fulfill these conditions would make it more practical to apply the really needed regulations with the vigor they deserve. Simplification of accounting requirements for small enterprises would be a good place to start.

E. Needs, Availability and Gaps in the Provision of Services to the Small Enterprise Sector

This section reviews the provision of services to small enterprise in Ecuador in relation to the needs for those services. Attention is directed to credit, technical assistance, training, joint mechanisms, and information.

The adequate provision of these services depends in an important way on the sector's ability to organize itself so as to communicate its needs to the government and to the service agencies, and to be represented in policy debates affecting the sector. Hence, we focus initially and in some detail on this representation function.

E.1 Sectoral Representation: Needs, Services and Strategy Options

The small enterprise sector including artisanry, small merchants and small industrialists has representational needs in its relations with:

- 1) the government macro level policymaking process;
- 2) public agencies intended to serve the sector;
- 3) other municipal, provincial and national government agencies;
- 4) other representational organizations from the agricultural, commercial and industrial sectors; and
- 5) international agencies providing financial and technical assistance.

The increased complexity of the political and economic system combined with the increased impact of policy decisions on the small enterprise sector have made the individual entrepreneur more aware of the need to influence and to participate in the policy making process. There is a realization among entrepreneurs of all sizes and from all regions that they can no longer function in relative isolation of the major decisions being taken on economic issues. The pressures to adjust to the changing economic environment have also increased the need to interact and get assistance from public sector institutions and local, provincial and national governments.

### E.1.1 Representational Services and Gaps

The representational needs of the three branches of the small enterprise sector cited above are in part being met by the following networks of organizations:

1. Provincial Chambers and County Cells (Camaras Provinciales and Nucleos Cantonales) of small industrialists and the National Federation, FENAPI;
2. Trade or Sectoral Associations (i.e. Asociacion de Madereros, de Empresarios del Cuero, etc.);
3. Artisan Associations, The Conferacion de Artesanos Profesionales del Ecuador (CAPE) and the Junta Nacional de Defensa del Artesano (JNDA); and
4. Small Merchants Associations and their federation FENACOMI (Asociaciones de Comerciantes Minoristas).

Membership levels and participation. These representational networks have different degrees of organization and cohesiveness. They all claim to represent very large proportions of their potential constituencies. FENAPI claims that about 8,000 small industrialists are affiliated with the network, FENACOMI leaders affirm that as many as 200,000 small merchants are linked, formally or informally with its national network, and artisan organizations similarly claim over 20,000 members. Despite such claims, there is evidence that significant portions of the potential constituencies are either not affiliated or not very active in these organizations.

### Representing the sector in government decision making

The system of sectoral representation in government decision making through the Camaras de la Produccion -- the Chambers of Commerce, Industry, Small Industry, Construction, Agriculture, Small Industry and Artisan Guilds -- is well established in Ecuador. However, for the small scale enterprise sectors this representation has been less effective and more formal than that of their counterparts.

There is at present a will among small scale sector leaders to exercise these right in more forceful ways. Inevitably these efforts contribute to occasionally tense relations between representational organizations and government institutions. Such tensions need not be seen in a wholly negative light, since they are also symptoms of an emerging positive dynamic between government and constituencies which if properly managed can become a driving force for reform and improvement of the system's operations.

Of the existing networks FENAPI is present in the widest range of government decision making bodies. (See the FENAPI profile in the Institutional Background Paper). However it lacks adequate resources for effectively representing the needs of the small manufacturing sector in those multiple decision making bodies in Ecuador where it has the right to participate, not to mention international organizations.

There are at least three key policy making settings in which FENAPI is not yet represented but should be: the Junta Monetaria, the key point for sectoral credit allocations; the tariff setting process; and SECAP, the principal training institution of the country.

The artisan organizations are represented through the Junta Nacional de Defensa del Artesano and more recently by the creation of the Sub Direccion de Artesania in the Ministry of Industry. Small merchants have less formal representation in the state apparatus.

These three subsectors of small enterprise share many policy concerns and their influence over the policy making process could be increased substantially through joint programs and actions. However cooperation among them is at this time very limited. Their contact with other sectoral organizations -- Chambers of Industry, Commerce, Agriculture, etc. -- is also very limited. While the interests of the different sectors may not converge on some issues, there is potential for cooperation on others.

Other private/public relations. Interaction between the small enterprise sector and public institutions is not limited to influencing "macro" policy decisions and the services provided by relevant national level agencies. Small entrepreneurs also have to deal with municipal authorities, the police, public utilities; they need operating permits and licenses, a road paved or water delivered, a legalized title to the land they own or occupy and so on.

Small entrepreneurs call on their "Gremios" for assistance in this full range of private/public relations. While the larger Camaras and Associations have the experience and resources to address these problems with reasonable success, the smaller groups need greater outside interactions effectively.

International relations and assistance. The representational networks can be effective in attracting external resources to the sector and they have, to some extent, been doing so. However, substantial international resources targetted to the sector are underutilized because of the inability of public sector agencies and the representational organizations to prepare and broker projects for their constituencies effectively.

### E.1.2 Strategy Options

The gaps in the representational services being provided to the sector can be addressed through some combination of the following strategy options:

1. Broadening the sectoral constituency base through greater program and action coordination among the representational network (artisan, small merchants and small industrialists). Such co-ordination would lead to greater integration of the sector and increased lobbying potential, but will probably be slow to achieve and politically complicated.
2. Building constituency participation in the networks. Attempts to do this directly through membership drives, campaigns, etc. would not likely be very successful unless linked to improved service delivery, judging by experience elsewhere. Improved service delivery is likely to motivate greater involvement and strengthen overall organization. It can, however, be a costly and lengthy process, and require trained staff.
3. Organizational and motivational training among national and local network leaders and active members, on organizational planning, lobbying, services, administration of representational institutions. Such training should have positive long term effects and strengthen the positive links of the network with FENAPI. Like the previous options, it may be slow in showing results.
4. Provision of additional professional staff and other resources to assist sector representatives in policy making bodies, lobbying and public relations efforts. This option can have a short term impact, but does not help to build a cadre of sector representatives, may be costly and may lead to overcentralization.
5. Support for Trade Associations, and other activity-specific organizations. The clear common objectives and the smaller organizations involved make this activity more straightforward than most of the others; the other side of the coin is the limited constituency base and the lack of any contribution to sectoral integration.

The above options can be approached from either a centralizing or a decentralizing perspective. The first would emphasize the role of the national federations in carrying out the representational function, the second would place greater emphasis on the strengthening of the "grass roots" organizations, the local Camaras, Asociaciones and Nucleos.

### E.1.3 Recommendations

In our view the most effective strategy for strengthening representational capabilities combines several of the options outlined above, and involves support for both the centralized national federations and the decentralized local organizations.

Providing organizational support and motivational training to leaders and active members of the networks is a key component of the strategy, to be complemented by an emphasis on increasing the service delivery capability of local and national representational organizations.

Organizational Support. The positive experience derived from the support provided to the small industry network and to FENAPI through INSOTEC and through the Creative Associates program can serve as a guideline for similar initiatives directed at the artisan and small merchants network.

Such programs ought to emphasize organizational and motivational training among national and local network leaders and active members, with a focus on developing the service delivery capabilities of the organizations.

Support for the artisan's network must focus on activities which enhance its evolution towards higher productivity, greater efficiency and growth. One objective is to encourage the move from artisan operations to small industrial enterprises. To this end greater contact and common activities with the small industry network are to be encouraged.

The small merchants network despite its numerical importance seems less critical to an overall sectoral strategy. However, the small merchants' potential to improve the marketing capabilities of both the artisan and small industrial enterprises is one area which deserves special attention and additional study.

Strengthening service delivery capabilities. We believe that increasing the ability of local and national organizations to deliver critical services to their current and potential membership is the most effective approach to building strong representational networks.

The local Camaras, Asociaciones and Nucleos appear as the most appropriate locations from which to address the key service needs of the small manufacturer, i.e.:

- \* Information on policy, legal problems, markets, supplies and technology issues,
- \* Brokering of technical and management assistance and training, from private and public institutions,

- \* Credit access. through autonomous institutions such as Cooperatives and Credit Guarantee Corporations, and through references and other assistance,
- \* Joint services such as bulk purchasing schemes, shared production facilities, storage and transportation.

These are the major components of a service function to operate from local organizations of the networks with a counterpart at the national federation level. The specific functions, as well as the human and material resources to be assigned to this function, will vary depending on local needs and on the degree of organizational development of each local Camara, Asociacion or Nucleo.

For the larger Camaras this function is already established and operating although not always at the levels necessary to meet all the needs of the local membership. For the smaller organizations the function either does not exist or is limited by a lack of adequate resources.

Initially, in most cases, the service delivery mechanisms will have to be subsidized. The key missing resource is salaries and training for technical and professional staff. The experience of the larger Camaras suggests that once the service mechanisms are operational there are various fee schemes which can gradually reduce the need for outside subsidies. In principle, each service contemplated can generate user income and thereby become self financed. In addition, increase overall membership and fees.

## E. 2 CREDIT

### E. 2.1 Availability, Desire and Need for Credit

Small enterprise in Ecuador, as elsewhere, is inclined to feel that access to credit is important and that inadequate amounts, terms or timeliness constitutes a major stumbling block to effective operation and expansion. While the businessman often overestimates his need for credit relative to other potential sources of increased profitability, and while sometimes his demand for credit may reflect in part its subsidized price, there is no doubt that the claim is frequently a valid one, and that small enterprises do not or cannot draw on the formal credit system as much as larger firms do. As of 1984, small industry and artisanry (SIA) appears to have received about 2.0 to 2.5 percent of all official sector credit going to the private sector and about 6.5 - 7.5 percent or so of credit going to the manufacturing sector. At this time establishments of less than 20 workers produced about 20 percent of manufacturing output in urban areas and accounted for 46 percent of urban manufacturing employment. No comparable figures are available for small enterprise in commerce or services.

#### Increased Availability Since the Early 1970s

Both the credit flow directed to manufacturing as a whole and that to the small scale subsector increased substantially since the early 1970s with the commercial banks, the Banco Nacional de Fomento (BNF), and the second tier institutions, the Fondos Financieros and FOPINAR (since 1981) all playing a role. More recently new sources of credit for very small enterprises have been added. When credit in current prices is deflated by the implicit price deflator of manufacturing value added, the increase over 1973-1983 was about eight fold for manufacturing as a whole; the increase for SIA was probably of similar magnitude. (Even though there may have been a considerable amount of diversion of credit from its alleged use, this would not affect the conclusion that its availability increased greatly since the early 1970s). For manufacturing as a whole

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1/ For those firms newly classified under the Small Industry and Artisanry Development Law the ratio of credit to value added was over 70 percent as high as for manufacturing as a whole in 1981 but only 46 percent as high in 1983. These data are probably unreliable as a source of information on the credit/value added trend for SIA. They also probably greatly overstate the ratio for all SIA since the average size of the firms (17 workers in 1983) was near the upper end of the small industry size range.

Table 1

INFORMATION ON THE FLOWS OF CREDIT TO SMALL INDUSTRY AND  
ARTISANRY BY SOURCE, 1984

(VALUE FIGURES IN MILLIONS OF SUQUES)

	FED (PRODEM <sup>a</sup> Program)	PROCREDEM <sup>a</sup>	BANCO DEL PACIFICO <sup>b</sup>	CACPE QUITO	FECOAC ASSOCIATED CACs	BNF	FOPINAR (Second tier)	COMMERCIAL BANKS
Number of Loans Made	1897	480	352	525		5793	1154	3,500-4,500
Number of Beneficiaries	566	227						
Number of Loans Outstanding					1,000-4,000 <sup>c</sup>			
Value of Loans Made	38.2	10.7	32.9	21.9		2668.5	1177	5,700
Balance Outstanding	11.9					3793.8		
Average Value of Loan	.0202	.022	.093	.042	.025-.050	.461	1.02	> 1.0

a) May 1984 to March 1985

b) Programa de Artesania

c) Rough estimate

d) Figures in this column are based on the rough assumption that total BNF and commercial bank credit to SIA was 2% of the banking system's credit to the private sector.

NOTE: Since Fopinar is a second tier credit institution and is therefore not a direct source of credit, the data appearing in its column correspond to loans made by the BNF and the commercial banks and thus appearing their respective columns. Fopinar data are shown in order to clarify where it fits into the credit structure.

the ratio of credit flow to value added rose from 0.28 to about 1.0, a dramatic increase. For SIA although scattered evidence confirms the expectation that this ratio is much lower, perhaps a third as high as for larger industry, 1/ it too rose markedly. Figures from the main sources of credit and from several surveys give an idea of the coverage of the credit system at various strata of SIA. In 1980 there were in the urban areas (covered by the economic census) about 22 thousand manufacturing establishments of 1 or 2 workers, over 10 thousand of 3-9 workers and another 1440 with 10-49 workers. Data on number and value of credits give to SIA, (Table 1) coverage of the credit system, though there appear to be some gaps both in the quantity and the conditions of access.

Our recent (April) survey of 200 small manufacturing enterprises in Quito and Guayaquil, with median size about 10 workers, revealed that about 55 percent had received credit from commercial banks and/or the BNF during the last two years, a reasonably good coverage though not such as to satisfy all the potential borrowers. Of the remaining 45 percent, about 29 percent had not received any credit, while another 15 percent had resorted only to private money lenders. A good number of firms had used more than one source. A higher share of Guayaquil enterprises received no credit (33 percent) than in Quito (24 percent). We presume the coverage of formal sector credit is considerably less in the secondary cities and that in particular the role of the commercial banks is less. Private lenders would relatively more important --perhaps more important in absolute terms as well.

A higher share of female entrepreneurs had received no credit in the last two years (32.5 percent) than for males (26.4 percent). Males had with greater frequency received credit from commercial banks and private money lenders, whereas a higher share of women had had recourse to the Banco nacional de Fomento.

#### Availability of Firm Size

We would expect the larger firms within SIA to have better formal sector credit access and the smaller ones to rely more on money lenders and own funds. As Table 2 shows, it is true that a higher percentage of the smallest firms (by level of sales) in our survey of 200 small manufacturing enterprises in Quito and Guayaquil (median size about 10 workers) had received no credit over the preceding two years (41.5 percent for those with sales under 1 million sucres), but it is noteworthy that private money lenders played a more significant role in the firms with a middle level of sales (especially the range 5-10 million sucres) than in either the smallest firms (where they were strikingly absent) or in the larger ones, though a third of all the establishments with sales of 10 million sucres did have recourse to this source. As expected the BNF plays its most important role among the smaller firms, especially the very smallest.

Table 2  
 PERCENT OF FIRMS WITH VARIOUS CREDIT  
 SOURCES, BY FIRM'S LEVEL OF SALES IN 1984

Sources of Credit in last 2 years	Level of Sales in 1984 (Millions of Sucres)						Total
	< 1	1-5	5-10	10-20	20-50	≥50	
No Credit	41.5	29.2	21.6	11.1	20.0	33.3	29.1
Private Money Lenders Only	3.8	13.8	29.7	22.2	20.0	16.7	15.3
National Development Bank Only	15.1	10.8	8.1	0	0	0	9.3
Commercial Banks Only	17.0	27.7	18.9	44.4	50.0	16.7	25.4
Private Money Lenders	11.3	23.1	43.2	33.3	30.0	33.33	24.9
National Development Bank	32.1	23.1	24.3	16.7	10.0	16.7	24.3
Commercial Banks	18.9	43.1	32.4	61.1	60.0	33.3	36.5
Number of Firms	53	65	37	18	10	6	189

Source: Mission Survey of small manufacturing enterprises.

It is evident that the PRODEM, PROCEDEM, Banco del Pacifico Artisan Loan Program and the various Savings and Loan Association programs constitute the bottom tier of the System, with average loan sizes in 1984 ranging from 20,000 sucres to 90,000 or so. Most of this credit is short term. At present, though the imprecision of their data leaves some uncertainty, it appears that the Savings and Loan Associations is a major source for the micro-enterprises in this submarket. Next on the ladder comes the Banco Nacional de Fomento; while its average loan in 1984 was 460 thousand sucres, over half of its loans were for less than 200 thousand sucres, and nearly 2,000 of them for under 100 thousand. Finally, the commercial banks provided loans to SIA whose average size was probably something over 1 million; as with the Banco Nacional de Fomento, the number of loans was substantial relative to the number of firms there appear to be in the size range of small industry which these banks serve.

In Quito and Guayaquil, for the size ranges mainly represented in our survey, 27.6 percent of the sources cited by entrepreneurs were private money lenders. Since they probably provided on average loans of somewhat smaller size than the other sources, their share of the total flow of credit to these establishments was more likely in the range of 15-20 percent or so. Its importance would be understated by such a figure, though, since it tends to be more timely than credit from other sources.

#### Desire For More Credit and Easier Access

Failure of firms to receive credit in the two years before the survey was not primarily a matter of choice, as reflected in the fact that a slightly above average percent of this group (63.6 percent) listed credit as one of the things which would be most useful in helping them to increase sales (Table 3).

In general borrowers from private lenders or from the B.N.F. were somewhat less likely to place high priority on more credit than were non borrowers or those dealing with the commercial banks. The only group with a well below average tendency to cite credit were those whose only credit source was the Banco Nacional de Fomento; apparently many of these were getting all the funds they felt were needed. On the other hand, of those getting credit both from a commercial bank and at least one other source 75 percent listed better credit access as a priority, and of those with credit both from BNF and at least one other source this share was 61.8 percent, much greater than the 40.9 percent for those getting credit only from the BNF.

Borrowers from the commercial banks were also the most frequent critics of the guarantees and other requirements needed to get credit; BNF borrowers mentioned this least, though one cannot completely discount the possibility that this may be due

to the regulations totally blocking more of the potential borrowers in this than in other cases.

Table 3

SOURCES OF CREDIT AND VIEWS ON WHAT WOULD BE MOST HELPFUL  
IN INCREASING SALES: PERCENT OF FIRMS<sup>a</sup> IN EACH CREDIT CATEGORY  
WHO CITE VARIOUS FACTORS WHICH MIGHT INCREASE SALES

Views on What Would be Most Helpful in Increasing Sales	Sources of Credit During the Last Two Years							All
	None	Private Lenders Only	BNF Only	Commercial Banks Only	Private Lenders	BNF	Commercial Banks	
1. General Economic Situation	83.6	61.8	63.6	74.4	64.1	57.1	73.0	70.0
2. More Credit	63.6	58.8	40.9	62.8	56.6	53.6	66.7	60.5
3. Less Guarantees & Requirements to Get Credit	16.4	17.6	0	18.6	15.1	12.5	25.4	19.0
4. Better Access to Inputs	41.8	41.2	50.0	37.2	41.5	46.4	41.3	41.5
5. Assistance in Promotion	25.5	17.6	18.2	20.9	17.0	28.6	25.4	26.5
6. Less Imports	14.5	20.6	13.6	27.9	28.3	19.6	30.2	21.0
7. Help in Exporting	10.9	11.8	22.7	14.0	20.8	14.3	17.5	14.5
8. Less Bureaucratic Obstacles	9.1	5.9	0	20.9	9.4	7.2	19.0	10.0
Number of Firms	55	34	22	43	53	56	63	

a) The percentages assume all firms responded to these questions, as appears to have been the case.

## E.2.2. Gaps Between Availability and Need for Credit

### Very Small Establishments; Centers Outside the Major Cities

The partial data on the level and composition of credit to SIA suggest that for the size range of firms reached by BNF and commercial bank credit the unmet need is of modest proportions; a significant share of firms do have access, and some of those who feel unsatisfied with credit availability already have at least some access. (During the general credit crunch of the last few months, the situation has probably worsened, but we do not have up to date information to assess this.) Thus the more significant gap in the system corresponds to the smaller firms within the sector, where in spite of the programs available coverage remains so low that one can only assume that there is a considerable unmet need. The credit allocation priorities of the Central Bank have not taken into account the needs and economic potential of this "very small" enterprise sector.

The second gap (partially overlapping with the first one) arises in a number of the secondary cities and other centers outside Quito, Guayaquil and Cuenca. Provinces like Bolivar, Canar, Chimborazo, Cotopaxi and El Oro probably receive a significantly lower share of all credit going to SIA than their share of the output of the sector. (See Table 4). These provinces tend to receive a lower share of Banco Nacional de Fomento credit than their share of value added; this, given the greater regional concentration of commercial bank than of BNF credit, virtually assures that their share of all formal sector credit is still further below their share of value added.

For very small enterprises the lack of credit appears to be severe; it results from the insufficient number of lender institutions interested in or capable of handling the small loans involved. The micro enterprise sector depends partly on so-called street credit, at rates oscillating around 10 percent per month and for which no statistics are available, partly on family and friends, and partly on suppliers. Recent evidence from Quito and Guayaquil indicates that only about 25 percent of micro enterprises had debts outstanding in excess of 10 percent of their assets. Of the smallest 25,000-30,000 urban manufacturing establishments (with 1 to 3 workers), the data suggest that probably at most 2,000 to 4,000 have credit at any given time and that this credit is typically short term, up to three months or so.

Such private credit programs as FED/PRODEM in Quito and PROCREDEM in Guayaquil, while impressive and important as experimental pilot programs, are minute in relation to the total demand for credit from the micro enterprise sector. The network of Cooperativas de Ahorro y Credito also supplies an important share of loans to this sector, but even here the level of loans outstanding is modest.

Table 4

REGIONAL DISTRIBUTION OF CREDIT TO SMALL INDUSTRY  
FROM SELECTED SOURCES 1984 AND OF VALUE  
ADDED MANUFACTURING ESTABLISHMENTS OF  
LESS THAN 10 WORKERS IN 1980

Province	Value Added, 1980	Fopinar, 1984	Banco de Fomento, 1984
Azuay	7.40	10.44	6.70
Bolivar	0.75	0.14	0.61
Canar	1.19	0.22	1.10
Carchi	1.14	0.11	1.43
Chimborazo	3.34	2.47	2.18
Cotopaxi	2.71	0.71	2.36
El Oro	3.15	1.99	2.48
Esmeraldas	1.74	2.64	3.74
Guayas	25.60	18.84	18.35
Imbabura	4.44	4.78	5.92
Loja	1.84	3.64	5.65
Los Rios	2.88	14.66	17.48
Manabi	6.25	4.99	6.65
Oriente-Napo	1.0	0.99	1.95
Pinchincha	29.75	26.43	18.50
Tungurahua	7.36	5.60	4.15

The gap between supply and need for credit is clearly less wide in the middle and upper size ranges of SIA. Both aggregate and survey figures indicate that depending on the size range and the region of the country, either a majority of a sizeable minority of these SIA firms do have access to credit from the financial institutions. Some others use private moneylenders as their source. Most firms in this size range do believe that they would benefit from better credit access. In many cases this view is no doubt valid, especially in those parts of the country least well covered by the banking system.

Probably the difficult years just past have diminished the capacity of firms to self finance their capital, and a study conducted by the Camara de Pequeños Industriales de Pichincha (CAPEIPI) claims that there have been significant cuts during 1984 and 1985 in the relative share of credit aimed at small industry through Fondos Financieros as a result of Central Bank policies. Entrepreneurial perceptions are supported by some regional managers of the Banco Nacional de Fomento who point out that they encounter periodic liquidity crises in their credit lines for small industry and artisanry. On the other there is little doubt that some firms overestimate the potential of credit relative to other ways of raising profitability.

#### Magnitude of Unmet Needs

Because of the lack of precise data on the loans of the Savings and Loan Cooperatives, and the difficulty of estimating the extent of credit needs in the lower size range of SIA, it is hard to gauge the magnitude of unmet needs there. But we suspect it is large, at least in terms of the number of establishments now receiving no or too little credit, or credit not meeting the firms needs in terms of duration or other conditions. In terms of the level of funds involved, however, these unmet needs are very modest. As of 1984, the institutions providing credit at the bottom of the SIA size range probably accounted for only 2-5 percent of all credit outstanding to SIA, and less than half of 1 percent of that going to manufacturing as whole, although the 25,000 or so smallest firms provided 45-55 thousand jobs or about one quarter to one third of urban manufacturing employment.

Thus, relative to manufacturing as a whole, this subgroup receives virtually no credit. Its legitimate needs, while probably a multiple of what it currently receives, are nevertheless minuscule in relation to the overall financial flows in Ecuador. Since the subsector has the highest ratio of productive job creation per sucre of investment, it deserves all the credit which it can productively use and which can be efficiently channelled to it. Both an increase in the number of firms receiving credit and an improvement in the type of loans available (longer terms, less difficult conditions, more time access, etc.) are needed.

In the middle and upper part of the SIA sector the share of legitimate credit needs which is unmet is much smaller than in the lower range, but still significant enough to warrant attention, especially when credit access can be combined with other efficiency raising services.

#### SIA a High Priority Destination for Formal Sector Credit

Satisfying the unmet credit needs (as distinct from desires) of SIA should be an important objective of Ecuador's policy in the SIA area in the coming years. While most small enterprises typically do get their start with little or no formal sector most small enterprises typically do get their start with little or no formal sector credit (and this was probably the case with many of the new small establishments created in the 1970s), this is more difficult when the overall state of the economy is stagnant, as is now the case. It is reasonable to expect that an effective credit system, along with other services, would contribute to the creation of many new firms and the expansion of others. The importance of the formal sector seems also to be underlined by the limited role of private moneylenders as a source of funds for the small firms (as distinct from micro-entrepreneurs) we interviewed in Quito and Guayaquil

### E.2.3. Difficulties and Inefficiencies in the Credit Process

Apart from the need to expand the potential of the credit system, especially in the lower ranges of the SIA size range and in the smaller population centers, important improvements can be made in the quality of the credit process.

Related to the various weaknesses in the BNF's credit process is a history of a significant default ratio, creating a periodic need for new injections of capital from the public sector. Better banking practice could diminish the need for this sort of subsidy. Despite the numerous complaints about the functioning of the BNF, though, most entrepreneurs feel it is the most important credit institution for small manufacturing.

Delays in processing. The credit issue most often mentioned in personal interviews with borrowers was the delay between application and first disbursements. While Banco de Fomento officials often state that the process takes only a few weeks, many applicants claim it takes between 3 and 6 months.

Processing delays sometimes reflect insufficient overall availability of credit. The Banco de Fomento also faces a freeze in personnel and wages and its efforts to modernize and automate lending procedures and record keeping have not yet resulted in a big improvement in service as might be hoped.

Inexperienced and untrained borrowers. There are also "demand" side constraints to credit access. The most important is lack of technical and administrative experience on the part of borrowers, which hinders their completing the required documents for credit application. They are frequently unaware of the lines of credit available to them, the terms for which they can ask, the amounts and limits, etc. These problems are more acute for the smallest entrepreneurs.

The banker's perception that loans to SIA are risky. The inexperience of some borrowers with formal credit results in slow repayments or defaults, which in turn biases bankers and the public in general against lending to small enterprise. The erroneous conclusion is drawn that lending to small enterprises is necessarily more risky than other types of lending. In many instances, however, the default rate on small enterprise loans would drop significantly if the loans were followed up regularly. Experienced bankers know that they must periodically visit borrowers in order both to demonstrate support for their efforts and to discuss and observe how things are going. If problems have come up in the business the sooner the banker and the borrower talk together about how they will be resolved, the better is the chance that they will be and that the credit obligations will be met. If the guarantee systems now at the experimental stage expand as hoped they will provide additional security to the banks.

Misuse of credit lines. Diversion of credit from its designated use arises particularly among larger and more experienced borrowers. One BNF official who attended a meeting of the Camara de Pequeños Industriales bitterly complained about the misuse of small industry/artisanry credit for unauthorized purposes. The practice is widespread and often takes place with the participation and complicity of corrupt "inspectores de credito." The Camaras and Nucleos condemn these activities but do little about them in practice.

#### E.2.4. Interest rates

At present most credit provided by the formal financial system is subsidized, most real interest rates being substantially negative given the rates of inflation obtaining over the last few years. At the very low end of the scale, we are informed that PRODEM loans carry an average monthly interest rate of 2.25 percent, implying a slightly positive rate in real terms given the present rates of inflation, but probably not enough to quite cover costs given the very small short duration loans in the program. The Banco del Pacifico was until recently charging only a 12 percent annual rate in its Artisanry Program. BNF charges 18 percent on its loans to SIA, while the costs of credit based on FOPINAR resources, including a 2 percent commission, varies between 18 percent and 21 percent (according to the term of the loan) for small industry and is 16 percent for micro enterprise. Except for the PRODEM loans, these rates are strongly negative in real terms at this time, though it is true that the appropriate nominal rate for longer term loans should reflect not only current inflation but the level expected in the relevant future period. Short term real rates of minus 10 percent are clearly unwise, so there is a genuine need to raise nominal rates, especially with credit allegedly in short supply. In low end programs like PRODEM, although there may currently be some subsidization since it appears that the program cannot cover costs, this is not a serious problem since none of the other negative effects of subsidized credit are present, i.e., discouragement to the provision of credit to SIA, incentive to divert the credit to other uses and creation of the expectation of a very low rate making the graduation to regular credit channels more difficult.

There seems no good argument for subsidization of credit either to SIA or to larger enterprises. Since the cost of processing loans is higher per unit value for small loans, it is important that lending to SIA not be discouraged or credit diversion encouraged by especially low rate ceilings.

The Banco del Pacifico's Artisan Loan Program exemplifies the discouragement of credit provision to SIA. This program was begun in 1977, and by mid 1982 had made nearly 3,000 loans. But as of 1982 the government's interest ceiling of 16.25 percent was deemed inadequate by the bank, which felt that it needed 18 percent to make a profit. Given the impossibility of this, the Bank decided to consider this a "Social Project" and charge only 12 percent. Such social projects necessarily remain of more or less "token" dimensions.

Interest rates are in any case not a decisive concern of the small borrower. In our discussions of credit the

cost of money" was not mentioned as a critical issue at least as long as it remained within certain "reasonable" limits. More important to the entrepreneur were the processing time of applications, repayment time of loans, grace periods, and excessive demands for business and personal guarantees.

While competitive interest rates like those now being paid on polizas de acumulacion and certificados financieros are desirable to encourage a higher level of national savings, their presence makes it doubly important that other financial flows in the system not carry unduly low interest rates. And their presence makes it the more important that the overall policy setting for small enterprise be kept as satisfactory as possible; otherwise some entrepreneurs will move out of real productive activities and put their capital in these attractive financial assets.

In terms of resource misallocation, the problem is not so much the need to end subsidized credit to the small enterprise sector as to avoid subsidizing large commercial and industrial concerns, both private and public, whose social and economic contributions are of debatable value. Many large enterprises have been unable to overcome their serious financial problems. Rescuing them already has probably absorbed several times more funds than all the combined needs of the small enterprise sector.

### E.2.5. Recommendations

While the credit system serving the middle and upper ranges of SIA could be considerably improved, the improvements and expansion of coverage needed are less drastic than in the lower ranges. With what should be feasible improvements to the present set of institutions, a satisfactory system should be possible.

The major needs of very small enterprise, both in manufacturing and in other sectors are:

#### Credit Access

1. A further expansion of the existing, but still very small, credit network.
2. Development of capacity to provide credit on a longer term basis than is now available or than would be available if the present network were simply to expand without any change in its functions.
3. Facilities, information, and advice to assist the very small entrepreneur who begins on the low rungs of the SIA size range to graduate to other credit facilities as his/her business opportunities permit.

Further details are presented in Section F.

#### Interest Rates

The interest rates charged of small enterprise borrowers should not be so low as to constitute a serious incentive to diversion of credit to other uses, especially socially unproductive ones; to lead to an excess demand for credit to invest in low productivity projects even in the designated sector; or to reduce the attractiveness of lending from the lender's point of view; this suggests that rates should not be far below zero in real terms. Changes needed at present include:

1. Raising nominal rates on short term loans with strongly negative real rates at present. The Banco Nacional de Fomento rates appear too low, as do those of some sources of credit at the low end of the spectrum;
2. Narrowing of the range of interest rates in the financial system as a whole, to discourage diversion.

### E.3.1 Technical Assistance

By the term "technical assistance" we refer to those services which are firm-specific, which involved follow-up, and which help in some way to improve the firm's efficiency.

Technical assistance is one of the services most desired by the small enterprise sector in Ecuador. In our Quito/Guayaquil survey of small manufacturers, 41% of those interviewed put it among the three most important services for them. Recent surveys by INSOTEC in various regions of Ecuador were even more definitive -- of 208 firms interviewed on this question, 81.2% wanted to receive some form of technical assistance. Our visits with several Chambers of Small Industry confirmed this high demand.

Concrete technical assistance needs are sector, region and enterprise specific. The kinds of technical assistance that are demanded by small entrepreneurs include:

- New production techniques
- Marketing
- Identifying better equipment
- Product design
- Quality control
- Management skills
- Cost analysis
- Planning
- Access to raw materials

We have grouped these categories into four broad areas: planning, financial analysis, production, and marketing.

Planning. Planning is basic to effective management of small enterprises. Although basic, its value is often underestimated by business owners, as evidenced by their common perception that credit is the solution to most business problems. Small business advisors have in many countries concluded that the felt need for credit is frequently a reflection of poor planning and controls. In a survey by the Asociacion Nacional de Empresarios (ANDE) in 1982, 89% of respondents indicated that a major obstacle to business development was inadequate management. Entrepreneurs in Ecuador need assistance in the design and application of management and planning tools which will enable them to better utilize their resources.

Financial Analysis. Awareness of costs and cash flows in an enterprise is essential to business profitability and viability. But small enterprise, especially very small ones, frequently suffer from insufficiency of financial records and cost analysis. Firms need assistance in designing and using simplified accounting systems, cost analysis formats, and cash flow forms. Such assistance facilitates improvements in pricing, in controlling costs, and in assessing credit needs

improvements which can result in a more efficient use of financial resources and greater profitability.

Production. Surveys in Ecuador and elsewhere indicate the need for assistance in the areas of quality control, production processes, technology choices, product design and access to raw materials. The observation of advisors working in this sector is that significant productivity gains could be achieved without further mechanization, merely by adjusting the plant layout. Additional gains can be attained through the adoption of better technologies, new or otherwise. An important component of productivity is having access to better quality raw materials at a lower cost. Assistance is needed in establishing bulk purchasing schemes and in selecting raw materials.

Marketing. A common complaint of small businesses is difficulty in selling their products. In our survey, 41% mentioned the need for assistance in the area of "marketing." Assistance is needed in identifying markets, promotion, pricing strategies, and identifying and analyzing channels of distribution.

### E.3.2. Existing Services and Gaps

Technical assistance services in the areas of planning, financial analysis, production and marketing are provided in varying degrees in Ecuador. The following is a partial and illustrative list of these services:

#### Planning:

- \* FED-PRODEM and Fundacion Espejo-PROCREDEM - project planning for micro-enterprises.
- \* CEFE - production and strategic planning and feasibility analysis to medium and large enterprises.

#### Financial Analysis:

- \* FED-PRODEM and Fundacion Espejo-PROCREDEM - accounting for micro-enterprise.
- \* CENAPIA - financial management, accounting and loan application preparation for artisans and small enterprise.
- \* INSOTEC - cost accounting workshops for small industry.

#### Production:

- \* CENAPIA - improving production process, quality control, product development, inventory control.
- \* COOPRIN - bulk purchasing for small industry.
- \* INSOTEC - production methods, group consultancies, industrial extension for small industry.

#### Marketing:

- \* OCEPA - product design and marketing of artisan products.
- \* CENAPIA - product design and marketing for artisans.
- \* INSOTEC - market studies for specific industrial sectors.

Despite the number of agencies with some involvement in this field, the major sources of technical assistance to the small enterprise sector are few. On the public sector side, CENAPIA is the main institution; in 1984 it provided direct assistance to 610 artisans (of which 557 were in Guayaquil) and 48 small industries. A host of organizations (such as FED-PRODEM, Fundacion Espejo, the Peace Corps, Catholic Relief Services, Desarrollo Juvenil Comunitario) are providing assistance to a variety of beneficiaries, but these programs are very small. Apparently the most frequent source of technical assistance at this time is private consultants, who are hired by

the individual firms. INSOTEC surveys indicate that up to 50% of the small business owners receiving technical assistance in the last few years had done so through such consultants, who may be individual professionals, university faculty members, members of consulting firms, and frequently public sector employees working after hours.

We suspect, though we have no quantitative information, that their assistance often falls in the area of accounting or related activities and is typically of limited scope.

The demand for technical assistance services far exceeds the supply. Most illustrative is the fact that approximately 64% of the firms indicating that they wanted technical assistance had never received it (INSOTEC Studies, 1981-1984). Given the many small businesses for whom the cost of hiring a private consultant is prohibitive, the public service, CENAPIA, is simply insufficient. Only 6.5% of the firms in our survey and 3.7% of those interviewed by INSOTEC had received services from CENAPIA. In the specific area of marketing, of 171 firms surveyed by INSOTEC, 22.9% wanted to receive assistance, and only 3.65% had received any. It should be noted, further, that these surveys included mostly the firms towards the upper end of the small industry range.

The technical assistance needs of women appear to be particularly inadequately satisfied. Although women do not request technical assistance as openly as do men, the needs are nevertheless present, while programs designed to meet them are generally absent.

The present technical assistance system falls short of needs, not only quantitatively but qualitatively. We heard many complaints about the ineffectiveness of the "standard" technical assistance available at this time. Further, for technical assistance to be effective, it has to arrive on time. We were told of many instances in which by the time the assistance arrived, the firm had already gone bankrupt.

### E.3.3. Strategy Options

The gaps in the area of technical assistance are major and need to be addressed through an assistance program which effectively mobilizes the technical resources available in Ecuador and at the same time helps to increase the supply of such resources over time. This section discusses the types of advisors required, their characteristics, and where they might be found. It then suggests four technical assistance program options, and the possible mechanisms with which to finance them.

The expertise required of persons providing technical assistance. A successful program of technical assistance requires an adequate supply of advisors, including both a sort of "cadre" of full time people and a roster of other persons for whom the provision of technical assistance would be a part time activity. Between these two groups, the following expertise is needed:

In the area of planning:

- production
- sales
- finance
- personnel
- equipment

In the area of financial analysis:

- cost analysis
- financial statements

In the area of production:

- technology alternatives
- installation and production start-up
- repair and maintenance
- plant lay-out and production process
- technological innovation
- quality control
- packaging and storage
- product development - new and improved

In the area of marketing:

- marketing of small business products
- techniques -- promotion, distribution, pricing
- market research/studies

Some assistance personnel would be specialized in one of these areas, particularly that of promotion. Others would be "generalists" with skills in assisting small businesses to solve problems.

Many such packages are designed by technicians and professionals with very limited direct exposure to the real operating and physical environment of small enterprises.

Desirable qualities or characteristics of persons providing technical assistance. Expertise in one or more of the above areas is not the only requirement for persons working to assist small enterprises. Certain other qualities or characteristics are necessary for an effective program, specifically:

- experience with small business
- experience in training/adult education
- curiosity and creativity
- a sense of responsibility -- awareness of the risks faced by small businesses
- good interpersonal skills with persons of all social and cultural backgrounds
- sensitivity to the special needs of female entrepreneurs

For members of the full time cadre of technical assistance, these characteristics are extremely important, especially for the generalists who are likely to have considerable contact with the recipient of the assistance, and for whom success is likely to depend on a smooth working relationship.

People with these qualities are scarce, and it is expected that some orientation and training would be needed to ensure effective services. Even for members of a part time roster, whose skills may be narrower and whose contact with the client briefer, such qualities are likely to be a big plus.

Sources from which technical assistants can be drawn. Both the private and the public sectors can and should contribute to the body of advisors. In the private sector, sources include large enterprises, the chambers, and consulting firms. The main public agency sources are CENAPIA, SECAP, CEBCA, INEN, and the Universities and Politechnical Schools. Some of the likely pros and cons of drawing from each source follow:

Persons from large enterprise

- Pros:
- considerable experience with systems
  - ability to make links between small and large industry
  - may have more time available
- Cons:
- difficulty in adjusting to small scale
  - different social class leading to possible paternalism
  - small businesspersons may fear theft of product ideas

Persons from the chambers or credit guarantee corporations

- Pros: - sympathetic to needs of small business ("has gone through it")  
- experience with similar systems and technologies  
- similar social class

- Cons: - may be part of the "competition"  
- less time available (pressure from own firm)  
- may have limited vision as to options

Persons from private consulting firms

- Pros: - objective (outsider)  
- range of experience, diversity  
- time available

- Cons: - self interest may be placed above service  
- can be expensive  
- can have inappropriate experience

Persons from the public sector agencies

- Pros: - experience in small business sector  
- may have appropriate background  
- relatively cheap  
- have a supporting infrastructure

- Cons: - frequently characterized by a didactic approach  
- possible conflict of interest between private and public roles (e.g., when they provide after hours private consulting)

University students and school leavers

- Pros: - lower cost  
- willing workers  
- trainable  
- could become future entrepreneurs

- Cons: - immaturity and insecurity  
- bias towards the theoretical (lack practical experience)

#### E.3.4. Program Options

The framework or coordinating mechanism for a technical assistance system could take one of the following three forms:

1. One staff person based to the extent possible in each local chamber, association or NGO coordinates and provides a technical assistance program for that local group.

Pros: - decentralization permits response to specific local needs  
- feedback is available  
- lower travel costs and time savings  
- more beneficiaries  
- more timely delivery of services

Cons: - no economies of scale in the system  
- complexity of overall system

2. A centrally located technical assistance program, with resource persons travelling to the different regions.

Pros: - economies of scale (efficiency in coordination)  
- relatively good access to public and international agencies

Cons - less responsive to local needs  
- contact/feedback is reduced  
- increased travel costs, time and staff turnover  
- fewer beneficiaries  
- untimely delivery of services

3. Groups of businesses with similar problems are trained with subsequent follow-up.

Pros: - high number of beneficiaries

Cons: - leads to possible difficulty in handling group dynamics

### E.3.5. Financing Options

The implementation of a program of technical assistance, be it centralized, decentralized, or training oriented, can be financed in a variety of ways. Some of these are:

1. Budget allocations for staff or for hiring consultants:

Pros: - permits inclusion of those who cannot afford the service  
- permits quicker expansion of program

Cons: - instills welfare mentality  
- creates institutional dependency

2. User fees (full or partial):

Pros: - program self-accountable when it is paying for staff account  
- small enterprise given advice  
- greater likelihood

Cons: - excludes those who may be difficult to start-up

3. Income derived from the technical assistance program to which

Pros: - may provide a base  
- larger business assistance  
- NGO competition for the resources available for provision of the services may induce a higher quality of services

Cons: - politics may be a factor in who is chosen to provide the technical assistance  
- the cost of assistance either increases interest rates to borrower or reduces lender income

4. Income derived from other components of an NGO program (e.g., services, investments, etc):

Pros: - program self-sustenance  
- experience in income-generation improves quality of NGO business services  
- provides integration of services to small enterprises

- Cons: - may distract attention from other provision of services
- dilution of limited financial resources

5. Volunteers:

- Pros: - low cost
- good motivation and service-orientation

- Cons: - accountability problem
- irregular time availability
- requires greater coordination
- higher rate of turnover

### E.3.6. Recommendations

Based on the analysis of the situation in Ecuador at this time, and evidence on small business technical assistance services elsewhere, we recommend a combination of program options (1) and (3). The most effective and efficient approach to technical assistance combines training and group discussions with follow-up visits to individual businesses. The provision of this assistance should be decentralized, with one or more persons located in each provincial Chamber or in some other local intermediary organization. In working with entrepreneurs, advisors should apply learner-centered methodologies in which the entrepreneurs solve their own problems to the extent possible. In addition to these persons who are more or less generalists, several other persons in each province, perhaps specialized in different areas, should be selected and oriented to become part of the technical assistance "cadre."

In localities where there are women entrepreneurs, the technical advisor should encourage their greater participation in local associations, and promote services which more closely meet their needs. For new women entrepreneurs, the advisor should promote the development of activities which are not traditionally associated with women, e.g. carpentry, block-making, etc.

#### E.4. Training and Education

By training, we are referring to activities oriented to relatively specific tasks of workers and managers, which are carried out in groups, with a fixed schedule and length, and tending to have a predetermined curriculum. Training includes both courses for managers and for workers. Education refers to more general, less specific occupation oriented teaching. Vocational schools tend to fall more or less between these two broad categories.

##### E.4.1. Needs

Training is a useful means of upgrading skills and like technical assistance it can improve business sometimes significantly. In our survey of small industrialists in Quito and Guayaquil, 43 of 200 mentioned training as one of the 3 most wanted services for improving their business. The apparently lower demand for training vis-a-vis technical assistance (mentioned by about twice as many entrepreneurs) reflects in part a preference for a form of help which responds more directly to the specific situation. We suspect that this may also be due to the businessman's discomfort with the frequently didactic style of training generally available.

The main areas of training desired by entrepreneurs for themselves and their workers are:

##### For Managers:

- management techniques
- cost analysis
- market research
- marketing
- credit procedures and management
- supervision
- inventory control
- production management (industry specific)
- importing & exporting

##### For Workers:

- trade skills

Formal training for workers and managers, as practiced by SECAP and others in Ecuador, is more effective in the upper size range of the small business sector. Other forms of training are needed to better serve the smaller businesses. There is a special need for training that will encourage more active participation of women entrepreneurs. The content and the process of such training should be characterized by:

##### Content of Training:

- simplified systems (accounting, etc.)
- use of simplified terminology
- practical topics with concrete small enterprise examples
- relevant and specialized (as opposed to broad topics)

Process:

- participant involvement in course design, whenever possible
- use of adult education techniques, such as role-playing, story telling, drama, group discussions
- participatory training
- practical exercises based upon own business activity
- short duration courses with follow-up
- evaluation of course effectiveness every 3 to 6 months

#### E.4.2 Existing Services and Gaps

Training is at present concentrated in a few agencies. For the small enterprise sector, SECAP and CENAPIA do the bulk of the training. FED-PRODEM and Fundacion Espejo-PROCREDEM provide training for micro-enterprises in Quito and Guayaquil, while CEFE trains managers of medium and large enterprises and AID is embarking on a new effort in management training. SECAP's statistical report for 1984 indicates that 36,054 persons were trained in 1,688 courses (sometimes the same person may be trained in several courses, so the number of persons receiving one or more courses is not known). It appears that little of this training reached the smaller businesses, as confirmed by our survey of small manufacturers which indicates that only 19% of the respondents had received services from SECAP. We suspect that an even lower proportion of small businesses outside of Quito and Guayaquil have received SECAP training. Also a common complaint of small industrialists is that the skills training of SECAP is not appropriate to their technological level. It should be noted, however, that SECAP does provide courses for artisans preparing for the "master artisan" exams.

FED-PRODEM has provided short courses in accounting, project planning, marketing, and quality control to micro entrepreneurs in Quito, while the Fundacion Espejo-PROCREDEM had provided those same courses plus skills training for florists, silks-screening, tailoring, woodfinishing, and electric soldering to 158 persons in Guayaquil. Staff of these programs have indicated that there is a large unmet demand for training of these sorts at the micro-enterprise level.

More generally, it appears that there are important gaps in the available training for micro-entrepreneurs, particularly in secondary cities. There is too little training which could enable artisans to increase their productivity. And too little training takes the non-traditional forms which are appropriate for most small enterprises.

The process of formal education, and especially higher education also seems to be seriously inconsistent with the needs of the Ecuadorean economy at this time, and in particular those of small enterprise.

Ecuador's educational system has grown dramatically over the last 15-20 years. At the secondary level, enrollment rose by about 11% per year over the 1967-1968 to 1982-1983 period and at the higher level, by 19% per year. The resulting outpouring of graduates from higher education is almost without parallel. Adding to the problem is the high share of university students who have studied humanities and other less "salable" skills.

A mismatch between the output of higher education graduates and the demand for their services would have occurred even had the fast growth of the large scale and public sectors of the

economy which characterized the oil boom period continued. But it is now being magnified by the dramatic slow-down of employment creation in those sectors. Employment growth for some time to come will of necessity be concentrated in the small scale sector. The task of matching high aspiration graduates with jobs in small, labor intensive activities will be daunting. Graduates of higher education, and even of secondary, expect formal sector jobs.

What Ecuador needs for a satisfactory level of job creation over the next decade, is a flourishing of productive entrepreneurship. The educational system, including higher education, could better contribute to such a flourishing were it less didactic and more oriented towards problem solving. Graduates more open to participation in a range of activities not traditionally classified as high status ones and less inclined to overestimate the practical value of the knowledge the system has given them would be better suited to needs.

Vocational schools suffer the same tendency as the rest of the system to be didactic and non-problem solving. Recent initiatives demonstrate the potential of a more modern, problem solving and student centered approach.

#### E.4.3. Strategy Options

The present training system is inadequate both in its reach and in the skills of the trainers in its integration with technical assistance and credit, and in its contribution to encouraging continuing business growth from the micro to medium scale. Both quality, in the senses just mentioned, and quantity of training services need to be improved. If the quality improvements cannot be achieved, the agreement for increased coverage would be much diminished, of course.

Such improvements would entail upgrading of the training skills of the existing trainers and would justify identification and training of additional persons. Some of these could be drawn from the technical assistance "cadre." Experience has shown that to be effective, trainers need skills in non-formal education, adult education, and group problem solving. Such a transfer of personnel would further raise the priority on identifying and developing more people with skills in technical assistance.

To achieve the desired fit between the training needs of managers and workers and the offering of institutions, a mechanism is needed whereby the needs are communicated to the purveyors of the training, and appropriate programs emerge from a process of consultation.

In order to encourage and prepare more students from the universities to enter small enterprise, courses particularly focussed on management and analysis of small business need to be added to the curriculum. Universities we talked with expressed interest in developing such courses, but indicated that they would need additional resources in order to be able to do so. Our feeling is that current programs do not respond to the realities of the job market for graduates in Ecuador and that some re-allocation of existing resources should be made to better align with it.

#### E.4.4. Program Options in Training Activities

To improve and expand the training available to small enterprises, three types of options should be distinguished.

1. Working with existing programs, upgrading and possibly adding staff.

- Pros:
- takes advantage of the existing infrastructure
  - experience with small enterprise and training
  - already known

- Cons:
- set in their ways
  - system does not encourage flexible response to needs
  - unlikely to provide very effective training unless substantially improved
  - little or no follow-up at present

2. Creation of new training agencies

Centralized:

- Pros:
- economies of scale (efficiency in coordination, lower training costs)
  - better access to public and international resources
  - easier to introduce new techniques

- Cons:
- less responsive to local needs
  - turnover likely to be higher due to the heavy demands of the job
  - slow start-up

Decentralized:

- Pros:
- local, responds to specific needs
  - feedback is available
  - lower travel costs and time savings
  - lower staff turnover
  - easier to introduce new techniques

- Cons:
- complicated to set up and manage as a system
  - few economies of scale

3. Combine training and technical assistance

- Pros:
- efficiency of overall assistance system
  - increased effectiveness of training

- Cons:
- need to achieve much better integration of these services than now exists, may be difficult

Regardless of which of the above options (which are not mutually exclusive) were followed, a consultative process involving small enterprise, the training institutions and possibly a brokering institution would be either essential or very important to the success of the program. Hopefully, the recently announced provincial Consejos Consultivos will fulfill this function.

Finance options for these programs could follow along the lines discussed in the technical assistance section above.

#### E.4.5. Recommendations

Any management training for small entrepreneurs should be combined with some sort of follow-up in the participant's business to ensure proper applicability of new material. The need for training should be determined locally and training be provided that is particularly relevant to that local need. This would imply that the local advisor should coordinate the training courses and work with any trainers in developing course materials. These trainers can be drawn from SECAP, CENAPIA, or other private companies or individuals.

Existing worker skills training services (SECAP, CENAPIA) should be improved and expanded to reach more small industry workers, especially in secondary cities. This will entail designing courses more appropriate to small industry; extending them to secondary cities can be done by using a local plant in off-hours as a training site. The skills training of various private voluntary organizations should also be supported because they reach more marginal populations, both urban and rural.

Consideration should be given to the possibility of developing a small enterprise management training program in CEFE. Such a program might be modelled along the lines of that currently operated by the Asociacion Panamena de Ejecutivos de Empresa which, like CEFE, focussed originally on management training appropriate to medium and large firms but which seems to have successfully adapted its program to the needs of small entrepreneurs. The program includes a technical assistance component and guaranteed access to bank credit.

Consideration should also be given to a university small enterprise program, perhaps along the lines of those functioning in several Philippine universities, involving a curriculum on small business, related research and as a by-product if nothing else, technical assistance services. One expected product would be an increase in the number of small businesspersons.

Vocational training needs a major revamping in approach to achieve the sort of well trained, versatile graduate which should be its goal. The learning setting should challenge the student, in developing his/her manual and problem solving skills. The curriculum could also be oriented more towards training in the small enterprise setting.

Creation of new training or educational agencies is not recommended, given the already developed infrastructure and the experience of existing institutions. With respect to the current training system, the success of the new Consejos Consultivos will be pivotal to the needed improvement. If they are not properly constituted or do not function effectively, a change will be needed in this area.

## E.5. Information and Research

### E.5.1 Needs

For the potential of small enterprise to be achieved in Ecuador, more information and research is needed, as is a mechanism through which to disseminate them. In two principal areas information and research should be increased: at the microeconomic level, to aid small business owners, and at the macroeconomic level, to facilitate government policy-making.

Adequate information is essential to the improved operation of small businesses. It facilitates decision-making, helps entrepreneurs adjust to changing conditions, and can lead to technological innovations and increased productivity. Our surveys (and those of INCOJTEC) revealed much desire for assistance in production and marketing, and suggested a special need for more information in these areas. Specifically there is a need for more information about local and regional markets, national market trends, and about technologies which have proven effective and efficient in small-scale industry. Information on credit, technical assistance and training programs as well as on legal requirements and rights is also important to many firms.

Adequate information is also essential for the government as it chooses policies to aid the small enterprise sector. There is a general shortage of macroeconomic data for Ecuador and a specific lack of information on aspects relevant to the small-scale sector such as labor markets and financing problems. Among the unknowns at this time are how extensive employment is, whether the incomes of poor urban groups have risen or fallen, or who buys or might buy the products of small industry. Discontinuance of the publication of INEC's monthly survey of employment and wages in 1981, because it was felt to be unreliable, is symptomatic of the problem.

Information on the industrial sector suffers more from obsolescence than from non-existence. INEC's Annual Survey of Manufacturing and Mining is currently (May, 1985) available only through 1980; as a result there are no systematic data on trends in manufacturing employment, output or investment for the whole of the period of economic crisis beginning in 1982. Rough output and employment figures for large-scale manufacturing are available on a reasonably current basis, but not for smaller firms. With information four or five years out of date, it is impossible for policy framers to take due account of recent trends and patterns. Though considerable research has been done on artisanry and to a lesser degree on some other types of small enterprises, there has been virtually no detailed work on the implications of trade policy or other elements of macroeconomic policy on the small scale sector. Recently the MICEI and the University of Boston carried out an analysis of the levels of protection and of efficiency in three different branches of manufacturing; appropriately extended, this study could throw

some light on the effect of current and future tariff systems upon small industry. There appears to be no detailed studies on how monetary contractions, creation of new financial assets, or interest rate policy in general are likely to impact small enterprise. All of these lacunae are potentially costly.

For information to be useful it must be disseminated. A good deal of research has been produced by public and private agencies and by the universities; some of it has been relevant or potentially useful to small business sub-sectors or macro policy-makers but has not reached them. Mechanisms for dissemination of information to end-users are limited and require special attention.

Finally, information does not pay off unless the potential user recognizes its value. Technical assistance makes business people more aware of what information could be useful to them. Training on what is useful and how to seek it out may also be worthwhile since, the above mentioned gaps notwithstanding, there is a considerable amount of relevant and useful information available.

### E.5.2 Existing Services and Gaps

The principal sources of information for small enterprises are CENAPIA and INSOTEC. Both have undertaken several studies on markets and technologies for specific industries, and have identified small scale industries which appear to have growth potential because they could complement existing branches of manufacturing. However, these studies tend to be too sophisticated for the average small business person to take advantage of them.

In addition, numerous other entities have done research. CONADE and the Instituto Latinoamericano de Investigaciones Sociales (ILDIS) have prepared excellent documents pertaining to artisanry, small industry and informal sector workers. The ILDIS material especially has been prepared in a very readable fashion and has been disseminated more widely. There is a great deal to be learned from the simple and direct way in which they present a particular topic.

For years, CENDES has prepared pre-feasibility and feasibility studies, particularly for those industries allocated to Ecuador under the Andean Pact. However, its work caters to medium and large industries, and dissemination has been limited. Institutions such as CEBCA and INEN have undertaken some investigations in the past and have the capability of offering more in the area of technology.

Universities and Politechnical Schools have produced a considerable body of research in Ecuador. Economic, business and engineering studies, financed through grants from the Consejo Nacional de Universidades y Escuelas Politecnicas or from public entities such as CONACYT, have been numerous but have usually lacked direct applicability to small enterprise. There is a need for investigations and bulletins which are more practical and more region specific. Abstracts of existing studies by CENAPIA, CENDES, INSOTEC, MICEI and the Universities need to be disseminated to Camaras, associations, nucleos and private voluntary organizations throughout the country.

In the area of macroeconomic information, INEC is the principal source. However, lack of resources and of certain types of technical capacities have prevented it from collecting and publishing new data on a regular basis.

### E.5.3. Strategy Options

In general, Ecuador needs an expanded and up-to-date system of information for small business. The following suggestions could increase the available "data-base":

1. Information could be gathered at the local level through the Camaras, associations and nucleos as a counterpart to INEC data.
  - Pros: - this would upgrade the representational, function by substantiating the institutions' policy proposals
  - the resulting information would reflect local needs
  - Cons: - would be difficult to implement due to local organization's inexperience in dealing with statistics
2. Research departments of government agencies such as CENAPIA, CONADE and INEC could be expanded.
  - Pros: - they already have staff with knowledge of and experience with small enterprise sector
  - they have access to relevant statistical data
  - Cons: - most of these institutions have shown limited skills in the areas of research and dissemination
  - reports written are difficult for the average small business person
  - bureaucracy can slow or limit field research and delay publication of reports
3. Contracts could be expanded or increased to local private agencies, such as INSOTEC, ILDIS and the Universities for studies pertaining to the small enterprise sector.
  - Pros: - many of these institutions have demonstrated their research skills
  - involves less bureaucracy than the preceding alternative
  - can draw on experience of practicing engineers
  - Cons: - most institutions have not shown high skills in this area.
4. The capacity of the statistical office (INEC) could be enhanced with better funding and organization, as necessary, to enable it to produce promptly and continuously the statistics necessary for a better understanding of basic patterns and trends in the small enterprise sector and in the labor market. The key needs are:

- (i) the publication of the Annual Survey of Manufacturing and Mining with less delay than at present.
  - (ii) the development of periodic labor market surveys designed both to gauge developments in that market and to provide a direct window onto the very small enterprise sectors, micro-enterprises, artisanry, etc.
5. Several means to disseminate information, should be considered in order to strengthen the link between the producers of information and the end users:
- (i) Creation of a central information agency for the small enterprise sector.
  - (ii) Establishment of a quality periodical given special (or complete) emphasis to small enterprise; this could be along the lines of INSOTEC's publication, SUMA.
  - (iii) Establishment of documentation centers in the Camaras, associations of local private agencies.
  - (iv) Distribution of bulletins, reprints, abstracts, and newsletters to all small industries or members of local organizations, perhaps with assistance from ILDIS.
  - (v) Utilization of mass media (radio, newspapers) to disseminate information on markets, legal issues and others.
  - (vi) Allocation of Consejo Nacional annual research grants for studies pertaining to the small business sector. The results of these could then be disseminated once a year in a seminar with small enterprise sector representatives.
  - (vii) Distribution of relevant technological information through CENDES (and its SITE program), CEBCA and CONACYT.
6. Attention would be given to training managers in awareness of what information would be useful to them and in how to seek it out.

#### E.5.4 Recommendations

INEC should be strengthened to permit it to provide expeditiously the statistics needed to monitor the evolution of small enterprise and to better analyze its problems and characteristics. Options (1) and (3) to increase information and study of the sector should all be considered seriously; we are inclined to believe option (3), contracts with selected private agencies, holds the most promise, for most types of study but no option should be foreclosed. Research by public and private agencies and universities should be encouraged. One such channel, clearly, would be with respect to dissemination. Given the expense, the limited track record of the model, and the lack of experience of businesses in using information for decision-making, a centralized information agency is not recommended. Each of options 5 (ii) through 5 (vii) should be pursued however. To order priorities and give coherence to the system. It is suggested that an information officer be hired for a 6-12 month period to identify current and potential information sources which could serve the small enterprise sector and means to channel the information accrued.

Training programs for managers and intermediation services of the Camaras, etc. should include some attention to development of the capacity to search out relevant information.

## E.6 JOINT MECHANISMS

### E.6.1 Needs

There are examples of joint mechanisms in at least four areas:

1. bulk purchasing
2. marketing schemes
3. common service facilities
4. financial services

Bulk purchasing schemes. When businesses undertake joint purchases of raw materials or inventory needed for their respective businesses. Usually organized by sector of production, formally or informally, they help address common input supply problems and thereby cut costs. Cost savings are attained through purchasing in large quantities. Although there are numerous examples in Ecuador, there seem still to be untapped opportunities, even in the large Chambers and Associations.

Marketing schemes - when owners producing similar products distribute them jointly. This can be done through a cooperatively owned retail outlet, through organization of fairs and expositions, or merely by filling large orders from distributors jointly.

Common service facilities - when similar businesses join to undertake activities which will rationalize their operations. Examples are raw material processing plants used by a group of businesses, joint facilities for production or for storage, joint transportation, or joint office services (accounting, typing, etc.).

Financial services - when businesses address their financial needs, jointly, such as with savings and loan cooperatives, credit guarantee corporations, life insurance companies, or emergency or funeral cost funds.

A variety of efforts to purchase supplies or to market products jointly in Ecuador have come to our attention. Unfortunately, neither information on the degree to which such joint mechanisms exist nor on the degree to which they are needed or desired is available. The mere fact that efforts exist, however, is usually indicative of a need. Experience from other countries has shown certain joint mechanisms to be an important means to increasing business profitability. In the garment industry in the Philippines, for example, savings of more than 25% in the cost of raw materials could be achieved by small businesses through bulk purchasing.

The most developed joint mechanism in Ecuador involves financial services, where savings and loan co-operatives play a significant role and other institutions exist or are getting started.

Experience in Ecuador in promoting the development and implementation of joint mechanisms is limited, however. Interest expressed in these mechanisms by entrepreneurs suggests the need for greater technical and possibly financial support, particularly for common service facilities. The potential for savings by group action is often inadequate by itself to lead to group action; some institutional dynamic is often essential.

### E.6.2 Existing Services and Gaps

Although we were unable to develop a complete and detailed picture of existing joint mechanisms, we heard of a number of such activities from entrepreneurs in different parts of the country, including:

- the Quito Exposition Center for small industry
- Productos Andinos and OCEPA for marketing and artisan products
- the artisan market center in Guayaquil
- common facilities for artisan producers in various cities
- consideration by the Azuay small industrialists' chamber of the establishment of a discount store for consumer goods
- small business savings and loan cooperatives in Pichincha, Azuay and Chimborazo
- life insurance for members of the Pichincha small industrialists' chamber

Despite the existence of such efforts, there is no established program for assisting the development of joint mechanisms. This we consider to be an important gap in the current small business service map of Ecuador.

### E.6.3 Strategy Options

Experience has shown that joint mechanisms developed by their users tend to be stable and effective. Initial orientation is all that is needed to facilitate their development. Such orientation could be effected through several channels:

1. A two person team specialized in joint mechanisms which would visit the camaras, associations, and nucleos introducing various models and discussing their utility.
  - Pros: - efficient at reaching whole groups directly
  - does not impose any particular model, encourages local initiative
  - Cons: - higher cost
  - could duplicate local efforts
  - could create unrealistic expectations
2. Seminars in joint mechanisms for representatives from the camaras, associations and nucleos. These would be conducted regionally or nationally.
  - Pros: - can reach more groups more quickly
  - people from different groups can meet and discuss ideas
  - low cost per group reached
  - Cons: - fewer people from each group participate directly
3. An orientation seminar for small business advisors.
  - Pros: - can provide on-going support
  - could be low cost
  - could ultimately reach more groups through a multiplier effect
  - Cons: - information might not be transferred on to small business persons
  - if advisor is "resident" with the group it could result in too much reliance on the advisor to implement ideas for the group
  - could inappropriately impose models

#### E.6.4. Recommendations

It is expected that these orientation options would not involve a major cash outlay. This activity could be financed through a small grant, fees of participants, or by using volunteers and would involve a combination of the above three options. One or more persons could be hired on a short-term basis to visit particular camaras and associations and lead an orientation seminar or organize regional ones. These seminars might include local business advisors, who could later provide follow-up support as needed.

Through the magnitude of potential benefits in this area is obviously hard to judge, they could be very high in relation to modest outlays.

## F. Overall Sector Strategy

### F.1 Introduction

The basic objective of the proposed strategy for promotion of the small enterprise sector in Ecuador is to permit and induce that sector to make its maximum possible contribution to national development -- to growth of the economy, to employment creation and to the raising of living standards. Because many activities within small enterprise are contributing or have the capacity to contribute effectively towards these goals, we believe the sector deserves support to permit it to continue doing its job and to encourage new entrepreneurs to engage in such activities.

But as with all sectors, it is also important to raise small enterprise productivity. For some small firms this may not involve growth in either capital or labor used, but only increased productivity through better technology, better management or more skilled workers. In other cases, the firm's greatest contribution involves its growth in inputs as well as output, so it is important to facilitate and encourage this process.

The report has reviewed how the small enterprise sector's contribution to development may be improved by 1) economic policies in monetary, tariff, labor market and other areas which take into account their impact on the small enterprise sector's performance and 2) a range of services (technical assistance, credit, training, etc.) which can raise firm level productivity.

For small enterprise's concerns and needs to be adequately reflected in either the design and performance of service systems or in the broader economic policy making process, we believe it is essential that sector representation be strengthened.

Improvement in the quality of economic policy involves a better understanding of the structure and functioning of the economy and, in the present context, a better understanding by decision makers of how small enterprise fits into the system and under what conditions it functions best. At present its concerns tend to be given little weight both because of its under-representation in the political process and because of a lack of understanding of its actual and potential economic contribution. It is important that the sector's influence on policy making be increased and its professional capacity to participate in technical discussions as well as articulate its needs be expanded.

## F.2 Macroeconomic, Trade, and Labor Market Policy

The best service delivery system for the small enterprise sector is unlikely to yield positive results if overall economic policy is prejudicial to it. The key elements of an economic policy package which would complement a strong service program are:

1. A balanced trade policy which avoids negative rates of effective protection on the goods produced by small industry, avoids unduly sudden changes in the level of protection, and facilitates the export activities of this sector.

2. A monetary policy which does not victimize this sector in times of overall credit contraction, recognizing that its share of total credit is so small as to have no real significance in the rate of money growth or the level of aggregate demand, and that the output and employment losses per sucre (of credit contraction) would be much greater than in other sectors. The likelihood that the small enterprise sector will be taken appropriately into account in the formulation of monetary policy would be greatly enhanced by formal representation on the Junta Monetaria.

3. An adequate allocation of government expenditures which likewise recognized the low budgetary cost of achieving an efficient system of services for small enterprise, provided that the system is well planned and user oriented. While we have not attempted to cost out a competent technical assistance apparatus with adequate coverage in Ecuador, it is safe to say that it would not loom large in the public budget, while achieving a very high benefit cost ratio.

4. A balanced labor market policy which accepts the reality both of labor aspirations and of limits on what can be attained, tries to provide a setting of stability by avoiding sharp changes in the real minimum wage in either direction, focuses on new directions which could benefit both labor and business (a number of possibilities were cited in Section D.1, and works gradually toward a system in which labor and business issues can be discussed in a context of information, understanding, and perhaps eventually even some mutual respect.

While as discussed in greater detail in Section D, some important ways in which overall economic policy should take account of possible effects on the small enterprise sector can be outlined on the basis of existing evidence, there are many other policy issues and contexts in which understanding is seriously deficient. Until this is rectified, there remains a great risk that serious errors will be made inadvertently, and will tend to reduce the benefits of improvements as are achieved on the service provision front.

At an institutional level, the strategy outlined here involves a related strengthening of the representational capacity of the small enterprise sector and of the institutions involved in providing services to it.

### F.3 Representational Networks

The networks of representational organizations in the small industry, artisan and small merchant sectors make up the institutional core of the proposed integrated structure. These organizations can perform two critical roles in the overall strategy: they can increase the beneficiaries' influence on policy decisions and on the behavior of public sector institutions intended to serve them; and they can both provide services directly to entrepreneurs and serve as brokers and facilitators for services available from private and public sector institutions. The networks' capacity to carry out these functions can be assisted in a number of ways.

### F.3.1 Organizational Support

The positive experience derived from the support provided to the small industry network and to FENAPI through INSOTEC and through the Creative Associates program can serve as a guideline for similar initiatives directed at the artisan and small merchants networks. Such programs ought to emphasize organizational and motivational training among national and local network leaders and active members, with a focus on developing the service delivery capabilities of the organizations.

Support for the artisan's network must focus on activities which encourage higher productivity, greater efficiency and growth. A major objective is to encourage the move from artisan operations to small industrial enterprises. For this purpose greater contact and common activities with the small industry network are to be encouraged.

The small merchants' network despite its numerical importance seems less critical to an overall sectoral strategy. However this sector's potential for improving the marketing capabilities of both the artisan and small industrial enterprises is one area which deserves special attention and additional study.

### F.3.2 Strengthening service delivery capabilities

We believe that increasing the ability of local and national organizations to deliver critical services to their current and potential membership is the most effective approach to building strong representational networks.

In Section E.1 above, we noted that the local Camaras, Asociaciones and Nucleos appear to be the most appropriate location from which to access and broker the key service needs of the small entrepreneur. The "service function" activities, supported by counterpart functions at the national federation level, should thus include:

- \* Information on policy, legal matters, markets, supplies and technology issues,
- \* Brokering technical and management assistance and training from private and public institutions,
- \* Assisting with credit access, through autonomous institutions such as Cooperatives and Credit Guarantee Corporations, and through references and other assistance,
- \* Facilitating joint services such as bulk purchasing schemes, shared production facilities, storage and transportation.

The specific activities as well as the human and material resources to be assigned to these activities will vary depending on local needs and on the degree of organizational development of each local Camara, Asociacion or Nucleo.

Through this "Service Function" within the representational system, an individual entrepreneur or a group is able to interface with the private and public institutions which provide the services needed. In the larger Camaras this function is already established and operating although not always at levels adequate to the needs of the local membership. In the smaller organizations the function either does not exist or is limited by a lack of adequate resources.

Initially, in most cases, the Service Function will have to be subsidized. The key missing resources are salaries and training for technical and professional staff. The experience of the larger Camaras suggests that once the service mechanisms are operational various fee schemes can gradually reduce the need for outside subsidies. In principle each service contemplated can generate user income to become self financed. In addition, increased service delivery capabilities are expected to increase overall membership and fees.

#### F.4 Service/Intermediary Organizations

The archetypal private resources organization for the small enterprise sector in Ecuador is the Instituto de Investigaciones Socioeconomicas, INSOTEC, whose relationship with the small industry network is a unique model worth supporting and perhaps replicating.

INSOTEC has provided a range of services for the sector:

1. Organizational and motivational training for network leaders and active members. INSOTEC personnel have helped organize and plan activities for small and large Camaras. They have provided organizational assistance to FENAPI.
2. Assistance to FENAPI in its representational functions, through organizing public events for policy and opinion makers and providing the technical assistance to develop policy alternatives for the sector.
3. Technical assistance and training on an "industrial extension" model aimed at groups of entrepreneurs with common problems on a region and sector specific basis, including assistance on management, production and marketing issues.
4. Research and information assistance, developing training manuals, special sectoral and region specific studies and policy recommendations, bulletins and technology publications for individual Camaras and for the network.
5. Brokering of specific services for the sector from public institutions such as FOPINAR, CENAPIA, and SECAP among others, functioning in effect as an intermediary between the representational groups and the public sector.
6. Assistance to individual Camaras and FENAPI in developing projects and obtaining outside (public and external) financing. In this area it also provides technical assistance for the implementation of these projects and has participated in their evaluation.

INSOTEC's activities constitute an unusually valuable combination as a complement and an aid to the activities of the Camara networks and as an important resource institution in developing the "Service Function" we have outlined above. In these activities it is not alone. As detailed in our Institutional Profiles (Institutional Background Paper), certain non-governmental organizations working with the micro enterprise sector combine the functions of both representational institutions and service or resource organizations. The FED/PRODEM and the Fundacion Espejo/PROCREDEM programs are two examples of this hybrid institution. Although they are not "membership" or "guild" type institutions they in fact lobby for and in some sense represent the micro entrepreneurs of the neighborhoods in which they operate. Similarly, while they are not strictly speaking "service/resource" institutions they deliver such services to their "constituencies".

These hybrid institutions can and ought to be supported along similar lines as the Camaras and Asociaciones networks, particularly where the latter are least active at the micro enterprise level.

We see these resource/intermediary institutions playing an important role in the implementation of a number of recommendations included in Section E, e.g. in

- (i) . Disseminating and extending of AITEC model credit programs.
- (ii) Identifying and training the cadre for the "Service Function".
- (iii) Developing plans for the "Service Function" in each of the Camaras/Asociaciones/Nucleos.
- (iv) Interfacing with public institutions to encourage more user oriented programs in technical assistance, credit training, information and research.
- (v) Project development, supervision and evaluation of decentralized assistance projects financed by international institutions.
- (vi) Undertaking research and information projects on the small industry, artisan and micro enterprise sectors.
- (vii) Developing information centers in the Camaras and Asociaciones.

These institutions have developed the capacity to organize special project teams combining their in-house staff with outside consultants in cost efficient project teams.

## F.5 Credit Availability, Access and Assistance

The two services of greatest importance to small enterprise, in our judgment, are technical assistance and credit, though in the latter case a serious gap between needs and availability appears to exist only at the lower end of the size spectrum and in secondary (or smaller) cities.

A strategy to address the credit needs of the small enterprise sector should have three components: 1) increasing the availability of credit institutions, 2) improving the borrowers' ability to access the credit available and the lender's efficiency in providing it, and 3) assuring that the interest rates are not so far from scarcity levels as to diminish supply, encourage diversion, etc.

We envision the preparation of a set of detailed recommendations for the monetary authorities through a joint effort of FENAPI, FENACOMI, JNDA, private organizations such as FED and Fundacion Espejo, the FECOAC credit cooperatives network and individual credit cooperatives. The ability of these organizations to come up with a joint proposal is likely to be key to the proposal's success.

Credit availability is especially relevant for the smallest enterprises. The absolute amount of credit going to this range of firms is so small in relation to the total credit flows in the financial system that it should be allowed to increase as much as legitimate demand indicates. Achievement of this objective will depend mainly on the lobbying influence of the credit user organizations, that is to say on the representational networks discussed above, on government support, and on the cooperation of the private and public credit institutions working with this sector.

The existing Fondos Financieros and FOPINAR discount mechanisms are appropriate for channelling credit to the more established firms within the sector but they do not reach the very small borrower. One way to extend their reach would be to make these mechanisms available to the Cooperativas de Ahorro y Credito.

Subsidized credit has serious disadvantages in Ecuador. It has occurred mainly in the context of large commercial and industrial concerns, both private and public, whose social and economic contributions are of debatable value. Furthermore, rescue operations for the many large enterprises which have not been able to overcome their serious financial problems could absorb many times more funds than all the combined needs of the small enterprise sector. Small enterprise would fare best under unsubsidized interest rates, and the overall allocation of credit would be more efficient.

### Access to available credit

The small borrowers' access to available credit ought to be improved through technical assistance and training to be provided by the representational organizations, the "Service/Intermediary" organizations and the autonomous credit institutions. Several

initiatives already exist: INSOTEC is developing a "Small borrowers' credit manual", FED and Fundacion Espejo are assisting micro entrepreneurs to graduate to mainstream credit lines and the savings and loan cooperatives have similar services. Informal coordination and exchange of experiences around this issue ought to be supported.

In part the problems of credit diversion and other lending "irregularities" can be traced to subsidized and sometimes negative interest rates. But there is also a need for greater supervision and control of lenders and borrowers. Training will address some of these problems. Greater overall availability of credit at market rates will also help. But more effective enforcement will also be required. And it should be applied to all borrowers large and small.

There is a need to simplify and modernize the Banco Nacional de Fomento loan application and processing methods and regulations. To some extent this process is underway, albeit at a very slow pace. A review and simplification of the loan application processes and the guarantee requirements for small borrowers is needed. The recommendation to create a Sub Gerencia for small industry and artisanry ought to be given serious consideration.

### F.5.1 Autonomous Credit Institutions

We believe that the most promising though not the only component of a solid strategy aimed at increasing credit flows to small and micro borrowers is to strengthen private independent credit institutions, specifically: 1) Individual Savings and Loans Cooperatives and their national Federation (FECOAC), 2) the emerging Credit Guarantee Corporations System, and 3) existing and new AITEC-type micro enterprise credit programs.

#### F.5.1.1 Savings and Loan Cooperatives

Capitalization. There are at least two mechanisms through which to contribute to the capitalization of savings and loan cooperatives: the Banco de Cooperativas and the Federacion de Cooperativas de Ahorro y Credito (FECOAC). FECOAC has structured its operation so as to permit loans to individual cooperatives for specific lines of credit. Capitalization could be aimed at very small enterprises, small industry or artisan operations. These two mechanisms can also be used to help capitalize new cooperatives.

Technical assistance to new cooperatives. FECOAC and the Cooperativas de Ahorro y Credito de la Pequena Industria in Pichincha and Azuay can provide technical assistance to guide efforts to organize new cooperatives around specific subsectoral activities, trade associations, Camaras, Asociaciones and Nucleos. But this organizational assistance would initially need outside financing.

Legal and policy issues. Finally there is a need for legal, technical and lobbying assistance to address unresolved issues of administration and control among the Savings and Loan Cooperatives, their Federation, the Superintendencia de Bancos and the Central Bank. The accountability of the Cooperatives needs to be established under the supervision of the Superintendencia de Bancos; this achieved, they should have access to the re-discount mechanisms of the Central Bank.

#### F.5.1.2 Credit Guarantee Corporations (CGC)

After a long gestation period the legal framework for the establishment of credit guarantee corporations within a public/private system is now in place and the first CGC has been formed in association with the Camara de Pequeños Industriales de Pichincha.

The GCG system is a mechanism for sharing lenders' risks, by combining a closely monitored technical assistance function to be borrower with an insurance mechanism through a mixed public/private Corporacion de Retrogarantia.

Outside support for the system has taken or could take the following forms:

(i) contributions to the capitalization of the Corporacion de Retrogarantia, undertaken thus far by the Banco Central de Ecuador and the Banco Nacional de Fomento, to be possibly joined by a small consortium of private banks.

(ii) support for the capitalizataion of selected CGC's deemed to have greatest potential and/or others as pilot projects in more difficult environments.

(iii) collaboration with the Konrad Adenauer Foundation in their well established technical assistance program to help the organization of new CGC's, promote the concept and conduct motivational seminars in cooperation with representational organizations.

### F.5.1.3. Credit Associations for Micro Entrepreneurs

The AITEC type credit mechanisms for micro entrepreneurs have demonstrated capabilities to deliver credit to borrowers normally dependent on street credit. The system has a number of positive secondary effects in terms of social organization, cohesiveness of the sector and mutual support structures. While the system may encounter liquidity problems due to the currently higher level of inflation, the approach and particularly its organizational aspects remain essentially sound.

Outside intervention could support this credit deliver system by:

(i) contributing to the recapitalization of the Quito and Guayaquil programs.

(ii) evaluating the FED/ICRW women's project for possible application to other programs.

(iii) supporting pilot expansion of the AITEC model to secondary cities.

(iv) simultaneously with (iii), supporting the evaluation of the Quito and Guayaquil programs to identify appropriate modifications in new pilot efforts.

(v) exploring the use of FENACOMI and Artisan organization networks to promote the AITEC type credit systems in those sub-sectors.

## F.6. Technical Assistance

There is at present less evidence of important initiatives towards closing the needs-availability gap for technical assistance than in the case of credit. Accordingly it is not possible to point to many developments which clearly deserve support. The first major step towards improving and expanding both technical assistance and training programs should involve a quickening of the intermediation function of the Camaras and other representational agencies, to generate a consultation process between users and suppliers of technical assistance. Out of such consultations should emerge concrete suggestions to move towards a relatively decentralized system with training, group discussions and follow-up visits. Existing activities of CENAPIA, INSOTEC and other agencies will provide take-off points for some activities of a quality system, but the task of improving its orientation, quality and coverage will be a large one. Its importance, however, places a premium on an early and vigorous attack on it.

#### F.7. Support for Women's Small Enterprise Activities

Much of the appropriate support for women's involvement in small enterprise should be channelled through the regular service programs. This will be better achieved if female participation in the representational agencies rises.

There remained, however, the possibility that in certain contexts, special programs for women can play a valuable role. Several current initiatives warrant attention and ongoing evaluation to see if they provide models for larger programs. These include:

1. The income-generating project which Church promoted womens groups have discussed with the Episcopal Conference's social arm, Promocion Humana, and for which Catholic Relief Services, an international voluntary organization, is hiring a consulting team to help plan details. The project would include a major credit and technical assistance program. Since there are over 500 of these women's groups in Ecuador, the potential for expansion is great, should the project prove to be a good model.

2. The Instituto Nacional del Nino y la Familia, a private agency which has received substantial multilateral funds from UNICEF, and part of whose funds have been used to foster income generating activities for women and the new women in business program of the Comision Interamericana de la Mujer (CIM) and the Overseas Education Fund. The regional focus of both programs has been in the Guayaquil area.

3. The FED/PRODEM and Fundacion Espejo PROCREDEM programs, while not designed exclusively for women, actively encourage their participation in their programs. The former has a full time staff person funded by AID through the International Center for Research on Women, seeking out new women borrowers and designing workshops.

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