

**SMALL AND MICRO-ENTERPRISES:
CONTRIBUTIONS TO DEVELOPMENT AND
FUTURE DIRECTIONS FOR AID'S SUPPORT**

Prepared by:

Robert G. Blayney and Maria Otero

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TABLE OF CONTENTS

	Page
List of Tables.....	v
Acknowledgments.....	vi
Preface.....	vii
CHAPTER I: SETTING THE STAGE.....	1
A. Background: Rationale for Supporting Small and Micro-enterprises.....	1
B. Historical Overview of AID's Support for Small and Micro-enterprises.....	2
C. Other Donor Assistance to Small and Micro-enterprises....	7
D. A Working Definition for Small and Micro-enterprise.....	8
CHAPTER II: SOCIOECONOMIC IMPACT OF PROJECTS FOR SMALL AND MICRO-ENTERPRISES.....	15
A. Introduction.....	15
B. Changes in Income.....	17
1. General Discussion.....	17
2. Findings and Observations.....	18
a. The Enterprise as the Unit of Analysis.....	18
b. Recent Approaches for Measuring Economic Impact..	27
C. Changes in Employment.....	32
1. General Discussion.....	32
2. Findings and Observations.....	34
a. Job Creation and Job Sustainability.....	34
b. Costs of Creating Jobs.....	35
CHAPTER III: ASSESSMENT OF FACTORS THAT CONTRIBUTE TO PROJECT EFFECTIVENESS.....	39
A. Introduction.....	39

TABLE OF CONTENTS (Cont.)

B.	Socioeconomic Context.....	40
1.	Macro-level Considerations.....	40
2.	A Closer Look at National Policy and the Private Sector.....	42
C.	Institutional Mix and Selection.....	45
1.	General Discussion.....	45
2.	Findings and Observations.....	47
D.	Project Design	53
1.	General Discussion.....	53
2.	Extending Credit.....	55
3.	Nonfinancial Resources.....	64
CHAPTER IV:	SUMMARY CONCLUSIONS.....	69
A.	Socioeconomic Impact of Small and Micro-enterprise Projects.....	69
B.	Factors That Contribute to Project Effectiveness.....	71
C.	General Conclusions.....	75
CHAPTER V:	RECOMMENDATIONS FOR FUTURE AID SUPPORT OF SMALL AND MICRO-ENTERPRISES.....	77
A.	Introduction.....	77
B.	Lines of Action Within AID.....	79
1.	Policy Formulation.....	79
2.	Additional Steps to Strengthen AID's Program of Small and Micro-enterprise Promotion.....	79
C.	Program Strategies: Alternatives for Reaching Small and Micro-enterprises.....	81
1.	Macro-economic Environment and National Policy.....	81
2.	Project Design.....	82
3.	Promote Small and Micro-enterprise Lending Among Private Sector Financial Institutions.....	87
4.	Pursue Effective Approaches for Working with Public Institutions.....	89
D.	Other Initiatives.....	90

LIST OF TABLES

	Page
1. Comparative Statistics on Micro-enterprise Establishments by Region.....	10
2. Economic Impacts of 19 Projects.....	19
3. Project Design and Dimensions for 19 Projects.....	20
4. Benefit Synopsis of Five USAID Small and Micro-enterprise Projects.....	29
5. Loan Amount Per Job Created in Five Small and Micro-enterprise Projects.....	36
6. Employment Impact and Cost Per Job: Calcutta Urban Development Program II.....	37
7. Classification of Small Business Support Institutions.....	46
8. Project Design Factors that Affect the Delivery of Credit....	58
9. Project Design Factors that Affect the Health of the Credit Portfolio.....	62
10. Levels of Private Sector Banking Institution Commitment and Lending to Small and Micro-enterprises.....	88

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PREFACE

The purpose of this paper is to highlight the contribution of small and micro-enterprises to economic development, and to provide recommended strategies to the Agency for International Development (AID) for future agency support of this subsector of private enterprise. The thrust of the document is to formulate a well-reasoned set of recommendations on policy based on the findings recorded in this paper.

The intended audiences for this paper are AID policymakers, and practitioners in and outside AID working in programming and project implementation.

This paper draws on data and analysis contained both in the PISCES documents and in a wide array of project evaluations, policy analysis, sector surveys, and state-of-the-art papers. It also draws on conversations and discussions with key figures in the field of small and micro-enterprise development. After providing a historical review of AID's support for small and micro-enterprises and a working definition for these subsectors, the paper seeks to address three broad areas:

1. analysis of how small and micro-enterprise projects have affected employment and income among participating entrepreneurs.
2. assessment of what constitutes an effective project by examining the findings in three areas: implementing institutions; types of interventions extended; and methodology used for delivering a project's resources.
3. based on the above, the paper offers recommendations to AID on future development assistance support for small and micro-enterprises. The paper suggests assistance strategies that from experience appear to be the most effective, and also suggest exploration of various yet untested strategies for improving both AID understanding of and support for the small and micro-enterprise subsectors.

Chapter four of this document presents summary conclusions, and, in conjunction with chapter five, which presents recommendations, can be considered the Executive Summary.

- 1 -

CHAPTER I

SETTING THE STAGE

A. BACKGROUND: RATIONALE FOR SUPPORTING SMALL AND MICRO-ENTERPRISES

Over the last decade, the potential of small and micro-enterprises to contribute to social and economic development in developing countries has captured the attention of national governments and international development organizations alike. The major arguments, already familiar, which have pointed significant economic and development assistance in the direction of small business development can be summed up as follows.

From an economic perspective, small and micro-enterprises represent a growing source of productive employment, especially for the lowest income groups, because these firms are more labor intensive than large industry, and require fewer technical skills. Strategies to create productive jobs are of increasing importance in developing countries. Employment and under-employment issues are quickly moving to the forefront of economic policy and resource allocation considerations, and yet promising strategies for productive employment creation remain scarce.

Absorbing new entrants into the labor force, most of whom will be poor and unskilled, and will come from rural areas and urban slums, will remain one of the principal challenges facing developing countries (World Bank, Employment and Development of Small Enterprises, Sector Policy Paper, 1978). It is estimated that Bangladesh, for example, must absorb over one million new entrants into its labor force each year (World Bank, 1983). Close to 45 percent of Brazil's population is under 15 years of age, a demographic pattern not unlike that of many developing countries, which leads to the staggering calculation that nearly 780 million new jobs will be needed by the year 2000 in developing countries (AID, PISCES Final Report, 1981). In this context, support for small and micro-enterprises is seen as one key mechanism for responding to an ever-growing need for jobs.

Small and micro-enterprise promotion translates into support for the economic activities of the poor, and in turn, enhancement of their capacity to earn incomes. Especially in urban areas, where migration has swollen the ranks of the unskilled and semi-skilled, tiny, informal businesses continue to spring up at a rapid rate. It is estimated that in Lima, Peru, approximately 30 percent of the city's population (over two million people) lives on income earned through small and micro-enterprise activity (Carbonetto and Kritz, 1985). In Sierra Leone, economic

activities in the informal sector have grown at a rate of 25 percent a year (Moser, 1984). Support for the economic activities of the poor majority is also seen as an effective avenue for improving the skewed distribution of income prevalent in most developing countries.

Development of small and micro-enterprises offers one possibility for creating productive jobs and increasing the income of the poor through a nonpublic sector strategy. In this case, channeling assistance through private organizations and tapping the resources of other financial and commercial institutions in developing countries emerges as an alternative to government sponsored development. Indeed the informal, nonlegalized nature of some of these enterprises--which will be further discussed below--means that public organizations may not have the mandate or the capability to effectively assist them. Further, by strengthening this subsector of a country's private economic activity, one contributes to the growth and health of its private sector, and does not limit entrepreneurship development to those with ready access to skills and capital.

Recent findings indicate that, in the aggregate, small and micro-enterprises make important contributions to economic growth at low capital costs. Preliminary data measuring value added in relation to financing among enterprises, suggest that small rural-based manufacturing enterprises outperform larger enterprises operating in the same manufacturing sector (Liedholm, 1985). These findings are based on time series data in five countries and eight manufacturing sectors, such as clothing, furniture, metal products and rice milling, in which production takes place in firms of all sizes.

Finally, there are broader social objectives that may be attained through promotion of small and micro-enterprises. As noted in the AID Private Sector Development Policy Paper, 1985, "assistance to the smallest of productive activities in a society may be the only effective way to stimulate broad-based growth and development."

B. HISTORICAL OVERVIEW OF AID'S SUPPORT FOR SMALL AND MICRO-ENTERPRISES

1. The Focus on Small and Medium Industry:

Prior to the 1970's, AID concentrated in assisting small and medium industry through projects that included components for capitalization, technical assistance, technology transfer,

training, policy dialogue, promotion services (in investment and exports), and economic support (commodity import programs, and balance of payments support). These resources were channeled through a variety of delivery systems, such as central governments, government agencies, parastatals, nonprofit organizations, and private for-profit enterprises (Robert R. Nathan Associates, Inc., 1985).

Capital markets constraints--low liquidity in regional banks, access to credit, lack of collateral--were considered the most important stumbling blocks for medium and small industry. With the exception of a small percentage of projects which were comprised strictly of technical assistance and training (vocational training, university curriculum development), or infrastructure development (construction of learning institutions), the bulk of AID's assistance to industry was designed to expand the capital markets in developing countries through three schemes: direct lending; rediscounting; and loan guarantee funds.

a. Direct Lending: These projects provide funds to host national institutions through two different delivery mechanisms: private industrial finance corporations (IFCs), also referred to as development finance corporations (DFCs), and private intermediate finance institutions (IFIs). These direct lending and equity investment schemes support medium and long-term industrial investment by responding to the deficiencies in the capital markets of each country. While successful examples of both IFCs and IFIs exist--in terms of efficiency of operation, longevity, and achievement of goals and objectives--there were problems endemic to the scheme. For example, government policy stipulating interest rate ceilings and other controls, discouraged local investment and hampered both public and private institutions from mobilizing domestic savings. Also, although both public and private institutions were involved in direct lending, the public entities entered into these projects with few or no requirements for return on investments, which lessened their efficiency and their ability to raise domestic savings from private sources.

b. Rediscounting: To support small and medium industry, AID also provided funds to the host national central bank to re-discount loans made by lending institutions, including commercial banks. There are rediscounting schemes that have been effective in reaching the smaller enterprises. However, rediscounting programs seem to have been attractive to commercial banks as a way of increasing their loan portfolios without using their own

resources, rather than as a way of expanding their clientele to include smaller firms (Levitsky, 1985). In addition, the financial and economic crisis of the early 1980s meant scarce foreign exchange for most central banks which, compounded with fear of loan defaults, resulted in more layers of loan review and tighter application requirements. These factors effectively stymied the credit lending process and favored the larger enterprises.

c. Loan Guarantee Funds: With the 1974 amendment to the Foreign Assistance Bill, AID was authorized to guarantee private sector loans to small enterprises, and, for example, initiated the Productive Credit Guarantee Program (PCGP) in selected countries in Latin America. AID served as a partial guarantor of loans to small, low-income entrepreneurs by commercial lenders. The scheme involved the Central Banks, which refinanced part of the approved loan, and the IFIs, which carried part of the loan and assumed the entire credit risk. Like the other two mechanisms, the guarantee and refinance scheme assisted hundreds of smaller manufacturing industries that may not have secured financing otherwise, but its overall results were also mixed, primarily due to cumbersome bureaucratic requirements imposed by Central Banks.

In spite of AID's efforts and success in relieving the critical constraints of the small and medium enterprises through capital support and technical assistance programs, and in providing strong encouragement and incentives to public and private institutions to lend to this clientele, these projects still tended to reach the larger among the enterprises targeted. The smaller, low-income entrepreneurs did not benefit from these schemes as expected, and the micro-enterprises were left out altogether.

2. New Approaches:

In the 1970s, AID and other donors recognized the weaknesses of previous approaches, and also began to take serious note of the significant socioeconomic contributions made by the very small and micro-enterprises in developing countries. In 1978, AID's erstwhile Office of Urban Development, now absorbed into the Office of Rural and Institutional Development of the Bureau for Science and Technology, launched the five million dollar project, "Small Enterprise Approaches to Development," designed to improve the agency's understanding of the small scale enterprise sector (SSEs) and to increase its capacity to

formulate, implement, and evaluate projects that generate productive employment among the poor. At the time, preliminary analysis had indicated that a growing number of the poor, especially urban dwellers, initiate economic activities in order to employ themselves, and to produce incomes for their families.

To learn more about these micro-entrepreneurs and the nature of their work, three subprojects were planned under this project. The first, under the guidance of Michigan State University, explored policy issues relevant to small and micro-enterprises. The second, headed by Development Alternatives Inc., developed a comprehensive methodology for impact evaluation which was used to evaluate small and micro-enterprise projects in Indonesia, Peru and Burkina Faso. The third subproject studied existing small and micro-enterprise projects to record lessons learned regarding their implementation, and also initiated demonstration projects for testing improved methodologies. This third subproject, and the most relevant to this study, was called "Program for Investment in the Small Capital Enterprise Sector," and was known as PISCES Phases I and II.

PISCES started in 1978 with a review of projects in over twenty developing countries, and sought to:

- determine if it was possible to reach the very poor urban dwellers with assistance to their economic activities;
- assess which project approaches and methodologies in place at the time seemed most effective; and
- explore the implications of these findings for donor organizations.

The findings of PISCES Phase I, contained in 23 case studies of projects in 13 countries, documented in a systematic way the existence of assistance approaches which, by providing resources, especially credit, technical assistance and training, seemed to be reaching the poor and enhancing their economic activities. In addition, this first phase served to isolate those characteristics of project design and implementation that appear to contribute to project effectiveness among the very smallest of enterprises (PISCES, 1981).

These findings led to PISCES Phase II, which involved private organizations and USAID missions in the design and

implementation of four demonstration projects of assistance to micro-enterprises. 1/ These projects were designed to:

- use different approaches which when compared could yield insights on how to optimally assist micro-enterprises;
- use demonstration projects to answer fundamental questions about impact that could add an empirical underpinning to the impressionistic and anecdotal pattern of evidence that emerged from the case studies: that projects which assist the smallest already existing businesses often increase income of the owners and generate productive employment for family members and others. 2/

PISCES Phases I and II can be seen as a catalyst to increased AID activity in small and micro-enterprise promotion. Currently, the following are among the projects being implemented through the Enterprise and Employment Development Division in the Office of Rural Development of the Bureau for Science and Technology (S&T/RD/EED):

- the Employment and Enterprise Policy Analysis (EEPA) project provides analytical resources to identify policy and regulatory hindrances to private sector performance, job creation, and entrepreneurial behavior, and to promote policy dialogue and initiatives to address these hindrances.
- the Research on Entrepreneur Identification and Development (REID) project is an action-research initiative designed to isolate a refined set of entrepreneurial characteristics. These characteristics will be used in a pilot training program for entrepreneurship development.
- the Small Enterprise Approaches to Employment project and the Micro-enterprise Support Institutions Development

1/ Demonstration projects were implemented in the Dominican Republic and Costa Rica--directed by national development foundations-- and Kenya and Egypt, directed by local nonprofit organizations with technical assistance from U.S. based organizations (Accion International, Partnership for Productivity, The Development GAP). See Ashe, PISCES II, 1985. 2/ PISCES, 1981. It is important to note that the case studies were not designed to gather empirical data on impact, but rather to determine if these projects were reaching micro-entrepreneurs, and with what level of effectiveness.

project are the successors to--and incorporate lessons learned from--the S&T/RD PISCES and Small Business Capacity Development projects, both of which terminated in fiscal year (FY) 1985. These new projects will provide technical support, research and training services related to the strengthening of host country institutions that provide assistance to small and micro-enterprises.

AID has other major efforts in the area of small and micro-enterprise promotion. USAID Missions and AID/W bureaus, responding to the interest awakened by PISCES and to other factors--the growth of nonfarm economic activity in the rural areas of most countries; continued migration into cities; the growing emphasis on private sector assistance--are currently assisting small and micro-enterprises through a wide range of service delivery and institution building projects, and research/evaluation efforts. Nearly every USAID Mission has developed projects for assisting small and micro-enterprises, and is implementing these through Operational Program Planning Grants (OPGs) to local or international nonprofit organizations, or through bilateral projects with public and private sector entities.

C. OTHER DONOR ASSISTANCE TO SMALL AND MICRO-ENTERPRISES

Bilateral and multilateral development assistance organizations in general have also increased their support for small and micro-enterprises. As early as 1969, the International Labor Organization (ILO), asserted that unemployment was not cyclical but chronic and intractable in almost every developing country, and undertook a series of studies at the country, city and sector levels in which policy formulation focused on employment as a major policy objective (ILO, 1969).

Expanding on this initiative, the World Bank sector policy paper on employment and development of small enterprises, published in 1978, charted the path for that institution's increased financial support for the promotion of small and micro-enterprises. As will be seen below, the World Bank has also made substantial contributions, through research and project design, to current understanding of these subsectors. The Inter-American Development Bank (IDB) has created a Small Projects Division which primarily supports small and micro-enterprises, but also conducts evaluations and research, and collaborates in workshops and conferences on this issue. The portfolios of smaller funding organizations, such as the Inter-American Foundation (IAF), Appropriate Technology International (ATI), and Private Agencies Collaborating Together (PACT), also reflect an increased focus on small and micro-enterprise development.

D. A WORKING DEFINITION OF SMALL AND MICRO-ENTERPRISE

Definitions for small and micro-enterprise abound, many dictated by the biases of the writer, the use of the definition, and the stage of development of the country or region in question. Also, small and micro-enterprise activity is so varied and complex, that no one phrase can encompass its global, even regional diversity. An often-cited study identifies more than 50 different definitions in 75 countries (Georgia Institute of Technology, 1975). However, some argue that the scale of a business needs to be defined only for a specific purpose, such as inclusion or exclusion of firms in a project, or for focusing government policies (Harper, 1984).

Our intent here is to adopt a working definition, which although not definitive, will be reasonably precise so as to guide the scope of this study, and will serve as a consistent basis for analysis. We classify small businesses into three categories:

- micro-enterprises;
- small enterprises; and
- emerging-out-of-small, or small/medium enterprises.

The first two categories above are the focus of this paper. These small and micro-enterprises are productive or economic units operating in rural and urban areas, and, as in larger enterprises, generally combine at least two factors of production: labor and capital, as in furniture making or textile processing; labor and natural resources, as in agricultural goods processing; and labor and some type of organization in the workplace, as occurs in most petty trading and commerce. Although, as explained below, many of these entities are one-person firms, the activity of small and micro-enterprises implies coordination of a variety of functions--money, marketing and management--for a specified economically productive end.

In general terms, the production of goods and services by these firms is targeted at local markets, differentiating them from subsistence activity at one end, and from export oriented industry on the other. Their productive activity, when viewed in the aggregate, clearly signals their contribution to and participation in the economic activity of the country (H. Gomez Buendia, et al., 1983).

1. Size as a Measure:

Size is the most often-used variable in defining small and micro-enterprise. It is generally agreed that **fixed asset amounts** (machinery and equipment), and number of **wage employees** are appropriate starting points for classification, and are used for this definition with several caveats.

The use of size as a classifying variable varies widely from country to country, and even among different types of economic activities within a country. A review of "official definitions" for small and micro-enterprises in 14 countries, showed that all 14 used number of employees as a classifying variable. However, the standard for defining small and micro-enterprises varied among countries from firms with less than 20 employees to firms with less than 500. In addition, there were variations within countries depending on whether the firm was rural- or urban-based, and on the type of activity--manufacturing, commerce, or service (H. Gomez Buendia et al., 1983).

The fact that there is no defined upper limit to the size of small means that survey data and projects designed to reach these subsectors define their target groups with no uniformity. The World Bank, for example, defines as small, firms with assets under U.S. \$250,000 (in 1976 prices), setting no lower limit for assets or for number of employees (World Bank, "Employment and Development of Small Enterprises," Sector Paper, 1978). The term small, then, can encompass everything from small manufacturing firms that are relatively modern to petty traders and transporters that operate in an informal way. In understanding small and micro-enterprises, the distinction between modern and informal may be as important as the quantifiable classifications of large and small (Harper, 1984).

The quantifiable indicators of size used in this paper are guided by the data summarized in Table 1, based on a survey of nearly 11,000 micro-enterprise establishments in nine countries (Kilby and D'Zmura, 1985). Because of the substantial number surveyed and because the figures in Table 1 are fairly representative of findings documented by others (Ashe, 1985; Berenbach, 1985), these data can be taken as illustrative of the situation in cities, towns, and villages in most developing countries, and are used here to set the definitional parameters for this paper.

TABLE 1

COMPARATIVE STATISTICS ON MICRO-ENTERPRISE ESTABLISHMENTS
BY REGION 1/

INDICATORS OF SIZE

	LATIN AMERICA	CARIBBEAN	AFRICA	ASIA
FIRMS SURVEYED	5,278	722	1,637	3,507
AVERAGE NUMBER ENGAGED	4.5	2.2	3.1	3.2
AVERAGE % WOMEN	15.0	32.0	15.0	21.0
AVERAGE % OF WAGE EMPLOYEES	78.3	n.i.	50.0	n.i.
AVERAGE MONTHLY SALES (\$ U.S.)	1,900	n.i.	370	n.i.
TOTAL INVESTMENT (\$ U.S.)	5,000	800	1,300	7,254

CHARACTERISTICS OF OWNERS

AGE	39	40	32	43
YEARS OF EDUCATION	10	4	3	8
AVERAGE % WOMEN	20	51	18	57
AVERAGE MONTHLY EARNINGS (\$ U.S.)	284	n.i.	170	n.i.
AVERAGE % OTHER SOURCE OF INCOME	32	n.i.	55	13

1/ Source: Kilby and D'Zmura. Countries used in sample are as follows: Latin America (Dominican Republic, Brazil, Honduras, Peru); Caribbean (Jamaica); Africa (Burkina Faso, Sierra Leone, Ghana), Asia (Philippines). n.i. indicates no information.

Table 1 shows that on the average, the number of people engaged in a micro-enterprise--including the owner--is between three and four. Half of the firms surveyed in this study were one- or two-person units, though others caution that the presence of single-person cottage enterprises may be underrepresented in any survey (Ashe, 1985). On the average, women make up one-fifth of the small and micro-enterprise population, both as owners and employees. Other studies cite a larger percentage of women involved in micro-enterprise development, and find that they tend to own the smallest of enterprises (Austin and Dulansey, 1985). The number of paid employees ranges from about 50 percent in African countries to nearly 80 percent in Latin America, with family and unpaid apprentices providing the rest of the sector's labor force.

The table also shows that total investment per firm ranges from less than \$ U.S. 800 in the Caribbean to over \$ U.S. 7,000 in Asia. This range underlines the danger of generalizing without considering the regional factors that partly account for this diversity. Also, there is great variation among countries in industry mix of the sampled firms, and in the incidence of ownership versus rental land and building, which is reflected in the level of investment.

The figures for monthly gross sales are likewise quite disparate, and accuracy is complicated by the fact that often sales figures are either inflated to enable the owner to seek credit, or deflated to lower or avoid taxation. In addition, the majority of records kept are sketchy and incomplete, making gross sales a less reliable indicator of size.

These definitional problems preclude consensus on what constitutes small and micro-enterprises. We use the survey material and other data to define micro-enterprises as firms of no more than five employees and with fixed assets of less than \$ U.S. 10,000. Small enterprises comprise businesses with less than 25 employees and with fixed assets of no more than \$ U.S. 25,000.

2. Qualitative Measures:

There are also nonnumerical indicators of size, which although not quantifiable, enable us to define better the nature of the firms we are addressing. Five are suggested here.

a. Externally-supplied Inputs: The smaller the firm the less access it has to inputs into the productive process, such as

finance, imported capital goods, intermediate inputs, knowledge of effective production techniques, or assistance in improving management procedures. Limited access increases the firm's vulnerability, margin of risk, and contributes to market restrictions: the further the firm is from alternative sources of technology and from readily available finance--other than the moneylender--the closer it must remain to its suppliers and consumers.

b. Location: Micro-enterprises are often home-based operations or use makeshift quarters. In most cases, these firms represent one of several productive activities for the family unit. Each family shifts labor and capital based on need and circumstance, and on the present profit-making capacity of a given enterprise. Thus, as shown on Table 1, a significant number of owners interviewed reported other sources of income. In addition, there is considerable comingling of funds between the business and the household, making it difficult to specify where one ends and the other begins. This free exchange of capital and labor among diversified activities has paradoxical effects: on the one hand it contributes to the survivability of the family, and on the other hand it restricts the family's ability to concentrate its resources on one enterprise and expand it.

Small enterprises, in contrast to micro-enterprises, tend to operate out of rented or purchased establishments that are quite separate from the owner's household or financial activities. These firms also tend to represent the main income-earning activity for both the owner and the employees, with less tendency to use capital for a variety of entrepreneurial activities.

c. Production and Organization: The personnel for most micro-enterprises include family labor or apprentices paid in-kind. The level of participation by family and apprentices varies among countries and type of enterprise (Ashe, 1985). Management questions related to planning, accounting, and record-keeping are resolved on a day-to-day basis in no planned or systematic way. Finances rely heavily on local lenders or extended family. Production varies in quality within the same firm and can be quite disparate from week to week. In sum, while being labor intensive, micro-enterprises entail little division of labor or production organization, and rely primarily on existing skills and on low levels of technology.

Small enterprises, on the other hand, exhibit a more formalized and systematic internal organization, based on more

defined division of labor and greater technological specialization. With a more developed management system and sometimes even access to formal sector institutions--such as finance and management/business organizations--these small firms may use both local and imported resources, and generally manifest a higher productivity level than their counterparts in the micro-enterprise subsector.

d. Skill Level: Low level of formal education characterizes small and micro-entrepreneurs, though the latter tend to register lower literacy rates than the former. Table 1 shows that the majority of micro-entrepreneurs in the survey have not completed elementary school, with Africa and the Caribbean depicting the lowest levels of formal schooling. Most entrepreneurs in these sectors also lack formal vocational training. They use skills acquired through practice, by serving as apprentices, or passed down in the family (Anderson, 1982). In the case of women, skills perfected through traditional roles of domestic chores and childrearing are often applied to income generating purposes, such as in textile and food processing (Dulansey and Austin, 1985).

e. Entrepreneurial Profile: Small and micro-enterprises tend to be initiated by "older" men and women who perceive the firm as a permanent economic activity and a major source of long-term income (Kilby and D'Zmura, 1985; Moser, 1985). These firms are not formed by people seeking marginal, temporary employment while they seek higher paying jobs in the formal sector.

In the case of younger people, an apprenticeship to an entrepreneur is seen as a training ground for future productive employment. These apprentices often will leave a firm to establish their own enterprises, approaching the venture as a long-term investment of time and capital. For this reason, they often are willing to earn minimal if any wages while learning a trade.

3. The Informal Sector: Arena for Small and Micro-enterprises

The economic activity of small and micro-enterprises takes place largely in what has come to be known as the informal sector, a term that has been interpreted in a wide variety of ways and applied to many different contexts.

Many of the earlier attempts to define the informal sector were based on the dualist model which treats the formal and informal sectors as distinct components of a country's economy (Hart, 1973; Mazumdar, 1976). The informal sector was characterized as having large concentration of "working poor" whose economic activities generally escape recognition, regulation, government protection or enumeration. Other observers, while acknowledging this dichotomy, emphasize that an economy is a continuum of productive activities with complex linkages and dependent relationships and it is within this setting that informal economic activities take place (Moser, 1984).

First outlined in its 1972 Kenya Report, the ILO definition focused on the characteristics of the enterprise as a means of determining what economic activities were contained in the informal sector (Moser, 1984). The characteristics attributed to this subsector by the ILO--ease of entry, reliance on local resources, family ownership, small-scale operation, labor-intensive, adapted technology, skills acquired outside the formal school system, and unregulated, competitive markets--have remained the most popular and widely used, and are also reflected in this paper's working definition of small and micro-enterprises. Expanding on these attributes, Sethuraman, in 1982, formulated a definition for the informal sector which has guided much of the subsequent research and interventions, and is a useful reference for the discussion that follows. The informal sector, he says,

consists of small scale units engaged in production and distribution of goods and services with the primary objective of generating employment and incomes to their participants, notwithstanding the constraints on capital, both physical and human, and know-how (Sethuraman, 1981).

CHAPTER II

SOCIOECONOMIC IMPACT OF PROJECTS FOR SMALL AND MICRO-ENTERPRISES

A. INTRODUCTION

Whether by design or happenstance, all small and micro-enterprise projects will affect the client population in economic as well as other less quantifiable ways. Our purpose in this section is to concentrate on assessing the quantifiable economic impact of small and micro-enterprise projects as recorded in the secondary sources reviewed for this paper. Economic benefits are measured most generally as additions to the national economy, and are here considered under two broad categories: changes in income and changes in employment resulting from a project's interventions.

In the case of small and micro-enterprise promotion, capturing the full impact of outside assistance requires an analysis of benefits and losses occurring at various levels: the local institutions used for delivering resources; the firms receiving support; and the community as a whole. 1/ It is also evident that while economic indicators of impact can be quantified, other social indicators--such as capacity to make more informed decisions, sense of self-esteem, increased access to existing resources--are much harder to measure empirically. To record these benefits we rely primarily on the testimonials of those affected and on the observations documented by the outsider.

The usefulness of any development project also must be judged in terms of the benefits created relative to their cost. The financial costs of a project consist primarily of outside assistance--plus host country counterpart--and are easily verified. Less accessible for analysis, however, are the benefits derived. The relationship between these two--benefits and costs--give us an insight into the cost-effectiveness of the project, and will be discussed in Chapter III below.

Determining the degree to which a project's input directly relates to an observed change in existing conditions is of course a problem in all impact evaluations. This is especially true in the case of small and micro-enterprise promotion, where the range

1/ For an in-depth analysis of this "impact hierarchy" see Susan Goldmark and Jay Rosengard, "A Manual to Evaluate SSE Projects," Development Alternatives, Inc. Prepared for AID, S&T/RD, 1985.

of exogenous variables is so wide that even the most rigorous examination cannot determine categorically their full effect on project performance and on its subsequent impact.

For example, key among these variables is the market environment in which a firm operates, that is, the existing demand for its product. If the market for a firm's product line is sluggish or saturated, thereby driving its price downwards, no amount of outside finance or technical assistance will enhance the income or job creation potential of that firm, unless inputs are so subsidized that unit costs of production or services are artificially lowered, and as a result unit sale prices are reduced. Indeed, the economic climate within which small and micro-enterprises operate has enormous effect on the costs of goods sold as well as on the demand and marketing aspects. Other factors, such as newly paved roads or improved transportation systems, will also affect a firm's performance.

In spite of these measurement difficulties, some of the economic impacts, both positive and negative, recorded in the documents reviewed can be attributed to projects that provide financial resources--mainly in the form of short and medium-term credit--and technical assistance to small and micro-enterprises.

The methodologies used most often to collect impact data for both income and employment issues, include:

- examination of central records;
- administration of questionnaires at the time of the evaluation to a sample of project beneficiaries. This approach also can include on-site review of business records;
- in-depth, open-ended interviews with a sample of beneficiaries also conducted at the time of the evaluation;
- establishment of a control group during the course of the project against which project beneficiaries are measured;
- process documentation, conducted parallel to implementation, in order to assemble and analyze data periodically during the life of the project. 1/

1/ Most evaluations, including those conducted under PISCES, the World Bank, and the Inter-American Development Bank, utilize some combination of the first three, with control groups used less often. Studies such as Jennefer Sebstad, "Struggle and Development Among Self-Employed Women," AID, Office of Urban Development, 1982, and Libbet Crandon, "Women, Enterprise and Development," Pathfinder Fund, 1984, also utilize the latter two.

This chapter is divided into two sections. The first, relating to changes in income, suggests that most project evaluations focus on the firm as the unit of analysis for measuring income impact. Such analysis may go beyond recording indicators of direct income to the entrepreneur and wage employees, and also consider diversification of productive activities and savings mobilization.

This section also reviews other more complete yet fairly new approaches developed to assess more accurately the income impact of small and micro-enterprise projects. One of these approaches includes backward and forward linkages into the benefit equation, while a second approach uses benefit-cost analysis, not only to look at cost-effectiveness of a project, but also to measure economic impact.

The second section, focusing on changes in employment, draws from available data to assess whether and to what extent small and micro-enterprises can be considered effective vehicles for creating jobs in developing countries. It suggests that in addition to considering direct and indirect job creation, one should also take into account costs per job created, job productivity, variations in employment generation among countries, and among industries within each country.

B. CHANGES IN INCOME

1. General Discussion

Intermediate indices often used in impact evaluations to determine a project's success include new firms started, creation of additional productive capacity, expanded industry sales, and changes in productivity. In all cases, it is the additional income associated with the intermediary index which is the true benefit, since employment without income is of little utility and improved firm profitability and sustainability are desirable to the degree that they also generate more income.

Change in income is considered a key indicator of impact in nearly all enterprise assistance programs, and is examined both at the enterprise level and at the local economy level. Most efforts to assess a project's impact on income concentrate on direct income accrued by the beneficiary. Others suggest a broader definition of project success in which benefits include the society as a whole, and therefore look at both direct and indirect impact on income.

Indirect benefits are created by increased demand for inputs from suppliers--termed backward linkages--as well as growth in subsequent stages of production, which create forward linkage transactions (Goldmark and Rosengard, 1985; Kilby and D'Zmura, 1985). In both cases, a small and micro-enterprise project can generate additional income in firms outside the project, which, as is suggested below, should be included as an economic benefit.

2. Findings and Observations

a. The Enterprise As The Unit Of Analysis

The authors conducted an in-depth review of the findings of 19 small and micro-enterprise projects in fourteen countries recorded in evaluations conducted at the request of the donors--primarily AID, the World Bank and the Inter-American Development Bank. 1/ The summary findings of this review appear in Tables 2 and 3 below, which provide impact and project design information, and which are used as one basis for this analysis. When appropriate, the authors also draw from other evaluations and studies reviewed but not summarized in tabular form.

In general, the evaluations reviewed point to a positive relationship between the transfer of resources through small and micro-enterprise projects, and the change of income observed in the target populations. Setting aside for a moment the variances resulting from geographic location, type of firm assisted, and economic climate, in the aggregate, the infusion of credit and technical assistance into enterprises that suffer from a shortage of capital and technical/management skills leads to improved income levels for most of the assisted entrepreneurs and salaried employees.

i. Firm Profitability and Sustainability and Income Changes:

Findings that look at income changes utilize a variety of measures. Most relate to the firms' profitability and include data on level of sales, value added, net profit, and productivity. Some evaluations also consider the firms' sustainability, which includes increased investment, increased sales growth over time, and level of indebtedness.

1/ Project evaluations were selected with the following criteria in mind: a) inclusion of impact data in the evaluation; b) geographical diversity; c) inclusion of projects funded by a variety of donor organizations.

TABLE 2

ECONOMIC IMPORTS OF 19 PROJECTS

PROJECT	EVALUATION				IMPACTS ON:			
	Year	Author	Organiz.	Methodology	Profit	Diversif	Savings	JOBS created
AFRICA								
National Christian Council-Kenya	1985	Hunt	AID	records; questionnaire	+ 3 *	---	---	+ 3
Burkina Faso Phase I	1982	Goldmark	DAI	questionnaire	+ 1	+ 1	---	---
Burkina Faso Phase II	1985	Lassen	PfP	interview; control group; records questionnaire	+ 2 b	---	---	---
Entente Fund-Africa Regional	1982	AID	AID			---	---	+ 2
ASIA								
Calcutta Urban Dev. Prog. II-India	1985	Kahnert			+ 3 b	---	---	+ 1
Badan Kredit Kecamatan(BKKG)-Indonesia	1983	Goldmark	DAI	questionnaire	+ 2	+ 2	+ 1	---
Bangladesh Rural Advancement Com.	1985	W.B.	W.B.	interviews; records	+ 2 *	+ 2	---	---
Grameen Bank Project-Bangladesh	1985	W.B.	W.B.	interviews; record	+ 3	+ 3	+ 2 c	---
Manila Comm. Srvc Inc.-Philippines	1982	Bear;Tiller	ATI	interviews; case studies; records	0 *	---	---	---
Micro-industry Dev. Program-Philippines	1982	Bear;Tiller	ATI	interviews; case studies; records		---	---	---
SEWA-India	1982	Sebstad	AID	records; Interviews	+ 1	---	+ 2 *	---
LATIN AMERICA								
ADEMI-Dominican Republic	1985	Blumberg	AID	interviews; questionnaire	+ 2 *	---	+ 2 *	+ 3
Corp.Fabricato-Colombia	1984	IDB	IDB		+ 1	---	---	+ 2
DESAP/Carvajal-Colombia	1984	IDB	IDB		+ 2	---	---	+ 2
Industrial Bank-Peru	1982	Goldmark	DAI	questionnaire; records; interviews	+ 3 b	---	---	---
MSC-I - (Medium Sized Cities) Brazil	1984	Tippet;Smith	W.B.		---	---	---	+ 2
PRODEME/FDD-Dom.Republic	1984	Ashe	ACCION	questionnaire; control group	+ 1	---	---	+ 1
PROGRESO-Peru	1984	Reichmann	ACCION	questionnaire; case studies	+ 3	---	+ 1	+ 2
UNO-Brazil	1982	Jackelen	ATI	interviews; records	---	---	---	---

NOTES:

- * No numerical data provided. Narrative description is basis for value assignment.
- a) In order to provide some comparison between the impacts on income of the various projects, a rating system of -3 to +3 is used. The assignment of value is subjective, based on the reading of each evaluation.
Profit: pertains to average increases in sales of loan recipients, unless otherwise noted.
Diversification: pertains to the ability of the assisted businesses to diversify their main line of activity.
Savings: pertains to the ability of beneficiaries to save.
- b) Based on surveys of a portion of the firms assisted.
- c) Refers to group savings only.

For the 19 projects reviewed on Table 2, the impact on firm profitability and sustainability as a measure of income change appears in the column termed "profit." To provide a comparative basis among the 19 projects a rating system of -3 to +3 was used, which indicates the degree of change resulting from the project. In this rating system, "0" indicates no change; the numbers "1, 2 and 3" indicate changes of 30 percent or less, 60 percent or less and above 60 percent respectively. The same percentage variation between numbers applies to the negative ratings.

This same rating system is used for all impact measures recorded in the table. Where information was incomplete or not provided, no rating was assigned. To maintain maximum objectivity, all ratings, unless indicated by an asterisk, are based on numerical data contained in the evaluations. Since these projects were not selected based on the level of impact recorded in the evaluations, they can be considered representative of small and micro-enterprise projects that have been evaluated recently.

Income change using the enterprise as the unit of analysis is the most commonly found indicator in the evaluations. Eleven projects provide numerical information on income changes related to the firms' activities. An additional four provide narrative descriptions based on interviews and informal discussions with project staff and beneficiaries. Nine evaluations record changes in income considered moderate and good (+1 and +2 ratings); five show very favorable impact--rated +3--and one reflects no change at all (rated 0). No evaluation records a negative overall impact on firms' activities, although, as we will discuss below, an overall positive change may obscure the fact that some among project beneficiaries did experience a decline in income. The examples below help illustrate the findings recorded in Table 2.

Peru. In Peru, between 1975 and 1981, the Rural Development Fund (RDF) of the Industrial Bank of Peru (BIP), a development bank, disbursed approximately 6,200 loans totaling over \$ U.S. 42 million to about 3,000 small entrepreneurs (Goldmark, et al., 1983). Survey data at the end of six years showed an increase of 160 percent in average declared sales of borrowers, from the time of the first loan to the date of the survey (average size of loan in this program was about \$ U.S. 2,500). Annual value added at the time of the survey was \$ U.S. 16,000 per firm. Each loan dollar extended was found to produce, on the average a \$.29 increase in gross income per year. Sales increased at an average of 31 percent annually, while net profits went up about 54 percent annually.

In terms of impact on income, the RDF project contributed to an average yearly increase of 53.5 percent in net income for borrowers. That is, on the average, a \$ U.S. 1.00 loan generated \$ U.S. 1.41 net profit. Expressed in the aggregate, this project generated \$ U.S. 60.5 million from \$ U.S. 42 million in loans.

Bangladesh. The experience of the Grameen Bank Project (GBP) in Bangladesh also shows a positive impact on beneficiary incomes. In four years, this project operated in 1,250 villages reached through 86 branches, and extended over 115,000 loans for a total of Taka 195 million to over 58,000 borrowers, landless rural poor. 1/

On the average, household income rose about 70 percent in nominal terms over 2 1/2 years among the beneficiaries of the GBP. This data was collected by two outside evaluators using random samples of 600 and 175 (World Bank, 1985). This increase is compared to the average increase in income for landless rural poor in Bangladesh, which the study quotes is at best 2.6 percent per annum.

India. The data on income increases of loan recipients subsequent to receiving a loan were recorded for the World Bank Calcutta Urban Development Program II. Evidence of the impact income shows highly favorable results (World Bank: Kahnert, 1985). Household income among borrowers in the sample of 631 (in a project that extended over 8.3 million rupees in credit through nearly 3,500 loans), 2/ increased by an average of at least 60 percent. The data on income changes by subsector showed that income increases for borrowers in the tailoring business exceeded 200 percent, approached 50 percent in manufacturing and repair firms, and reached more than 20 percent in trade and other services.

The study points out that while the increases in tailoring are atypical, one can establish an upper limit for income in the other two activities by factoring in the earnings of waged employees. Using the going rate for unskilled labor, the author calculates an increase in annual income among owners and workers somewhere between 82 percent and 117 percent of the loan amount, and concludes that, "even if the true figures lie close to the minimum given above, the rates of return to income in this project are still very high." (World Bank, Kahnert, 1985).

1/ \$ U.S. 1.00 = 12 Takas (Tk.) (1985).

2/ \$ U.S. 1.00 = 10 Rupees (Rs.) (1981).

Dominican Republic. Other available data also presents useful information on income changes. As part of the evaluation of demonstration projects conducted under AID's PISCES Phase II project, a control group was used in the Dominican Republic to assess the Dominican Development Foundation's micro-enterprise project and its impact on firms assisted (Ashe, 1984). The study used five measures of business success which were applied to a control group of 24 entrepreneurs and to 101 assisted clients over a period of six months to one year.

A comparison of changes between the control group and the assisted businesses demonstrated that among those assisted the total investment in the business was 30.6 percent higher than in the control group, and total investment in machinery and equipment was 23.5 percent higher. Both findings indicate increased capitalization by assisted firms which could be from loans used for fixed capital, or from equity reinvestment into the firm, or both. Monthly sales among firms assisted were 25 percent higher than in the control group, and monthly costs for raw materials had risen more slowly, reflecting a change in aggregate value among assisted firms of 5.4 percent, compared to -15 percent in the control group. In this evaluation aggregate value is defined as sales less the cost of raw materials.

These changes in the firms' profitability and sustainability resulted in an estimated increase in the owners' income of about 27 percent per year. Total income to salaried employees--discussed in more detail below, in the section titled "Changes in Employment"--was \$ U.S. 195,206 per year, which alone exceeded the total value of the loans extended per year (\$ U.S. 194,033). The range of change among the assisted entrepreneurs was also analyzed and, on this basis, the study concludes that the project has proven itself in terms of increasing the income of beneficiaries.

Colombia. Conclusions drawn in an evaluation of the Corfabricato project in Colombia present a different picture (IDB, 1984). In two years, the Corporacion Fabricato, through a loan from the Inter-American Development Bank (IDB), extended 140 loans on the average of about \$ U.S. 1,400 each to micro-entrepreneurs in Medellin. Data from a sample were used to measure changes in income in real terms among beneficiaries. Although the sample group showed an overall real increase of 8 percent in income, this increase was due primarily to a limited number of micro-entrepreneurs whose incomes increased. Whereas, before the program 42 percent of the sampled business owners had incomes lower than the average, by 1983 this percentage had risen

to 77 percent. In other words, while in the aggregate, project clients showed an increase in income, 54 percent of the borrowers suffered a relative decline in their preloan income levels.

The study suggests that deficiencies in program design may have contributed to accepting loan applications from firms with little viability or growth potential, which, in fact, subsequently experienced lower sales and drop in incomes. Judging from the poor health of Corfabricato's loan portfolio--high levels of arrearage and defaults--the evaluators conclude that the eligibility criteria, the selection process, the follow-up and the recuperation policy need serious reconsideration if the project is to have positive economic impact on borrowers (IDB, 1984). As will be discussed in the next chapter, quality of project design is intrinsically tied to the project's economic impact.

ii. Reinvestment of Earnings Into New Productive Activities:

Diversification of productive activities is cited as an important indicator of change in the behavior of the clients resulting from the project's impact. With added income, entrepreneurs may shift resources to a new activity that may yield cash income, or may invest it to start a new enterprise while continuing the first one. The Grameen Bank Project shows that whereas before the program, 50 percent of the beneficiaries listed one income-generating activity, after the program that figure was less than 10 percent. Similarly, the number of beneficiaries with two income-generating activities increased by 20 percent, while 24 percent of those interviewed reported three income-generating activities. These findings suggest that the rural poor have skills and abilities that are underutilized because of lack of capital, and that when capital is made available, at least part of the resulting increase in profits is reinvested into productive activities (World Bank, 1985).

A review of loan clients of another small and micro-enterprise project in Burkina Faso showed that in both regions where the project operated, nearly half of the borrowers were considered to be at a higher economic level. An additional 37 percent had diversified into new businesses while continuing their original productive activity (Goldmark, et al., 1982).

Some argue that diversification or even reinvestment of added income into the firm may not always serve as an adequate indicator of a project's economic benefits. When an increase in

income is used for "nonproductive" purposes--health care, education, payment of debts, basic needs, emergencies--these too are considered by some as positive impact, albeit less direct. One study notes that in the case of two projects examined in the Philippines--the Manila Community Services and the Micro Industry Development Program--increases in income were used by a large number of borrowers to put more food on the table, that is, "the children literally eat up the profits." (Bear and Tiller, ATI, 1982).

In the case of the Self-Employed Women's Association (SEWA) in India, it is argued that the loans were used to reduce borrowers' indebtedness to private moneylenders. Even though direct investment in the business was more likely to produce a direct increase in income, providing an alternative to moneylenders as a source of capital indirectly meant less of a drain on enterprise earnings, and, in the long run, on disposable income, which in turn could be reinvested to expand current activities or initiate new ones (Sebstad, 1982).

It is important to underline the validity of this argument, especially among the poorest of micro-entrepreneurs. However, if the practice of diverting profits for consumption away from the firm, irrespective of beneficiary level, results in the gradual erosion of capital and eventual collapse of an economic activity, then there is the risk that the long-term detriment of that practice may outweigh the short-term benefits gained through the project.

iii. Savings Mobilization:

Savings mobilization resulting from small and micro-enterprise projects provides an additional measure of the full impact of a project on borrowers' income. Arguments that the poor, living at subsistence levels, have no savings, and cannot save were countered in a variety of recent studies. In Costa Rica and Jamaica, low-income households have savings, and in the case of Costa Rica, preferred to save in "formal institutions" but claimed ignorance of procedures and terminology (Blayney and Gonzalez, 1984).

Stimulating family and personal savings among poor entrepreneurs was perceived as both an objective and challenge to small and micro-enterprise projects, since potential borrowers had little or no experience in saving. For most borrowers, whatever extra income was available was used to meet basic needs

or to reinvest into the firm. But if access to credit was resulting in diverting the personal funds which were originally reinvested into the firm into nonproductive expenditures, then access to finance was not creating "additionality," but increasing the entrepreneur's propensity to consume (World Bank, Levitsky, 1985).

Increasingly, the issue of savings has been included as a sub-component of small and micro-enterprise projects. Five of the evaluations reviewed provided data on savings mobilization. Two categories of savings schemes prevail, and are used in a variety of combinations.

The most commonly used are forced savings schemes in which agreement to establish and maintain a savings account at a determined level is a prerequisite to eligibility for credit. These savings are then used to ameliorate a credit fund's liquidity problems, as in the BKK program in Indonesia, maintain an emergency fund, as in the Grameen Bank Project in Bangladesh, cover bad debts, as in a World Bank project in the Philippines, or introduce the practice of saving among the beneficiaries, as in several of the solidarity group projects in Latin America (El Salvador, Dominican Republic, and Peru).

Projects also have savings schemes that are voluntary, though at times also closely monitored. In the BKK project in Indonesia, over 40 percent of the clients initiated voluntary savings accounts, which they placed in either informal non-interest bearing accounts--predominant in rural areas--or deposited in savings institutions more accessible to urban dwellers (Goldmark, et al., 1982). Though the total amount of savings mobilized under this scheme is not available, evaluators point out that the high number of clients that save voluntarily is in line with the findings of a household budget survey conducted in rural Indonesia.

In cases where savings data do exist, it is apparent that small and micro-enterprise projects, whether through forced or voluntary schemes, have generated impressive amounts of savings among the urban and rural poor. By the end of 1983, the Grameen Bank in Bangladesh had accumulated over Taka 16 million in savings through group funds, and an additional Taka 3.4 million in an emergency fund, the total representing 10 percent of loans disbursed to date (World Bank, 1985). The Bangladesh Rural Advancement Committee Project, which also extends resources to Bangladesh's landless rural poor, used a combination of fixed savings and negotiated profit-sharing schemes to register a similar level of savings mobilization among the rural poor (World Bank, 1985).

The experience of India's Self-Employed Women's Association (SEWA) is also positive, even though, as in other projects, most SEWA members had no previous experience in saving, and their practice, by necessity, was to spend all earnings on food and other needs. In two years, by 1976, SEWA opened over 10,000 savings accounts with over Rs. 1 million in deposits from its members, women employed, among other things, as junksmiths, incense makers, vegetable and wood sellers, and garment dealers. By 1981, SEWA tripled the amount to over Rs. 3 million and raised to nearly 14,000 the number of bank accounts (Sebstad, 1982).

Most recent small and micro-enterprise efforts reinforce this pattern. In its first two years, the Association for the Development of Micro-enterprises (ADEMI), in the Dominican Republic, notes that it has assisted 662 micro-entrepreneurs to open savings accounts, for a total amount of over \$ U.S. 100,000 (ADEMI Annual Report, 1984). The unique aspect of this experience is that it opened the doors of financial entities to a low-income population which never before had access to these institutions. Through the project, borrowers opened their first checking and passbook savings accounts.

These findings suggest that the poor are able to generate impressive savings. Indeed, one World Bank study points out that, in general, we may be underestimating the propensity to save of the poor, because in all cases where the loan is used to buy equipment and machinery, the amount of income generated and used to pay back interest and principal on the loan is not counted as "saved", when in fact it is part of the value added by the borrowing enterprise (World Bank, Kahnert, 1985).

b. Recent Approaches to Measuring Economic Impact

i. Direct and Indirect Benefits:

Another economic definition of small and micro-enterprise project success suggested by Kilby and D'Zmura focuses on the increment of national income in relation to the resources expended in the project. Benefits measured in this analysis consider the society as a whole, and therefore look at both direct and indirect income. Table 4 presents selected data from Kilby and D'Zmura, and is based on the findings of surveys contained in five project evaluations (Burkina Faso, Brazil, Honduras, Dominican Republic and Peru, with samples ranging in size from 69 in Honduras to over 2,000 in Brazil, and including

units in agriculture/livestock, manufacturing, commerce and artisan production), and provides information on direct and indirect benefits.

For example, direct economic benefit for a firm receiving project resources equals its value added; that is, its gross output less purchased inputs from other firms. Value added within the assisted firm is equal to wages, rent, interest and profit, and reflects what earlier in this chapter has been discussed as direct benefits to the firm.

Beyond value added, however, these authors also consider four other forms of benefits generated to those outside the project which are termed "indirect benefits." The most important, backward and forward linkages, defined earlier in this chapter, take into account changes in various stages of production resulting from the project. These are considered benefits to the extent that goods and services are produced within the country, and are new production rather than sales diverted from other customers. In the calculations provided by Kilby and D'Zmura, the backward linkage benefit generated by the projects is the most substantial contribution to the overall economic benefit stream of these projects. A portion of the direct factor income will be spent on consumer goods and services from producers who have underutilized capacity and who will increase production to meet added demand. This is called final demand linkage.

Two other forms of indirect benefits should be explained. Consumer benefit refers to the benefit derived by the consumer if increased production of a given good has resulted in a price reduction. This calculation is provided only for Burkina Faso, underlining the difficulty of arriving at a satisfactory measure of this benefit index. The last benefit, termed diversion benefit, records the clients that have diversified into new businesses, and has been addressed in more detail earlier in this chapter. We note it here because it provides monetary data that supports the increased percentage of micro-entrepreneurs that started new activities recorded in the studies reviewed.

TABLE 4

BENEFIT SYNOPSIS OF FIVE USAID MICRO-SMALL ENTERPRISE ASSISTANCE PROJECTS

	<u>Most Likely Case</u>				
	1981	1981	1982	1981	'75-81
	\$U.S.	\$U.S.	\$U.S.	\$U.S.	000's \$U.S.
	<u>Burkina Faso</u>	<u>Brazil</u>	<u>Honduras</u>	<u>Dominican Republic</u>	<u>Peru</u>
<u>Value Added</u>					
Wages	-2,880	1,302,665	180,792	84,617	5,120
Interest	17,615	1,535,045	-	-	-
Profit, Rent	117,328	1,798,394	267,775	363,400	19,222
<u>External Economies</u>					
Backward Linkage	66,812	811,355	98,792	20,993	9,417
Final Demand Linkage	31,604	620,212	89,713	89,603	3,224
Consumer Benefit	343,316	-	-	-	-
Diversion Benefit	27,500	2,311,650	51,777	-	4,283
Total Benefit	647,873	7,632,039	385,766	557,177	36,653
Total Cost	640,902	5,752,200	309,700	100,635	35,527
Benefit/Cost Ratio	1.01	1.33	1.25	5.54	1.03

SOURCE: Kilby and D'Zmura. "Searching For Benefits", selected indicators and table organization by R.G. Blayney. Kilby deducts an opportunity cost of labor from value added inputs, not shown in this table.

In four of the five cases presented in Table 4, it is the inclusion of indirect benefits that results in a benefit cost ratio greater than one. The authors assert that none of these projects would be considered "successful" if measured in conventional terms of interest income covering all administrative costs and capital erosion. It is interesting to note that the Dominican Republic, which shows the best benefit to cost ratio, has been documented as not being as cost-efficient as projects initiated later which used the lessons learned from this project to yield even higher levels of benefits as compared to costs (Otero and Blayney, 1984).

A second point raised in Kilby and D'Zmura illustrates the difficulty of generalizing among all small and micro-enterprise projects. They persuasively demonstrate that one of the major contributors to a favorable level of benefits is the backward linkage generated by a firm which, after accessing the project's resources, has increased production. Hence, it would make sense, at the project design stage, to reflect a concern not for simply assisting small and micro-enterprises, but for targeting those firms that operate in a market environment conducive to improved viability and growth.

The argument suggests a new approach for assisting small and micro-enterprises, linking provision of services more closely to identification of those sectors in an economy that show greatest promise for growth and backward linkages.

It is in the identification of the sectors that create backward linkages that economists disagree. For example, some point out that the largest category of small and micro-enterprises, retail trading, generates no backward linkages (Kilby and D'Zmura, 1985). Others argue that this may appear to be the case because of the intangible nature of value added by trading goods, which is less obvious than the value added through physical change made, for example, by manufacturing. In fact, traders supply and market many of the raw materials and products of larger and small-scale manufacturing enterprises, as well as supply inputs and market the products of agriculture (Harper, 1984). Field observation, certainly in small towns, supports the view that there is an abundance of trade of locally produced retailed goods. In sum, retail trading is characteristically the marketing of produce, locally produced utensils, and handicrafts, all considered important backward links to rural farm and off-farm productive activities (Bendavid-Val, 1985).

The disagreement in the significance of the retail trade sector in terms of backward linkage may be partially attributed to the fact that most small and micro-enterprise projects are located in major metropolitan areas. In these large cities, even among the small and micro-vendors, there is a significantly higher level of imported goods in retailing--with no backward linkage to the local economy--than in the medium and smaller cities.

When considering the economic impact of small and micro-enterprise projects, it is important to underline that the retail trading sector, whether located in metropolitan areas or small, rural communities, is not only the largest, but contains the poorest, the most women, and the least skilled among entrepreneurs. Projects that address the needs of these poor entrepreneurs may contribute to improved distribution of income, and lead to important social gains such as increased access to resources and improved skills. Therefore, evaluating projects only in economic impact terms--growth potential, viability, value added and backward linkage--could overlook the less tangible social gains. This attention to social and less quantifiable economic impacts is central to a discussion of small and micro-enterprise promotion, and will be further considered below.

ii. Economic Analysis of Project Benefits and Costs:

A second approach to measuring impact is based on benefit/cost analysis. While this method of project analysis has been utilized extensively for project planning and evaluation, its application often has been limited to determining if a project is a worthwhile investment of a funding agency's resources. In a recent study of four small and micro-enterprise projects, the authors attempt to create a more complete picture of project benefits and costs (Eng et al., 1985). In addition to considering the benefits and costs to a sponsoring agency (direct project costs, as well as planning and design costs), this approach also analyzes the benefits and costs from two additional perspectives: the individual project participant, and society as a whole.

Included in costs for project participants are all costs that they incur which are not necessarily covered by the sponsoring agencies, such as fees, transportation and food. Also included are the opportunity costs for the beneficiary participating in a given project, and the costs of repayment of the principal and interest on loans. For society as a whole,

this study considers the opportunity cost of designing and planning a particular project, of utilizing financial and other resources, and, on the benefit side, the overall benefits accrued through increased income and employment generated by the project.

An interesting finding in Eng's study is derived from its analysis of the Dominican Development Foundation (DDF), based on secondary data also used in this study (Ashe, 1985; Otero and Blayney, 1984). It suggests that from the perspective of the sponsoring agencies, the DDF small and micro-enterprise project appears to have a high benefit/cost ratio relative to other types of projects (Eng, et al., 1985). Even when costs of project development and unpaid loans are included under the highest assumed discount rate (the authors use four different discount rates to determine the degree to which external economic factors might affect the economic viability of the project) the benefit/cost ratio is over 4.3 for the sponsoring agencies.

This approach to impact assessment can be a useful way for developing comparative returns to investment among various project alternatives open to a donor agency. The findings in this study reinforce the assertion made by Kilby and D'Zmura after their indepth review of benefit streams in five projects, **that the rates of return recorded in small and micro-enterprise projects place these lending schemes among the most successful categories of all types of foreign aid programs** (Kilby and D'Zmura, 1985).

B. CHANGES IN EMPLOYMENT

1. General Discussion

Like income, employment impact is of overriding concern to those promoting small and micro-enterprise development. And yet determining the degree to which small and micro-enterprise activity generates productive jobs, and the costs of those jobs is not easy. At least two issues must be considered: first, what constitutes productive employment; and second, what alternative measures are used for quantifying job creation.

To define adequately job creation or "job additionality," one must take into account if the job is full-time, and its duration. Whether the wage earner was formerly unemployed or

underemployed, as opposed to transferring from another job, will also affect the overall results, a factor usually measured in terms of the minimum opportunity cost of employment. How the wage earned by a new employee relates to the minimum wage--if there is one--also enters into the discussion.

For example, a person that works for no compensation or below what is generally accepted in the economy as the minimum wage may be classified as an "apprentice" or "job trainee," or as a part-time employee. Most small and micro-enterprises--especially the latter--depend considerably on family labor, and yet pay very little if anything for this work. In addition, micro-enterprises provide entry-level jobs for nonfamily personnel who will often accept less than nominal minimum wage in order to have some earnings, and to learn a trade for improved job security and income in the future.

In many cases, especially among the smallest and most tenuous enterprises, job sustainability is as important a consideration as job creation. Averting the dissolution of a micro-enterprise that generates income, and the resulting unemployment of its owner, while not contributing to "job additionality," is nevertheless a key consideration in employment measures. Data collected should distinguish between job stability and job creation.

While most firms consider these various classifications, the above factors influence how one defines a full-time job or its equivalent, and affect impact calculations of job creation within small and micro-enterprises. Attempts to define employment creation include the following measures:

- the total employment generated directly by the enterprise, measured as number of jobs or number of person-days;
- stabilization or strengthening of precarious jobs, measured also in total number of jobs retained or number of person-days;
- composition of labor force, in which figures are disaggregated by sex, social or economic class, and other similar categories;
- indirect or secondary job creation through backward and forward linkages generated by the assisted enterprise.

2. Findings and Observations

a. Job Creation and Job Sustainability

The capacity of small and micro-enterprises to generate employment is particularly important in light of the magnitude of these sectors in the majority of developing countries. In an examination of 13 countries, employment distribution in manufacturing by size of firm demonstrated that nearly 60 percent of total manufacturing employment takes place in firms with fewer than ten employees (Liedholm and Chuta, 1979). The contribution of these small manufacturing units to the total manufacturing share of gross domestic product ranged from 22 percent in Jamaica to 50 percent in Bangladesh.

Not all the evaluations reviewed and presented in Table 2, p. 19, provide data on employment creation. However, most of the ones that record employment changes demonstrate that, with financial and technical assistance, the small and micro-enterprise subsectors hold the potential for contributing to job creation and job enhancement among the poor majority in developing countries. It should be noted that these evaluations provide micro-level and cross-sectional analyses and therefore do not address issues such as dislocation and macro-level effects over time.

The use of surveys is the most common way of collecting reliable data on job creation. In the majority of the projects reviewed where the evaluators conducted sample surveys, the results indicate that the projects had a positive impact on direct job creation, though there is considerable variance among projects. Table 2 above assigns a value number ranging between -3 and +3 to the employment impact of each project, the same rating system used for measuring changes in income. While this method is somewhat subjective, unless otherwise indicated, it is based on numerical data provided in the evaluations, and here serves as a basis for comparison among projects.

Some specific examples can help reinforce the assertion that small and micro firms, when assisted, generate considerable employment. In the Fundacion Carvajal's project in Cali, Colombia, among the 236 firms surveyed that received credit from an IDB line of credit, the increase in employment was 33.4 percent, an average in firm increase from 3.8 to 5.8 workers. The increase also varied according to subsector, with commerce registering a 75 percent increase, while industrial firms showed a 27 percent increase in jobs (IDB, 1985). In the Calcutta Urban

Development Project II, discussed in more detail below, there was a 62 percent increase in number of jobs among the 631 firms surveyed (World Bank, Kahnert, 1985).

The evaluation of the Industrial Bank of Peru also indicates an important level of job creation by the project. Survey results showed that 6,150 jobs were generated through loans to small entrepreneurs. This figure translates into an average of 2.5 jobs created per firm. Of these, 65 percent were full-time, paid jobs, while 31 percent were for family members who did not earn wages, and an additional 4 percent were for apprentices whose earnings were minimal while developing a skill. These figures, the study suggests, underestimate the true employment impact of the project, which also helped sustain the jobs of owners and family members. If one includes job sustainability as part of employment impact, then survey results show a total of approximately 15,730 jobs created or strengthened by this project (Goldmark, et al., 1982).

In assessing the employment impact of small and micro-enterprise projects, use of control groups can help highlight the differences between those assisted and other entrepreneurs, and can also help clarify how permanent these jobs are. The evaluation of the Dominican Development Foundation's Small and Micro-enterprise Project studied sample borrowers and a control group of firms over a one year period (Ashe, 1985). The average percentage change in number of full-time jobs sustained for a year among the assisted group was 70.6 percent; the percentage change among the control group was 3 percent. The study calculates that the amount of salary generated by new jobs alone exceeded the total value of the loans extended through the project. Were one to add the income changes by the owners and existing employees, which is discussed above, the total value of the project's economic benefits is much higher.

Most project evaluation findings, with some important exceptions, reinforce the above pattern of employment generation by the small and micro-enterprise subsectors. These evaluations also discuss the direct costs of creating new jobs, pointing out that job creation in small and micro-enterprises must be reviewed in relation to other existing alternatives for job creation in developing countries.

b. Costs per Job Created in the Small and Micro-enterprise Subsectors

Most calculations of job creation include a variety of cost inputs, such as direct investment costs; subsidized capital

costs; the cost of providing the technical assistance to program planning and implementation; the costs of administering a credit and training program; and related job training or enterprise management assistance. Obtaining uniform and accurate measures of these variables is difficult, and their inclusion raises the "real costs" of generating full-time jobs or their equivalent in the small and micro-enterprise subsectors.

The data below, drawn from five of the projects intensively reviewed for this paper, and which appear on Table 2, p. 19, give a general idea of the range of investment per job created in the small and micro-enterprises assisted by these projects.

TABLE 5
LOAN AMOUNT PER JOB CREATED IN FIVE
SMALL AND MICRO-ENTERPRISE PROJECTS
(U.S. dollars)

PROJECT	LEVEL	LOAN PER FULL-TIME JOB*
National Christian Council of Kenya	Micro	400
Entente Fund (West Africa)	Micro	6,400
BKK (Indonesia)	Micro	150**
ADEMI (Dominican Republic)	Micro	1,650
Industrial Bank of Peru	Small	7,000

* $\frac{\text{total amount lent}}{\text{total number of full-time jobs created}} = \text{Costs per Job}$

** The evaluators believe that this figure probably understates the cost per job because the survey excluded less productive branches and was biased against clients who had defaulted on their BKK loans.

Several other findings regarding job creation are worth noting. The level of education and skills available in a country appears to influence whether an entrepreneur chooses to invest in machinery or relies primarily on available labor skills. Countries where the labor costs are low still provide evidence of high capital cost per job, suggesting that when faced with an unskilled labor force and scarce management skills, it is easier to rely on more sophisticated technology operated by fewer, skilled workers (Levitsky, 1985). This issue is more applicable to the larger among the small enterprises. At the micro-enterprise level, the capital to labor ratio drops, and the majority of owners, as well as workers, have limited formal education or training (Uribe-Echevarria, 1985).

One finds, therefore, variation in the labor intensity in the same subsector from country to country. Also important, where data are available, one finds variations among subsectors within each country. Table 6 of The Calcutta Urban Development Program II, implemented by the World Bank, illustrates this point by showing the difference in amount lent per job created for the three sectors studied.

TABLE 6
EMPLOYMENT IMPACT AND COST PER JOB
CALCUTTA URBAN DEVELOPMENT PROGRAM II

SECTOR	NO. OF UNITS	EMPLOYMENT		LOAN AMOUNT PER ADDED JOB (In Rupees)
		Before Loan	After Loan	
Tailoring	315	90	382	892
Manufacturing & Repair	161	417	526	4,740
Trade & Other Services	155	232	290	5,890
TOTALS	631	737	1,198 (AVERAGE)	2,437

Source: The World Bank, Kahnert, 1985.

Finally, while estimates for direct job creation are included in many evaluations, few evaluators quantify indirect employment generated by small and micro-enterprise projects. If a loan generates sufficient income for loan repayment as well as for business expansion, and local resources are used, then borrowing enterprises can affect other local firms by creating increased demand for inputs as well as distribution and sales.

This issue was discussed under indirect income benefits created through backward and forward linkages. For example, with respect to employment, enterprises that process raw materials or agricultural products are likely to generate jobs indirectly in sectors such as agriculture, forestry, or fishing. They may also generate secondary employment if, as a result of increased demand or output, more jobs are created for transport drivers, delivery men and other intermediary functions.

In the BKK program, for example, the primary backward linkage has been through suppliers, since about 90 percent of surveyed borrowers have increased the volume of materials they purchase. In addition, they are spending more on personal consumption through increased purchasing power (Goldmark, et al., 1983). In several projects where bakers were a significant number of borrowers, (Ivory Coast, Kenya, Cameroon, Bangladesh), the number of jobs created among drivers and delivery men was at least as many as among bakery employees (World Bank, Levitsky, 1985).

CHAPTER III

ASSESSMENT OF FACTORS THAT CONTRIBUTE TO PROJECT EFFECTIVENESS

A. INTRODUCTION

A wide range of factors enter into the equation of a successful small and micro-enterprise project. In this chapter, we discuss these factors under three categories:

- The socioeconomic context in which projects are implemented has a great deal to do with their success, and yet it is the hardest to predict and analyze. In this section, small and micro-enterprises are considered in the context of the private sector in general. Two main areas are discussed: the financial and economic conditions pertinent to most developing countries, and the effects of government policies on private sector activity, especially small and micro-enterprises.
- The institutions selected to implement projects are of course key to project success. This section suggests ways of classifying the many and varied institutions involved in small and micro-enterprise promotion, discusses organizational factors that contribute to institutional effectiveness, considers issues particularly pertinent to Nongovernment Organizations (NGOs) and Private Voluntary Organizations (PVOs), which implement the majority of projects. 1/
- Since nearly all small and micro-enterprise projects contain a credit component, and most also include some technical assistance, delivery of both financial and nonfinancial resources is discussed. This section suggests that the design of each project component is crucial to successful implementation, and discusses characteristics of effective design for extending credit and technical assistance to small and micro-enterprises. Because the emphasis of all project

1/ The term "Nongovernment Organizations" (NGOs) is used to refer to all host national and international nonprofit organizations. "Private Voluntary Organizations" (PVOs) are a subset of NGOs, and are used to refer only to U.S.-based NGOs.

evaluations reviewed by the authors is on the projects' credit components, the discussion that follows focuses on the delivery of financial resources.

As in the previous chapter, each section presents first a general discussion of issues, followed by major findings and observations.

B. SOCIOECONOMIC CONTEXT

1. Macro-level Considerations:

Trends during the 1970's indicated that, with the exception of agriculture, the public sector in most developing countries was more significant than the private sector in terms of investment and production. In Latin America, the Caribbean, and Africa, in part due to policies that favored public institutions, public sector investment was larger in aggregate value than that for the private sector. Although the public sector channeled much of its resources through private banking institutions to private firms, it was public control, in many instances, that dominated the financial sector.

During this period, the larger enterprises in the private sector also grew rapidly due primarily to government incentives, e.g., import substitution policies, preferential credit and interest rates, tax holidays and others.

The protectionism that benefited large enterprise and public sector activity in the 1970's contributed to the institutional, financial and technological weaknesses that now constrain these sectors' ability to respond to the current economic and financial crises plaguing most countries. For example, the large enterprise subsector faces a severe liquidity crisis with high overall debt levels and with an external debt that is not matched by its export earnings capacity. The reaction of this subsector has been characterized by a sharp decline in investment, accompanied by capital flight, and a strong tendency to look to the public sector for solutions--such as absorption of foreign exchange losses on heavy borrowing, and demand for concessionary credit terms from central banks.

Current economic conditions in most developing countries have the following general characteristics:

a. Financial Crisis: Structurally low export earnings combined with devaluations and stiff import controls have created a crisis for the private sector in terms of shortage of imported inputs, shortage of foreign exchange to service ever-growing foreign debts, a narrowing of markets for export products, and a rising overall debt.

To the industrialized countries, the key issue that emerges from this financial scenario is the excessive indebtedness of the developing countries. They propose to solve the problem through traditional monetary and fiscal measures. To the developing countries, however, the issue is much more than the restructuring of foreign debt, and the application of restrictive domestic monetary policies. For many, the current situation threatens the survival of their political institutions. In Brazil and Argentina, for example, interest payments alone on the foreign debt are likely to equal at least 45 percent of export earnings; for Mexico, the figure is just under 40 percent.

Although other countries do not face quite as dire a situation, in many cases the current approaches to address these problems have had the paradoxical result of turning countries in desperate need of investment into exporters of capital. As has been suggested by the Harvard Institute for International Development (HIID), the structural adjustment costs for developing countries' governments are, and will continue to be, extremely high, and significant infusions of capital will be necessary.

b. Employment: While governments in developing countries cut back on fiscal expenditures and restrict the supply of capital in the domestic economy, as discussed earlier, they are also faced with unprecedented levels of "official" unemployment and underemployment. According to the IDB, Mexico, as an example, must create two million new jobs over the next three years, just to maintain current levels of "official" unemployment rates. Therefore, while government policies have contributed directly to the current structural weaknesses found in much of the private sector, their removal, or the application of "corrective alterations" necessary for a more market-responsive economy have proven extremely difficult in practice. Jamaica, Argentina and Nigeria are just some examples.

It is against this backdrop that one must analyze private sector development or expansion, and specifically small and

micro-enterprise development and expansion. These two subsectors are dependent on the economic context, which will inhibit or assist their growth. In addition, they will depend more on the prevailing macro-level policies of a given country than, as some suggest, all the project interventions of AID and other donors combined (HIID Roundtable, 1985). The following provides a discussion and general findings on how policies affect private sector development in general, and small and micro-enterprises in particular.

2. A Closer Look at National Policy and the Private Sector:

Cross-country analysis and experience suggests that private enterprise tends to perform most efficiently--in the sense of generating high economic returns to the country, not just financial rewards to investors--in environments with the following characteristics:

a. Legal and Political Factors:

- predictable policy environment;
- limited state enterprise activity;
- access to cost-effective financing;
- legal systems that protect private ownership and property;
- reasonable import and export controls;
- appropriate fiscal legislation and incentive system;

b. Local Infrastructure and Economic Factors:

- adequate physical infrastructure (roads, power, communications, etc.);
- adequate services and technical infrastructures, i.e., institutions, including associations, information sources, training systems, human resource development systems, consulting services, and research centers;
- functioning capital markets;
- predictable exchange and currency policies;
- accessible local and foreign markets;
- access to technology and supporting resources (spare parts, raw materials, etc.); and
- potential economies of scale for rapid growth.

c. Internal Enterprise Factors:

- entry to market opportunities is relatively unrestricted;
- access to capital, technology and other resources;

- access to a pool of trained workers;
- ability to analyze and use information;
- access to management resources;
- positive attitudes toward entrepreneurial risks;
- access to information linkages at the local level, such as urban and rural markets, and internationally.

While it is clear that the above outlined environment does not exist in any developing country, it demonstrates that the policy climate in the country is of overriding importance to enterprise promotion. Studies conducted by the World Bank in seventeen African and Asian countries over a period of twenty years (1962 - 1982) support this contention and enable one to draw important conclusions applicable to small and micro-enterprise development (Marsden, 1985):

- Economic growth among all countries studied was strongly correlated with real growth of domestic credit to the private sector. Economic growth was also positively related to the share of private sector credit in total domestic credit, which suggests that the private sector was more effective at stimulating growth than the government and public enterprises.
- Economic performance was not significantly linked to the financial flows from abroad. Foreign lending to African governments was generally much higher in relation to GNP than for East Asia. However, these international resource transfers failed to boost growth unless accompanied by measures to raise domestic savings and ensure ample access to credit for the private sector.
- With the exception of Zaire, all countries studied began the 1960s with active private sectors and domestic financial markets geared to their needs. It was only over the next twenty years that their paths diverged, with private enterprise responding to incentives and opportunities created through various policies, and contracting in reaction to government controls and state monopolies.

One can relate these findings to the small and micro-enterprise subsectors of developing countries. First, they suggest that mobilization of domestic savings is a key element to fostering development. The previous chapter has discussed the surprisingly high propensity to save demonstrated by small and micro-entrepreneurs--even among the lower income groups. While in

the aggregate these savings represent a small percentage of total savings in a country, the number of small and micro-entrepreneurs currently reached through projects is also very small. Second, access to credit is also identified as a crucial element for private sector development, and it clearly applies to the small and micro-enterprise subsectors as well. Policies must be found and used that increase the amount of and the access to credit by small and micro-entrepreneurs, such as reforming interest rate structures, and creating fiscal incentives for the private sector to lend to small and micro-entrepreneurs.

Small and micro-businesses should not be promoted because "they are beautiful for their own sake" (Berry, 1981). In fact, in many product groups, economies of scale make small firms noncompetitive. In the Indian experience, indications are that when small firms are also subsidized and protected, scarcities result, enterprises over-invest in plant and equipment, and consumers pay more than if small and larger firms had to compete (Kahnert, 1985). Promotion and services can best be focused on those small industry groups which:

- are small scale, labor-intensive, and competitive due to insignificant economies of scale in production;
- show sizeable growth prospects in local markets;
- have identified problems which can be tackled within a project context;
- constitute a significant share of output in the local or regional economy, or at least concentrations of like small industry exist enough to make sizeable impact with cost-effective assistance;
- have raw materials available locally or for which local value added is high (Berry, 1981).

With few exceptions, such as India, governments demonstrate a strong bias in favor of large businesses and benign neglect, if not negative bias, towards government incentives and other policies that favor small and micro-businesses. AID could play a significant role in encouraging countries to test new models of policy and regulation reform. This issue is further discussed in Chapter V.

C. INSTITUTIONAL MIX AND SELECTION

1. General Discussion:

To meet the needs of small and micro-enterprises in developing countries, there is usually a broad range of public and private institutions which provide credit, offer management services, conduct training, advise and consult, and develop new or expand existing small and micro-enterprise projects. In fact, the diversity of organizations that implement small and micro-enterprise projects is striking, and was reflected in the projects studied under PISCES I, which included nongovernmental organizations (NGOs), government agencies, commercial banks and business associations (PISCES, 1981).

A standard way of distinguishing among the many types of institutions has been to divide them according to whether they were private or public sector organizations. Some have also considered voluntary organizations as a separate category (Devres, 1981). Such neat categories, however, assume clear-cut distinctions between the private and public sectors which in reality do not exist. In essence, the private sector means those firms that are privately, as opposed to publicly owned. A recent AID-sponsored study defines the private sector as "the set of privately owned, for-profit firms engaged in the production for sale of goods or services." (Robert R. Nathan, 1985). These include commercial banks, financial companies, consulting firms, and contracting/supplying firms.

Public sector entities comprise those government instrumentalities that support small and micro-business development. State-owned banks--such as development banks and development finance corporations--though meant to reach larger businesses, may have a credit window for small entrepreneurs. Other public sector institutions such as ministries, extension centers, management and training institutions provide support services to small businesses. A study of small scale enterprise projects identifies 30 private and public financial institutions in Latin America and the Caribbean currently assisting small businesses (Devres, 1981).

Difficulties in classification arise in the case of "hybrid" organizations, which are owned by both public and private interests, and which may combine for-profit goals with community or social development goals. As will be detailed below, several of the institutions that have made significant contributions to small and micro-business development fall into this category.

The "voluntary" sector is also made up of private service organizations which operate on a not-for-profit basis. That is, their objective in assisting small businesses is to accomplish social as well as business goals. Most NGOs, religious organizations, and even some trade associations would fall into this category. Similarly, most publicly owned enterprises-- public schools, ministries of public works, some parastatals-- although not private, may share more characteristics with voluntary organizations than with market-oriented ones.

A useful dimension for classifying institutions is the degree to which they are market-oriented, that is, the degree to which making profits is essential to the success of the organization. The two-dimensional scheme illustrated below uses degree of market orientation as a variable to classify organizations that may be involved in small and micro-enterprise projects.

TABLE 7 *
**CLASSIFICATION OF SMALL BUSINESS
SUPPORT INSTITUTIONS**

Orientation	Publicly Owned	Hybrid	Privately Owned
Market- oriented	<ul style="list-style-type: none"> o Electric Power Commission (Brazil) o Grameen Bank (Bangladesh) 	<ul style="list-style-type: none"> o Commercial Bank (Malawi) o FEDECCREDITO Cooperative Bank (El Salvador) 	<ul style="list-style-type: none"> o Micro-firms o IFCs (Ecuador) o Small and Medium Firms
Nonmarket- oriented	<ul style="list-style-type: none"> o National Banks (Costa Rica) o State Enterprises (Thailand) 		<ul style="list-style-type: none"> o NGOs, PVOs o Chamber of Commerce (Barbados) o National Foundations (LAC)

* Adapted from Jerome Wolgin, "The Private Sector, The Public Sector and Donor Assistance in Economic Development: An Interpretive Essay," Prepared for AID, 1983.

2. Findings and Observations:

Table 3 on p. 20 summarizes the basic data on the projects reviewed. It shows that the majority of institutions involved in small and micro-enterprise projects are NGOs and PVOs. Thirteen of the 19 projects appearing in the table had an NGO or PVO as the major implementing institution, compared to five that were conducted by public agencies--development banks--and two that involved private commercial banks. Some programs, such as ADEMI in the Dominican Republic and SEWA in India combine institutions in these categories for implementation of different project components.

a. Type of Organizations in Relation to Level of Beneficiary Reached:

Institutions work at different levels of enterprise development depending on the target group that they have set out to reach. We identify three levels of beneficiaries, and the type of institution that is most likely to reach each one.

i. Pre-entrepreneurs: These beneficiaries are usually reached through community-based projects that include a wide range of components, such as literacy training, nonformal education, group-building, in addition to enterprise development. Most beneficiaries are among the poorest and often lack entrepreneurial experience. Community development components are seen as prerequisites to initiating self-employment activities.

Such projects are often directed by local NGOs or expatriate PVOs which appear best suited for projects that require grass-roots organizational skills more than business skills, continuous contact with beneficiaries, highly flexible promotional systems, mobilization of community leaders and active community involvement in the development process. Review of activities at this pre-entrepreneurial stage is outside the scope of this paper, but important to mention here for reference purposes.

ii. Micro-entrepreneurs: Growing out of community organization experiences, the next logical step in enterprise development has been to use group formation schemes among micro-entrepreneurs for the delivery and administration of credit and for provision of technical assistance. Solidarity groups--in which project beneficiaries form their own groups, receive one loan to be divided among group members, and then assume responsibility for repayment--have been used extensively, especially in Latin America (Reichmann, 1985; Blumberg, 1985; Ashe, 1984; Otero and Blayney, 1984).

All the projects in Table 3 that list an NGO as the implementing agency also show micro-entrepreneurs, as opposed to small businesses as a primary target group. This is not surprising, since, as discussed in more detail below, NGOs appear best suited to reach the smallest and least accessible firms. However, there are also important examples of public institutions, as in the case of the Grameen Bank in Bangladesh which are also effectively reaching large numbers of micro-entrepreneurs using group formation techniques.

iii. Small Entrepreneurs: With some exceptions, credit extension to individual borrowers reaches the larger among the micro-entrepreneurs, and the small entrepreneurs. It is at this business size sublevel of so-called small scale that one finds most development and commercial banks operating. Banking programs often are based on special units administratively separate from general banking functions, and use highly simplified business systems and selection criteria.

Although little documentation exists, it also appears that banks are increasingly using nonbanking intermediaries to carry out activities such as:

- assessment of a potential borrower's reliability and credit-worthiness;
- supervision of borrowers;
- collection of payments and follow-up on arrears.

Examples include the Working Women's Forum and the Calcutta "Y" Self-Employment Centre, both in India. Other examples exist in Latin America utilizing both local NGOs and international PVOs (Dominican Republic, Honduras). Banks may be increasingly receptive to this model because experience to date, though limited, demonstrates lower arrearage and default rates, increased credit turnover, expanded outreach and lower unit administrative costs to the banks (Ashe, 1985).

b. Characteristics of Institutions That Implement Effective Small and Micro-enterprise Projects:

NGOs are identified as being of overriding importance to small and micro-enterprise development. They operate locally, nationally and internationally, as with U.S.-based PVOs which link with local NGOs to carry out a project.

Despite their diversity, PVOs and other institutions that are effective at reaching small and micro-enterprises share several common characteristics. The discussion below summarizes the key characteristics as derived from several of the project evaluations and analyses of institutions cited elsewhere (Ashe, 1985; Tendler, 1982).

i. Goals and Objectives: Goals and objectives are well-articulated for the institution as a whole. In the case of NGOs and PVOs, those institutions that focus on one or two lines of work (e.g., rural credit, training, cooperative formation), clearly identify their target group (farmers, urban workers, range in income level), and avoid the trap of "being all things to all people," appear to be most effective. The presence of a strong, well-respected, charismatic leader who can communicate the institution's mission to the staff and to outsiders can be key to maintaining the institution on track.

ii. Activities: In addition to concentrating on few rather than many types of projects, the activities undertaken are decided upon with input from the potential beneficiaries. It is here that an NGO's proximity to the beneficiaries gives it a comparative advantage over other organizations. The planning process includes interviews, discussions or meetings with potential project participants who can help shape a more responsive, and therefore more effective project.

iii. Funding Sources: Institutions that have diversified their funding base tend to be more stable than those that are dependent on a single source. In addition, those institutions that choose not to depend entirely on concessionary monies demonstrate both ability to generate funds through charging real interest rates and fees for services, and concern with lowering administrative costs. Both factors contribute to a strong potential for self-sufficient credit delivery projects.

iv. Organizational Structure: Decentralized organizations that extend decision-making responsibility to field staff appear to be the most effective. This factor seems most important in projects with large geographic outreach--such as the Grameen Bank in Bangladesh and the BKK in Indonesia. A certain degree of autonomy allows field staff the flexibility to adopt strategies they consider appropriate and to modify or discard existing approaches over time.

v. Internal Management and Planning: The capacity to effectively coordinate the work of staff and to monitor

operational projects are key attributes of effective institutions. Especially in the case of credit delivery, record-keeping and monitoring systems that are easily kept up to date and that provide essential information on the status of the loan portfolio can help avoid decapitalization or unacceptable rates of arrearage and default.

The BKK in Indonesia has been particularly successful in this regard. Some of the newer institutions, such as ADEMI in the Dominican Republic, have vastly improved earlier monitoring efforts, by making the collection and classification of information an intrinsic part of project implementation. In addition, institutions that dedicate time to planning, with input and feedback from the field staff appear better suited to respond to problems and to try new approaches. This issue is discussed in greater detail under project components.

vi. Personnel: Effective institutions maintain a high level of commitment among their staff. Their staff are usually young, dedicated, believe strongly in the institution's work, and are usually willing to work for low salaries. While most do not have university degrees, the majority have post-secondary education, gain experience in the field and through in-house training. The organizations also maintain a moderate to high clientele to personnel ratio, and establish performance incentives for staff.

vii. Membership/Contributions: Local private sector participation--through financial and human resource support--can strengthen an institution's credibility both with other local sources of funds and with international donors. In some countries, existing laws channel private resources to these organizations (Jason Brown, 1983). In others, private sector representatives serving on an institution's board or advisory committee can assist in mobilizing local human and financial resources.

viii. Evaluation: Closely related to monitoring and record-keeping systems, evaluation--through audits on a regular basis, outside evaluations, and systematic feedback from clientele--assists an organization to increase project effectiveness. Outside evaluations are one mechanism for cross fertilization of lessons learned in other institutions, and usually identify weaknesses and provide recommendations to the implementing institution.

ix. Knowledge of Context: Ability to understand the relationship between the country's socioeconomic and political

climate and the institution's work contributes to the survivability and effectiveness of any institution. This factor is particularly applicable to institutions implementing credit projects because, as discussed elsewhere, both economic policies and the economic conditions of a country have great impact on the activities of the borrowers, and hence on their ability to repay their loans.

c. Related Issues Pertinent to NGOs and PVOs:

There are several institutional constraints endemic to all NGOs and PVOs which merit additional comment. Three are discussed below: the struggle of institutions to operate cost-efficient programs; number of beneficiaries reached; and staffing problems.

i. Implementing Cost-efficient Programs: The issue of cost-efficiency--here defined broadly as an institution's ability to cover its operating costs from income earned through the project--has not been a priority for NGOs and PVOs, in part because of the availability of concessionary monies--grants and low interest loans--which seldom carry requirements in terms of program efficiency and output. 1/ Since the philosophy and emphasis of most of these institutions have been to work with low-income groups in a manner that includes service provision, training, human and organizational development, concern with administrative costs remained a low priority. Indeed, the donors themselves have encouraged loose controls by not setting efficiency standards and by not assisting NGOs and PVOs to measure or attain them. These institutions have been sustained over time by grants and contributions and have looked less to themselves and the beneficiaries as sources of project income.

Other factors contribute to the level of cost-efficiency in projects. In the case of small and micro-enterprise projects, the transaction costs incurred through project implementation are high. Processing a large volume of short-term, low denomination loans, the key activity of these projects, requires numerous staff, coverage of a wide geographic area, and time to follow-up beneficiaries. In addition, most of the earlier project designs

1/ The term "cost-efficient" should not be confused with "cost-effectiveness." The latter is a comparison of costs--that is, the value of the resources used to secure goods and services--in relation to the effectiveness--that is, the magnitude and quality of the benefits resulting from the goods and services (Wilde, 1983).

concentrated more on outreach and beneficiary coverage than on the cost of credit delivery, with some spending upwards of \$ U.S. 0.45 per dollar lent.

Second, NGOs and PVOs have traditionally been involved in development programs that did not yield an income--such as service provision, education and health. However, as their involvement in financial and business activities, such as the provision of credit increases, and donor resources decrease, these institutions are forced to reassess their operational philosophy, and to combine social goals with profit-making considerations.

In the last few years, cost-efficiency considerations have moved to the forefront of project management concerns for both implementing institutions and donors. Responding to this concern, NGOs and PVOs are developing the capacity to operate more cost-efficient small and micro-enterprise projects. The newer generation of projects show considerably more potential for developing self-sufficient credit components than earlier projects. Institutions such as ADEMI in the Dominican Republic and the Fundacion Ecuatoriana de Desarrollo (FED) are implementing small and micro-enterprise projects and using cost-efficiency as one measure of project success. Results to date for these institutions indicate that the delivery and recovery of each dollar lent is costing, in real terms, less than 15 cents.

ii. Scale of Projects: Most NGO and PVO projects reach a relatively small number of micro-entrepreneurs, seldom servicing more than 2,000 borrowers. Some of the more recent NGO and PVO projects are showing an increased interest in scaling up their projects, and are experimenting with loan application procedures and disbursement schemes that allow these institutions to reach significantly more small and micro-entrepreneurs. Not only will expanding these projects respond to existing unmet demand among small and micro-entrepreneurs, but it will also generate more income through increased credit portfolio turnover, and internally cover a greater portion of administrative costs.

Other factors affect the ability of NGOs and PVOs to scale up their projects in a significant manner. Liquidity problems, especially in newer credit programs where repayments come in slowly at first, preclude extending credit even to some whose applications have been processed (Otero and Blayney, 1984). This problem is exacerbated by slow disbursement of funds by donors, and lack of alternative sources of liquidity, such as through savings. Also, NGO and PVO projects are often concentrated in a

given region or city and lack the institutional infrastructure to have a large geographic outreach. It is here that development banks in particular demonstrate a considerable advantage over NGOs and PVOs.

iii. The Problem of Retaining Staff: Most studies agree that highly motivated staff is a key ingredient for effective organizations. However, local NGOs that implement small and micro-enterprise projects face several constraints in hiring and retaining staff (Kahnert, 1978; Ashe, 1985; PISCES, 1981).

Most local NGOs lack inducements that enable them to recruit and retain highly qualified professionals. Salaries are often not competitive even with comparable public sector organizations, and raising salaries only increases operational costs. In addition, these institutions do not provide clear, attractive career paths that induce competent young staff to remain with the institutions for an extended period of time. Hence, extension or field workers, regardless of their competency, have few opportunities for promotion. With possibilities for advancement seldom available, experienced staff leave, and the institution is forced to continually train new employees.

Some have suggested approaches to address this problem, such as the use of promotions to reward for performance rather than seniority; the use of training planned over the employee's career to continue expanding his or her ability; and schemes to attract motivated entrepreneurial persons by assisting them, after a given number of years, to start their own small scale enterprises (Berry, 1985).

D. PROJECT DESIGN

1. General Discussion:

Small and micro-enterprises are difficult targets to reach through project assistance. The firms are numerous, widely dispersed in urban and rural settings, and not easy to assist in a cost-efficient manner. Virtually all small enterprise surveys reveal that only a tiny fraction of the entrepreneurs have heard of the projects intended for them, and even fewer have been aided by them. According to Colombia's National Planning Office, between 1976 and 1983, small and micro-enterprise projects have provided training for 4,132 micro-enterprises, of which 1,300 have received credit. These figures constitute less than 2 percent and .5 percent respectively of the micro-enterprise population in that country. The Grameen Bank, in Bangladesh,

which has an impressive portfolio of over 115,000 borrowers, and plans to expand operations to reach 400,000 borrowers, still remains a small effort compared to the number of potential clients.

Moreover, the constraints facing small and micro-enterprises, and thus the type of direct assistance needed vary from country to country, region to region, and enterprise to enterprise. The results of AID, World Bank and other donor-supported projects show that the assistance needs of small and micro-enterprise include a range of financial and nonfinancial inputs--credit, management assistance, management and vocational training, marketing, supply and procurement assistance, technology transfer, group formation, infrastructure and policy support. No one small and micro-enterprise project can address all these needs; instead, most projects concentrate on credit delivery and the provision of some form of technical assistance.

Deciding which project inputs to deliver, and the strategies used for delivering them, must take into account at least the following factors:

- environmental and contextual issues, including level of industrialization of the country, political and economic framework, and national policy;
- local institutional capacity;
- level of enterprise development (number of employees, skill level of owner, duration of operation, value of assets, volume of production, sales, etc.);
- location of the enterprise (rural, urban);
- roads and other physical infrastructure;
- sector in which the enterprise operates (manufacturing, trade or service); and
- availability of educational and training institutions.

All 19 projects intensively reviewed for this paper (see pp. 19-20) include a financial assistance component, in the form of credit extension. This finding coincides with previous studies that showed that nearly 90 percent of small enterprise projects of the World Bank and AID provide financial service components, complemented by a variety of non-financial management and technical assistance services (Devres, 1981). Of the 19 projects, 15 also include some nonfinancial resources, usually training or technical assistance, or both.

In this section, we will discuss the various project components present in small business development projects under

two main headings: provision of financial resources through credit, and of nonfinancial resources, through technical assistance and training, placing particular emphasis on the former. While the previous section of this chapter argued that the performance of implementing institutions is crucial to small business development, the focus here is on project design as an additional key element of successful projects. This section will suggest some characteristics of effective design based on existing experience.

The design of small and micro-enterprise projects has evolved considerably in the last few years, based on project experience and lessons learned. This learning curve has affected the way projects currently extend credit--with project planners concentrating on issues such as interest rates, transaction costs, the use of credit--and the delivery of nonfinancial resources. The discussion below summarizes what today are considered the most effective characteristics of small and micro-enterprise projects.

2. Extending Credit

A project's ability to extend credit effectively is considered under two broad, and often overlapping categories:

- factors that affect the delivery of the credit--outreach and promotion; selection of borrowers; loan application and review procedures; and terms of the loan;
- factors that affect the health of a credit portfolio--interest rates; monitoring and record-keeping systems; loan collection mechanisms; procedures for dealing with delinquency and defaults; savings mobilization; lender margins; and rediscounting and guarantee schemes.

Before discussing each of the above, it is worth summarizing what the PISCES Final Report identifies as two characteristics applicable to all project design (PISCES II Experience, 1985). First, a project is designed with the participation of, and focused on the needs of, the beneficiaries and their local community. The project staff plays an important role in establishing contact, developing a trust relationship, and assessing the needs and abilities of potential beneficiaries. Feasibility studies, as in the Dominican Development Foundation project, served to both elicit participation in planning and establish staff contact with the client group.

Second, projects must have built-in flexibility to meet changing needs and respond to changing environments. This adaptability implies a willingness to make programmatic changes based on new information that evolves out of the implementation experience.

a. Factors That Affect Credit Delivery:

No development project will accomplish its objectives if the project staff does not establish a relationship of mutual trust and respect with the beneficiaries. A crucial ingredient for such a relationship is a well-designed project that not only builds-in beneficiary participation, but also includes effective mechanisms to deliver services and to reach the intended groups. Tables 8 and 9 below summarize some of the characteristics of the most and least effective project designs and the potential effect of each characteristic on project outcome.

Generally speaking, the more effective credit delivery projects have the following characteristics:

-- **Selection of Beneficiaries:** Established procedures exist to select potential borrowers from the intended target group of beneficiaries. Indicators are developed for staff to assess easily a firm's viability (e.g., owners are motivated, longevity of business, percentage of family income it generates, character references, etc.). Solidarity groups or other methods of group formation are used as an alternative to character references, and as a way of increasing the beneficiaries' input into selection of borrowers. In addition, potential clients are brought in from the outset into decisions about project design and implementation. Finally, project managers develop criteria to make sure that women are reached, since they predominate among the poorest in individual and group lending schemes.

The outcome is more likely to reach the lowest income groups among the intended clients, lend to more viable firms, and reduce credit administration costs by encouraging borrowers themselves to assume ownership of the project, such as through the use of beneficiaries to assist in loan collection.

-- **Outreach and Promotion:** Outreach relies first on contact between field staff and potential clients and then on word-of-mouth communications among the beneficiaries. The project also uses channels of communication accessible to women and others of the smallest entrepreneurs (marketplace bulletins, community fora, low-cost housing, clinics, social service offices, etc.).

Outreach can be low cost and decrease over time if the beneficiaries, based on their satisfaction with the project, advertise it among their colleagues and in their communities. Proper outreach serves as the first step in establishing a trust relationship between staff and clients, contributes to rapid disbursement of credit funds, and lowers administrative costs.

-- **Loan Application and Review:** Both application and review procedures are kept simple yet effective. Use of character references and groups based on self-selection are used in many micro-lending projects with very high repayment rates (between 85 percent and 95 percent), such as ADEMI in the Dominican Republic, Grameen Bank in Bangladesh, SEWA in India, and FEDECCREDITO in El Salvador. With emphasis on visits to the place of production, staff can observe the business, assist the client to develop a business plan, and make more informed recommendations for loan approval. The loan review system is decentralized, using simplified procedures for the smaller loans, and involving staff in making loan decisions. These factors contribute to more rapid credit delivery, increased credit fund turnover, higher volume of loans per loan officer and therefore increased income through interest, and lower administration costs.

-- **Terms of the Loan:** Terms are set to reflect accurately the needs of the target population. Loans do not require much, if any, collateral; the initial loan is used as a "starter loan," and is small and short-term, with larger, longer-term loans based on payback performance and need. Nearly all first loans are for working capital, and subsequent loans are for fixed and working capital. The interest rates reflect, as nearly as possible, the real market interest rates. This important issue of interest rates will be discussed below, under health of the credit portfolio.

The potential favorable outcome of these terms is that the credit extended reaches the poorest among entrepreneurs. Also, by charging real interest rates, the project increases its chances of survival and avoids raising expectations which a highly subsidized, short-lived credit scheme cannot meet. These terms also are better attuned to the existing business needs of small and micro-entrepreneurs, who often require small loans for working capital. Finally, the incremental learning facilitated by the actual practice of borrowing and timely payback act as conditions precedent for authorizing subsequent loans while diminishing the initial risk to the lender.

TABLE 8

PROJECT DESIGN FACTORS THAT AFFECT THE DELIVERY OF CREDIT

	<u>DESIGN</u>		<u>POTENTIAL OUTCOME</u>	
	<u>MOST EFFECTIVE</u>	<u>LEAST EFFECTIVE</u>	<u>POSITIVE</u>	<u>NEGATIVE</u>
SELECTION OF BENEFICIARIES:	<ul style="list-style-type: none"> ○ CLIENT RESPONSIVE ○ INDICATORS DEVELOPED FOR ASSESSMENT OF FIRMS' VIABILITY ○ CRITERIA TO ASSURE WOMEN ARE REACHED ○ RELIANCE ON STAFF CONTACT AND JUDGEMENT OF POTENTIAL CLIENTS ○ MAKES USE OF GROUP LOANS 	<ul style="list-style-type: none"> ○ NO CRITERIA BEYOND INCOME LEVEL ○ RELIES PRIMARILY ON APPLICATION FORMS 	<ul style="list-style-type: none"> ○ MORE LIKELY TO REACH LOWEST INCOME ○ MORE LIKELY TO LEND TO MORE VIABLE FIRMS ○ REDUCE LENDING COSTS ○ BORROWERS ARE RESPONSIBLE FOR REPAYMENT COLLECTIONS 	<ul style="list-style-type: none"> ○ MISSED OPPORTUNITIES MOST IN NEED/VIABLE ○ MAY EXTEND CREDIT TO NON-VIABLE FIRMS
OUTREACH:	<ul style="list-style-type: none"> ○ INITIAL CONTACT BETWEEN STAFF AND CLIENT ○ RELIES ON WORD OF MOUTH ○ USES CHANNELS PARTICULARLY ACCESSIBLE TO WOMEN ○ DECREASES AS PROGRAM MATURES ○ LOW-COST 	<ul style="list-style-type: none"> ○ STAFF NOT USED AS A LINK IN PROMOTION ○ ADVERTISEMENT IN FORMAL MEDIA ○ REQUIRES CONTINUAL INVESTMENT ○ COSTLY 	<ul style="list-style-type: none"> ○ ESTABLISHES PERSONAL CONTACT BETWEEN STAFF & POTENTIAL CLIENTS ○ RAPID DISSEMINATION ○ LOWERS ADMINISTRATIVE COSTS 	<ul style="list-style-type: none"> ○ REACHES THE UPPER INCOME ○ DOES NOT REACH WOMEN ○ DECREASES SENSE OF OWNERSHIP OF PROJECT AMONG CLIENTS
LOAN APPLICATION AND REVIEW:	<ul style="list-style-type: none"> ○ USES CHARACTER REFERENCES ○ ENTERPRISE VISIT BY STAFF ○ BUSINESS PLAN DEVELOPED BY CLIENT/STAFF ○ DECENTRALIZED DECISION MAKING 	<ul style="list-style-type: none"> ○ LENGTHY APPLICATION FORMS ○ "PROFESSIONAL" BUSINESS PLAN ○ CENTRALIZED DECISION MAKING ○ COLLATERAL REQUIREMENTS ○ AUTOMATIC LENDING TO TRAINING PROG. GRADUATES 	<ul style="list-style-type: none"> ○ MORE RAPID TURNOVER OF CREDIT FUNDS ○ INCREASED RESPONSE TO NEED ○ LOWER STAFF/ADMIN. COSTS ○ AGILE ALTERNATIVE TO MONEY LENDER 	<ul style="list-style-type: none"> ○ LESS TURNOVER TO CREDIT [CONTRIBUTES TO DECAPITALIZATION] ○ CLIENT FRUSTRATION ○ MOST AFFLUENT CLIENTS ○ COSTLY TO CLIENT

TABLE 8 (CON'T)

FACTORS THAT AFFECT THE DELIVERY OF CREDIT

	<u>DESIGN</u>		<u>POTENTIAL OUTCOME</u>	
	<u>MOST EFFECTIVE</u>	<u>LEAST EFFECTIVE</u>	<u>POSITIVE</u>	<u>NEGATIVE</u>
TERMS OF LOAN & DISBURSEMENT:	<ul style="list-style-type: none"> ○ NO MINIMUM COLLATERAL REQUIREMENT ○ MARKET INTEREST RATES (SEE BELOW) ○ FIRST LOAN SMALL & SHORT-TERM (WORKING CAPITAL) ○ INCREMENTAL TERM & LOAN AMOUNTS IN SUBSEQUENT LOANS 	<ul style="list-style-type: none"> ○ INSIST ON COLLATERAL ○ SUBSIDIZED RATES ○ FIXED CAPITAL LOANS WITH NO PROVISION FOR WORKING CAPITAL ○ LARGER LOANS & LONGER TERM 	<ul style="list-style-type: none"> ○ REACHES THE POOREST AMONG MICRO-ENTREPRENEURS ○ REFLECTS REAL COST OF BUSINESS FOR BENEFICIARY ○ ENHANCES POTENTIAL FOR SELF-SUFFICIENCY IN CREDIT LENDING ○ BETTER ATTUNED TO BUSINESS PRACTICES OF M.E.s 	<ul style="list-style-type: none"> ○ REACHES ONLY THOSE WITH COLLATERAL ○ CAN LEAD TO LOAN FUND DECAPITALIZATION ○ ENCOURAGES CAPITAL INVESTMENT AND POTENTIALLY UNDER-UTILIZED EQUIPMENT

b. Factors That Affect the Health of the Credit Portfolio:

-- **Interest Rates:** Interest rates may be the single most important design factor in establishing and maintaining a healthy portfolio. Interest rates to the ultimate borrower must be as close to the prevailing commercial bank lending rates as possible (we assume that commercial rates reflect the cost of unsubsidized money, real administrative costs, and sufficient spread in the interest margin to create incentives for staff).

There are many cases where, due to high inflation rates and/or government policies that favor subsidization, the interest rate in a project is negative--in some cases, below the interest rates for deposits. Among World Bank projects in Indonesia, Colombia and Jamaica, for example, there is some evidence that the subsidized rates of loans encouraged investment in equipment which was subsequently underutilized. Heavily subsidized loans may also lead to distortions in the selection of beneficiaries and loans replacing other sources of funds (Levitsky, 1985).

Ceilings on interest rates and caps on interest spreads are strong disincentives to financial institutions in the business of "leasing money to enterprises." Once the subsidized money is fully disbursed, the financial institution will not continue the project with its own resources, but instead will lend to the sector or groups where it can charge the higher interest rate required to cover its full operating costs.

Positive real interest rates, including administrative charges that reflect the real costs of operation, lead more rapidly to project self-sufficiency in credit delivery, open the door to scaling up, and mobilize more aggregate lending to small and micro-entrepreneurs. Real interest rates:

- capitalize the loan fund because lending operations generate income for the project and improve its ability to attract capital at market rates (loans from other institutions and savings from both project beneficiaries and others);
- increase the implementing institution's access to national capital markets which are an alternative to outside funding, and a means of expanding a project.

-- **Loan Collection:** From the outset, loan repayment must be taken very seriously. Essential to a portfolio's survival and growth are clearly established and enforced procedures for loan

collection, especially since there is a tendency to assume that loans administered by the government or an NGO do not have to be paid back in full. To help facilitate timely payback, beneficiaries participate in maintaining amortization schedules and following-up borrowers. In most projects that enforce repayment schedules and use creative methods for loan collection, repayment rates have been maintained at relatively high levels, above 90 percent (Grameen Bank, ADEMI, and the FED in Ecuador). As mentioned before, one additional incentive to payback is the potential for receiving larger and longer-term subsequent loans.

-- **Savings Mobilization:** Enforced by project staff as a condition for client participation or encouraged and left to the discretion of the client, savings contribute to the health of a portfolio in two ways. First, clients have an investment in the financial institution they are dealing with; second, savings, even if small, increase the aggregate resources available to be lent. However, the high costs of administering small savings accounts must be factored in, and may be expected to offset some of the benefits derived from mobilizing savings.

-- **Lender Margins:** The administrative cost per loan covers a wide range of expenses. A recent review of administrative costs in small and micro-enterprise projects points out that the existing cost data are often extremely weak and include costs associated with provision of technical assistance and other nonfinancial resources (Liedholm, 1985). Care must be exercised when comparing these costs to those of a pure credit project, such as the BKK in Indonesia, or the Grameen Bank in Bangladesh.

The spread needed to cover costs varies from country to country and from program to program. For instance, Bhatt (1978) suggests that an eight percent spread might be needed in India to reach the smallest enterprises, while a spread of ten percent appears warranted in Bangladesh (Brown, 1985). If other than government-controlled financial institutions are to lend to small and micro-enterprises, lender margins must cover both real administrative costs and provide a sufficient spread to serve as a monetary incentive to the administering institution.

-- **Rediscounting and Guarantee Schemes:** These schemes have been utilized to lure market-oriented financial institutions into the field of lending to small and micro-enterprises. However, there is always the possibility, as often happens, that institutions stop lending to these subsectors once outside monies come to an end, and they can no longer lay-off most or all of the commercial risk.

TABLE 9

PROJECT DESIGN FACTORS THAT AFFECT THE HEALTH OF THE CREDIT PORTFOLIO

	<u>DESIGN</u>		<u>POTENTIAL OUTCOME</u>	
	<u>MOST EFFECTIVE</u>	<u>LEAST EFFECTIVE</u>	<u>POSITIVE</u>	<u>NEGATIVE</u>
INTEREST RATES:	<ul style="list-style-type: none"> ○ POSITIVE IN REAL TERMS 	<ul style="list-style-type: none"> ○ SUBSIDIZED 	<ul style="list-style-type: none"> ○ LEADS TOWARD PROJECT SELF-SUFFICIENCY ○ GREATER RESOURCES AVAILABLE FOR LENDING BY <ul style="list-style-type: none"> - CAPITALIZING LOAN FUND - INCREASING ACCESS TO NATIONAL CAPITAL MARKETS ○ INCREASES SIZE OF PORTFOLIO 	<ul style="list-style-type: none"> ○ INCREASED DEPENDENCY ON OUTSIDE GRANTS ○ LIMITS ACCESS TO LOCAL CAPITAL MARKETS ○ LEADS TO DECAPITALIZATION ○ LIMITS PORTFOLIO GROWTH
LOAN COLLECTION:	<ul style="list-style-type: none"> ○ ESTABLISHED AND ENFORCED PROCEDURES FOR LOAN COLLECTION 	<ul style="list-style-type: none"> ○ LAX 	<ul style="list-style-type: none"> ○ PORTFOLIO TURNOVER ○ PORTFOLIO GENERATED INCOME-CAPITALIZATION ○ GREATER SELF-SUFFICIENCY ○ GROWTH OF PORTFOLIO 	<ul style="list-style-type: none"> ○ ALL OF THE ABOVE
SAVINGS:	<ul style="list-style-type: none"> ○ VOLUNTARY, OR ○ INVOLUNTARY 	<ul style="list-style-type: none"> ○ NONE 	<ul style="list-style-type: none"> ○ BENEFICIARY "INVESTMENT" IN THE FINANCING INSTITUTION ○ MOBILIZATION OF DOMESTIC SAVINGS ○ CAPITALIZATION OF LOAN FUND 	<ul style="list-style-type: none"> ○ NO SENSE OF "PROJECT OWNERSHIP" BY BENEFICIARIES ○ LACK OF SAVINGS MOBILIZATION
LENDER MARGINS:	<ul style="list-style-type: none"> ○ COVER REAL ADMINISTRATIVE COSTS ○ MONETARY INCENTIVE TO FINANCIAL INSTITUTION 	<ul style="list-style-type: none"> ○ RESTRICTED 	<ul style="list-style-type: none"> ○ SCALING-UP POTENTIAL ○ STAYING POWER FOR FINANCIAL ENTITY AND BENEFICIARIES 	<ul style="list-style-type: none"> ○ PROJECTS REMAIN EXPERIMENTAL ○ LACK OF STAYING POWER ○ FALSE EXPECTATIONS FOR BENEFICIARIES

TABLE 9 (CON'T)

FACTORS THAT AFFECT THE HEALTH OF THE CREDIT PORTFOLIO

	<u>DESIGN</u>		<u>POTENTIAL OUTCOME</u>	
	<u>MOST EFFECTIVE</u>	<u>LEAST EFFECTIVE</u>	<u>POSITIVE</u>	<u>NEGATIVE</u>
REDISCOUNTING AND GUARANTEE SCHEMES:	<ul style="list-style-type: none"> ○ LEVERAGING OF DONOR FUNDS WITH LOCAL CAPITAL ○ CLEAR LINES OF RESPONSIBILITY AND TIMELY FULFILLMENT OF OBLIGATIONS 	<ul style="list-style-type: none"> ○ NON-EXISTENT ○ ESTABLISHED BUT INOPERATIVE 	<ul style="list-style-type: none"> ○ ENTRY INTO "SECTOR" BY NEW FINANCIAL ENTITIES ○ REDUCES PERCEIVED RISK ○ ADMINISTRATIVELY COST-EFFECTIVE 	<ul style="list-style-type: none"> ○ NO ATTEMPT BY LOCAL AUTHORITIES TO EXPERIMENT AND ENTER SECTOR FINANCING

3. Nonfinancial Resources

Nonfinancial assistance to small and micro-entrepreneurs can include a wide variety of features that pertain to the management, organization and production functions of the business. Most nonfinancial assistance is provided in the form of individual technical assistance or through group training sessions which are conducted either before extending credit, or while the borrower is using a loan, or both. Assistance in establishing marketing channels, in procuring inputs, and in securing improved technologies are other types of activities that enter into the category of nonfinancial resources. However, it is also a small minority of small and micro-enterprise projects that provide nonfinancial resources beyond training and technical assistance.

a. Technical Assistance and Training:

Most technical assistance can be classified under those topics that pertain to the management function of the firm--such as planning, accounting, organization--and those that pertain to the technical and production function--such as improved techniques, design, and quality control. In most of the projects reviewed, it is the loan officer of the project's credit component that also delivers the technical assistance, whether to individuals through visits to the place of work, or to groups through training sessions. Some projects that provide group training also include subjects such as group formation, decision-making and community organization as part of the curricula.

There are two schools of thought on the appropriate timing of technical assistance and training. One argues that small and micro-entrepreneurs should attend a given number of training sessions prior to qualifying for the first loan (Fundacion Carvajal, Colombia). Other contend that technical assistance and training should be provided as the enterprise develops, and as requested by the entrepreneur (ACCION International). Both schools agree, however, that the following are characteristics of the effective provision of technical assistance and training:

- is tailored to the individual beneficiary's needs, rather than requiring that all clients receive the same training;
- does not demand that all participants follow a preestablished set of rules on how to run their businesses, but builds on their existing knowledge and techniques for operating the firm;

- emphasizes group sessions;
- clearly differentiates between skills specific to the type of productive activity (food processing, furniture making, etc.), and skills needed for all business administration (management, planning, accounting, etc.);
- is provided parallel to credit, regardless of whether it is also provided prior to loan approval;
- charges all entrepreneurs, regardless of size of firm, a "fee for service."

The authors found no documents that provide systematic analysis and evaluation of experience with technical or management assistance services to small and micro-entrepreneurs. When technical assistance and training were discussed, it usually was in terms of numbers assisted, numbers trained, topics covered, and duration of assistance and training courses. Most accounts are descriptive and vague regarding outcomes. The impact recorded, as in most technical assistance and training programs, is qualitative. Nevertheless, there are recurring issues related to the delivery of nonfinancial resources which are discussed below.

b. Issues That Pertain to Provision of Nonfinancial Resources:

At least three issues should be considered under technical assistance, training and other nonfinancial resources extended to small and micro-entrepreneurs. These are: effectiveness of technical assistance and training; cost of providing nonfinancial resources; and level of subsidy that the delivery of nonfinancial resources requires. It should be pointed out that none of the evaluations reviewed discuss the last two points. What follows is the result of the authors' field observations and discussions with project managers, field staff and other development professionals.

i. The Effectiveness of Technical Assistance and Training:

There is little agreement on how necessary or useful technical assistance and training are for enterprise production and growth. The lack of available data makes it difficult to draw conclusions. In some projects, such as the Grameen Bank, no technical assistance or training is provided, based on the belief that the poor are well acquainted with a vast array of traditional activities to increase their incomes, and if given adequate access to credit at reasonable rates, they have the

capacity to substantially improve their situation (World Bank, 1985). For the Bangladesh Rural Advancement Committee (BRAC) on the other hand, training plays a major role, and three types of training are provided to borrowers: human resource development; skills training in income-generating activities; and extension services (World Bank, 1985). Other projects, such as the FED in Ecuador, ADEMI in the Dominican Republic, and Progreso in Peru use training both to strengthen solidarity groups and to develop management and technical skills.

The impact of training and technical assistance may not be readily recognized. Improved management and technical skills may enable an entrepreneur to expand production. The training session itself may provide a setting for entrepreneurs to help and seek help from each other, so that they participate in the provision of technical assistance based on their own experiences. The projects in Dominican Republic, Ecuador and Peru mentioned above have begun experimenting with providing only group training because of the useful exchange among beneficiaries that evolves during training sessions, and because such training is less costly. (Ashe, 1985).

Clearly, establishing the effectiveness of management or technical assistance and training in relation to firm performance and socioeconomic benefits is extremely difficult, time consuming and costly. It may be that a more realistic approach to measuring the impact of technical assistance is to determine if clients continue to request it, and if they are willing to pay for it.

ii. The Cost of Providing Nonfinancial Resources:

In most projects, it is difficult to isolate the costs of extending technical assistance, training, or other nonfinancial resources to small and micro-entrepreneurs. Since extension of credit technical assistance and training often are closely entwined and implemented by the same staff persons, few projects separate the costs of extending credit from those of extending technical assistance and training. In the Dominican Republic, for instance, field staff from one of the earlier small and micro-enterprise projects visited each potential borrower an average of 16 times prior to loan approval. Most of these visits involved one-to-one technical assistance, and yet were considered part of the cost of extending credit (Otero and Blayney, 1984).

Although part of the problem is the lack of information on the real cost of providing nonfinancial resources, there is

little doubt that nonfinancial resources, especially technical assistance and training, are expensive components of small and micro-enterprise projects. Organizations such as ADEMI have experimented with approaches to cover the costs of providing these services--charging small and micro-entrepreneurs a fee for training and technical assistance, and providing the same services at higher cost to larger businesses. These experiences demonstrate that, unlike credit extension, the income generated from the delivery of technical assistance and training represents only a small percentage of the costs of these components. They also highlight the importance of specifying which project components are included in calculations of administrative and operational costs of small and micro-enterprise projects.

iii. Level of Subsidy Required for Provision of Nonfinancial Resources: While the interest spread charged on credit can be expected to cover the administrative costs of extending loans, as was discussed above, it is difficult to envision that such a spread could also cover all the costs of nonfinancial resources, especially technical assistance and training. Experience demonstrates that provision of nonfinancial resources in small and micro-enterprise projects requires funding in the form of grants to the NGOs or PVOs implementing the projects. It is also clear that there are cost-efficient ways of providing nonfinancial resources--such as limiting one-to-one assistance, determining with care what material to cover in technical assistance, relying on the beneficiaries to assist each other, and equipping staff to prepare and conduct training sessions--which would decrease the amount of subsidy these components require.

CHAPTER IV

SUMMARY CONCLUSIONS

This chapter highlights the most important conclusions drawn from findings and observations contained in this paper. Although these conclusions appear throughout the text, they are presented here as a synthesis of the material covered, and as background to the recommendations outlined in the next chapter.

A. SOCIOECONOMIC IMPACT OF SMALL AND MICRO-ENTERPRISE PROJECTS

1. Empirical data demonstrate that most small and micro-enterprise projects have a positive impact on income of the assisted entrepreneurs and their employees. Some of the factors that affect the degree of impact of a project are: economic environment, subsector assisted (manufacturing, service, commerce), productive capacity of the enterprise, level of entrepreneurial development. Even allowing for regional diversity and exogenous variables, the overall trend ranges from positive to highly favorable.

2. There is no uniform methodology or indicators used to evaluate income and employment changes resulting from small and micro-enterprise promotion.

- Sample surveys are the most often used methodology for data collection.
- Use of control groups is likely to provide the most accurate and reliable data because it can factor out exogenous variables. It is rarely used because of its high cost.
- The most commonly used indicators of impact measure direct income changes by looking at the firm's profitability (level of sales, value added, net profit, and productivity) and, in some cases at the firms' sustainability (increased investment, sales growth over time, level of indebtedness). Employment is most often measured in terms of full-time jobs created. Often included in analysis of job creation is the cost per job created.

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3. The poor are able to generate impressive savings. Promotion of savings is becoming increasingly prominent in small and micro-enterprise projects. Savings subcomponents, whether through forced or voluntary schemes, have generally mobilized higher than expected savings among clients, and in some cases have helped avert the decapitalization of the credit fund.

4. The inclusion of indirect benefits into the economic benefit stream of small and micro-enterprise projects demonstrates that small and micro-enterprises are major contributors to overall economic growth. Income changes occur not only at the beneficiary level, but also outside the assisted firm through backward and forward linkages, income multipliers and consumer benefits.

5. Benefit/Cost analysis of small and micro-enterprise projects that factor in direct and indirect impact conclude that, in comparison to other AID projects, these projects are among the most successful in economic terms, and generate high economic rates of return.

6. Small and micro-enterprise promotion contributes to job creation and does so at a consistently lower investment cost per job than medium and large industry within the same subsectors.

7. Especially among the smallest micro-enterprises, underemployment and job sustainability are as important as job creation. Small and micro-enterprise projects contribute to job stability and reduce underemployment among owners and others working in the firm.

8. Jobs in small and micro-enterprises are not perceived as temporary depots for those seeking entry into formal sector positions. Rather, they are viewed as permanent sources of income for which young apprentices are willing to invest time learning a trade while earning minimal wages.

9. Not all countries, or subsectors within the same country generate jobs at the same rate.

10. In situations where the level of education and skills in a country are very low, entrepreneurs sometimes choose to invest in machinery and equipment rather than rely primarily on available low-skilled labor. This behavior is more typical of the larger among the small enterprises, and can contribute to higher costs per job created.

11. Experience to date demonstrates that projects reaching the smallest and poorest of enterprises may register lower levels of positive overall economic impact than projects that target the upper end of this same subsector. However, projects reaching the smallest also demonstrate higher levels of social benefits that are not easily quantifiable (improved decision-making capacity; decreased dependence on moneylenders; increased access to resources; increased capacity to organize, etc.) and greater positive effect on redistribution of income. **Therefore, in measuring the overall impact of projects that reach the poorest and smallest, other indicators, in addition to economic, should be included.**

B. FACTORS THAT CONTRIBUTE TO PROJECT EFFECTIVENESS

1. Macro-economic Environment and Policy Issues:

a. The financial crisis in developing countries will require structural readjustment which, for the foreseeable future, will impose high economic costs. **Austerity measures, high levels of inflation, unemployment and underemployment, and devaluation will continue to have a significant adverse effect on small and micro-enterprises, and will also limit projects' ability to achieve all their objectives.**

b. The policy climate in a country is of overriding importance to entrepreneurship development and enterprise promotion and expansion.

c. In the past, national policies and donor programs have favored large publicly and privately owned industry. More recent policy initiatives have included assisting small enterprises; **however, low-income entrepreneurs and micro-enterprises are still not reached in significant numbers.**

d. Development strategies have moved away from a government-centered approach to development toward a greater reliance on the private sector and market systems to achieve development objectives. **Support for small and micro-enterprises represents an important way of promoting development in one subset of a country's private sector.**

e. Cross-country studies highlight the importance of **domestic savings** as a key element in fostering economic development, and identify **access to credit** as crucial to private sector development.

2. Institutions involved in Small and Micro-enterprise Promotion

a. In small and micro-enterprise promotion, implementing institutions assume one or a combination of the following functions:

- administration of a project;
- provision of financial support, usually credit extension;
- provision of technical and management assistance, and other support services.

b. There are characteristics of institutions in small and micro-enterprise promotion that can be related to project effectiveness. Among these characteristics are: clear goals and objectives; diversified funding base; decentralized organizational structure; well-developed internal management and planning systems; committed staff; local private sector participation through membership or contributions; simple but effective project monitoring systems.

c. The types of institutions that work at each level of enterprise development are distinct:

- Pre-entrepreneurial activity usually involves integrated community-based projects managed by local NGOs or expatriate PVOs.
- Micro-enterprise projects also are managed primarily by national and international NGOs and PVOs with important exceptions of public institutions operating successfully at this level (Grameen Bank, Bangladesh; BKK, Indonesia; FEDECCREDITO, El Salvador).
- Small enterprise projects are also administered by NGOs and PVOs. Most government-sponsored projects, commercial banks and other private financial institutions involved in this subsector target small rather than micro-enterprises.

d. NGOs and PVOs are the linchpins in small and micro-enterprise promotion, administering nearly 70 percent of projects examined in-depth. Among their major strengths in small and micro-enterprise promotion are:

- project promotion within the community through close and continued contact with the beneficiaries;

- multi-skilled staff capable of providing a range of services;
- flexible operating and administrative procedures;
- ability to stimulate community involvement in the development process;
- high economic rates of return relative to other development projects;
- movement toward more cost-efficient management of projects.

Among their limitations are:

- ability to retain competent staff who have limited opportunity for advancement within the institution;
- programs reach a relatively small number of beneficiaries, are administratively costly and difficult to expand;
- dependance on donor assistance for the bulk of operating and program funds.

e. There is a paucity of private sector institutional involvement in the administration of small and micro-enterprise projects. The most direct involvement by private institutions --commercial banks, cooperative banks--has been in credit extension.

3. Project Design:

a. Small and micro-enterprises are difficult to reach through project intervention in a cost-efficient manner because of their ubiquitous nature, their inexperience and distrust of formal institutions and variance in assistance needs.

b. Nearly all projects providing assistance to small and micro-enterprises include credit extension, and many also include a variety of nonfinancial management and technical assistance services.

c. Most cost-efficient credit delivery projects in terms of placing thousands of loans on an annual basis and of achieving socioeconomic goals have:

- taken place in Latin America and Asia;
- been administered mostly by NGOs and PVOs, and also by government banks and cooperative banks;

- received, with some exceptions, support from international donors from the start of the program;
- been designed, administered, and implemented by use of similar credit delivery models, and while sharing this affinity, there is little or no evidence of direct model influence from one project to another in a different country.

d. Design factors that affect credit delivery include: how beneficiaries are selected; staff-managed outreach; agile loan application and review procedures; and terms of the loans that are responsive to the needs of the borrowers and that reflect the real cost of credit. These factors influence whether the project reaches the poorest among the intended beneficiaries, including women, the level of administrative costs, and the speed with which credit is provided.

e. Factors that affect the health of a credit portfolio center on charging real interest rates in relation to prevailing inflation and commercial bank lending rates. They also include: quality and enforcement of loan collection mechanisms; use of savings mobilization as a source of capital; appropriate lender margins; and guarantee or rediscounting schemes.

f. Positive interest rates that reflect the real cost of operation, can lead to project self-sufficiency and greater resources for lending to the subsector by capitalizing the loan fund and assuring against the decapitalization of the loan fund.

g. While there is little information on the impact of training and technical assistance, there is some consensus on what type of assistance seems to help. This assistance:

- focuses on a single issue or a few related topics, and makes assistance available after loan disbursement;
- charges a "fee for service," even if it doesn't cover costs;
- utilizes non-formal, adult education techniques.

h. Management and technical assistance to the small and micro-enterprise sector, like agricultural extension services, is very expensive. Technical assistance components have not achieved any significant degree of self-sufficiency.

C. GENERAL CONCLUSIONS

1. The PISCES project has served as an important catalyst for donor support of small and micro-enterprises, and has yielded crucial data that currently guide AID activity in this area.

2. Findings highlight the need to approach small and micro-enterprises as a complex and varied mix of productive activities, each with its own internal dynamic and connection to the rest of the economy. Information from longitudinal studies and applications of new methodologies will help avoid generalizing findings to all small and micro-enterprises, and will assist in the preparation of better suited policy and program responses.

3. A significant number of small and micro-entrepreneurs are women, and findings from the newer projects reflect an increased concern with developing mechanisms to reach women.

4. There is considerable growth and expansion potential in the small and micro-enterprise subsectors. Since the primary markets for their products are local, increases in demand are linked to increases in income, particularly among rural and low-income households. However, much more research is needed to understand the income elasticity of demand by local consumers for small and micro-enterprise products and services.

5. There are important gaps in our knowledge about the small and micro-enterprise sector, and the projects designed to assist them. Among these gaps are: percentage, if any, of clients from projects that "graduate" into the formal sector commercial institutions; urban/rural links created by small and micro-enterprise activity; and long-term durability and productivity of jobs created and sustained.

6. AID should expand its support for small and micro-enterprises based on existing experience regarding what works, by experimenting with new approaches to increase the number of entrepreneurs assisted and to lower administrative costs of projects, and by conducting research to fill knowledge gaps.

CHAPTER V

RECOMMENDED POLICY AND PROGRAM STRATEGIES FOR AID SUPPORT OF SMALL AND MICRO-ENTERPRISES

A. INTRODUCTION

From the point of view of AID, the discussion presented in this paper can be summed up in two questions:

- Is small and micro-enterprise promotion a good use of development assistance resources?
- If so, what, from the experience we have, are the most efficient and cost-effective policy and program directives that AID can adopt to improve its assistance to small and micro-enterprises?

Though simply stated, these are, of course, difficult questions to answer. From the analysis presented in this paper, we can answer the first one. If we posit that the underlying objectives of development programs are to reach the poor majority in developing countries with assistance which converts into employment and income, and to increase their access to existing resources, then small and micro-enterprise projects can accomplish both objectives effectively.

This chapter attempts to respond to the second question, and requires some introductory remarks. First, policy and program strategy recommendations must be guided by the lessons gleaned from our readings and from discussions with persons knowledgeable in this field. As this study attests, there is a great deal written on small and micro-enterprises, and important breakthroughs in effective assistance to these firms have been made in the recent past. However, there is still considerable learning to be done before we can understand more completely the complexity and dynamics of these subsectors. Any proposed strategy should consider what knowledge gaps exist and weave the filling of these gaps into future programming.

Strategy recommendations also must be presented in the context of current overall AID policy, and should serve to advance areas identified as priorities. Promoting private sector development, strengthening policy dialogue with host governments, highlighting technology transfer, and fortifying local

institutions are the four policy priorities that reverberate throughout AID's development assistance program, and also underline this proposed strategy.

Finally, the debate on how best to measure a project's success--using purely economic indicators, or including social considerations--redistribution of income, increased participation and representation in the political and institutional structures of the country--has been with us since the first dollar of development assistance was disbursed, and yet it still has a mettlesome, contemporary ring to it.

This dichotomy between social and economic gains seems particularly applicable to entrepreneurship and enterprise development among the poor, because it blends strictly business considerations--profitability, market responsiveness, etc.--with issues of equity, such as redistribution of resources, access, and increased participation.

The following recommendations reflect the assumption that both economic and social benefits must be factored into small and micro-enterprise promotion, especially when projects attempt to reach the smallest, poorest and least prepared among entrepreneurs.

This chapter presents recommendations for an overall strategy for AID small and micro-enterprise promotion. It draws from existing project strategies that have proven effective, and also suggests untested approaches to improving AID's understanding of and support for small and micro-enterprises. The recommendations include:

- lines of action that must take place within AID in order to improve its capacity to reach small and micro-enterprises;
- a program strategy that involves addressing policy issues at the country level, designing projects that better utilize NGOs and PVOs, encouraging private sector participation, and, where appropriate, building upon the experience of public institutions;
- research, evaluation and technical assistance initiatives that complement the above two areas.

B. LINES OF ACTION WITHIN AID

1. Policy Formulation

While AID has developed a Private Sector Policy Paper to guide its activities in private sector development, no such uniform directive exists for assisting the rapidly evolving small and micro-enterprise subsector. Although understood as a component of the private sector, small and micro-enterprise promotion receives only cursory treatment in the Private Sector Policy Paper, and is not given the treatment which its special nature, constraints and opportunities require.

Presently, there is not a concerted effort within AID to develop an overall strategy or approach to the small and micro-enterprise sector. Each mission's Country Development Strategy Document (CDSS) may or may not include a strategy and action plan for small and micro-enterprise promotion. In addition, where there is a plan, it may not draw on lessons learned through other missions' experience or from other agency support for this subsector.

Given the extensive project and evaluation experience amassed through PISCES and other efforts, and the importance of small and micro-enterprises in nearly all developing countries, we believe that this subsector merits closer analysis at the policy level, and an agency-wide articulation of policy.

We recommend that AID through its Policy and Program Coordination Bureau (PPC), in concert with S&T/RD/EED, develop a policy paper on small and micro-enterprise development which:

- provides a framework for understanding the informal sector in developing countries; and
- provides guidance to bureaus and missions on small and micro-enterprise promotion.

2. Additional Steps to Strengthen AID's Program of Small and Micro-enterprise Promotion

Several corollary actions to policy formulation are necessary to strengthen the agency's assistance to this subsector. We recommend the following:

a. Training for AID regional bureau and field mission staff on small and micro-enterprise promotion:

Improved methods for reaching small and micro-enterprises are evolving rapidly and there is considerable experimentation with new models in a variety of countries. AID can build on the Private Sector Training Seminars conducted by AID's Private Sector Bureau (PRE) for missions and bureau personnel, and develop curricula which address specifically small and micro-enterprises. These training sessions can be conducted as part of overall training on Private Sector Development, or as a separate training component, and should be done at the bureau and mission levels.

b. Revision of Foreign Service Personnel Standards:

In order to attract development professionals with business skills, and to encourage current AID staff to strengthen their knowledge of small and micro-enterprise promotion, AID should review its current personnel standards, and make revisions that serve as rewards and incentives. This recommendation applies to AID staff currently involved in project design, project management, and project review in the area of small and micro-enterprise promotion.

c. Guidelines for Project Design and Management:

The process of project design is central to any proposed strategy for small and micro-enterprise support. In the case of AID, it is in the Project Identification Document (PID stage) that crucial decisions are made about a project. With the existing decentralized system and increased authority at the mission level on project decisions, more time is necessary at the very beginning of the design process to ensure that at least the following have been studied carefully:

- local implementing institutions, their capacity and technical assistance needs;
- macro-economic policy issues (e.g., interest rates, fiscal measures, regulatory policies, etc.);
- level of resource allocation.

Strengthening the project design process is not enough. Part of AID's role in promoting small and micro-enterprise development is to manage existing projects in these areas. Project managers should consider part of their responsibility assisting the local institutions to pursue the path towards self-sufficiency, which AID so strongly emphasizes. For example, a

TABLE 3

PROJECT DESIGN AND DIMENSIONS FOR 19 PROJECTS

PROJECT	DONOR/ PVO	PROJECT COMPONENTS			DESIGN			PROJECT DIMENSIONS						TECHNICAL ASSISTANCE				
		Credit	T.A.	Other	Public	Private	NGO	Average loan size	CREDIT # loans # borrowers \$loaned	Interest	year data	# firms	type	year data				
AFRICA																		
National Christian Council-Kenya	AID/NOCK	yes	yes	---			X	X	X	\$242 *	330	n.i.	\$80,000	n.i.	1981 to mid 1984	6000	ind. & group	1981 to mid 1984
Burkina Faso Phase I	AID/PFP	yes	yes	---			X	X	X	\$684	416		\$284,566	comm.	7-76 to 9-81	n.i.	n.i.	n.i.
Burkina Faso Phase II	AID/PFP	yes	yes	---			X	X	X	\$478	987	n.i.	\$460,000	comm.	10-81 to 6-84	n.i.	n.i.	n.i.
Entente Fund-Africa Region	AID	yes	yes	---	X				X		572	n.i.	\$14.1 m		to 8-81	n.i.	n.i.	n.i.
ASIA																		
Calcutta Urban Dev. Prog. II India	World Bank	yes	no	---		X					3495	n.i.	Rs 8.8 m	subs.	11-80/3-83 (29 mos)	---	---	---
Badan Kredit Kecamatan(BKK)-Indonesia	AID/BKOK	yes	yes	---	X			X		\$50	300000	n.i.	\$11.5 m		1982 (12 mos)			
Bangladesh Rural Advancement Comm.	ERAC	yes	yes	group formation			X	X		\$37	600	32000	\$1.2 m	comm.	7-80/12-83	n.i.	n.i.	n.i.
Grassroots Bank Project-Bangladesh	GBP	yes	no	---		X	X	X		\$ 50 *	115689	58050	\$4.9 m	comm.	'80-'83 (32 mos)	---	---	---
Manila Commun. Srvc Inc.-Philippines	MCSI	yes	yes	---		X	X	X		\$45 *	768	768	\$35,000	comm.	'76-'81	n.i.	n.i.	n.i.
Micro-Industry Dev. Prog.-Philippines	MIDP	yes	yes	---	X			X		\$ 825 *	n.i.	n.i.	n.i.	comm.	n.i.	n.i.	n.i.	n.i.
SEMA-India		yes	yes	integrated development				X	X	\$60 *	679	500	\$42,441*		'76-'78	n.i.	n.i.	n.i.
LATIN AMERICA																		
ADEMI-Dominican Republic	AID/ACCION	yes		---			X	X		\$311	6213	1997	\$1.9 m	comm.	2-83/3-85 (23 mos)	n.i.	n.i.	n.i.
Corp.Fabricato-Columbia	IDB	yes	yes	---	X			X	X	\$1,367	440	n.i.			1-81/9-83 (32 mos)	1900	group	same
DESAP/Carvajal-Columbia	IDB/Carv.	yes	yes	---			X	X	X	\$1,545	464	n.i.			1980 to 9-83	1300	ind. & group	same
Industrial Bank-Peru	AID	yes	yes	---														
MBC-I-Brazil	World Bank	yes	yes	---				X	X		550	n.i.	CR220,592	subs.	(24 mos)	n.i.	group	n.i.
PRODEME/FID Dom. Repub.	AID/FDD/ACCION	yes	yes	---			X	X		\$1,532	554	2209	\$848,991	comm.	7-81/12-83 (30 mos)	n.i.	group	n.i.
PROGRESO-Peru	AID/Acc.Com. ACCION	yes	no	---			X	X		\$690	446	1046	\$307,951	comm.	11-82/5-84 (19 mos)	---	---	---
UND-Brazil	AI TEC	yes	yes	---	X		X	X	X	\$1,400	1700		\$2.3 m		1979 to 1981	n.i.	group	n.i.

* derived from other data and not specified in evaluation.
n.i. : no information

project manager should require that the institution implementing a credit and technical assistance project provide progress reports that enable both the donor and the local organization to periodically assess the health of the credit fund, the costs of its administration, and the project's overall cost-efficiency. Projects should not be funded unless the implementation plans include factors such as:

- an adequate payback enforcement system to prevent decapitalization of the credit fund;
- a system to monitor closely a revolving loan fund;
- guidelines to maintain the level of staff productivity necessary for a cost-efficient project (e.g., administrative costs related to credit line revenue);
- establishment of simple systems for regular collection and analysis of this information.

A more rigorous approach to project monitoring will improve the local organization's ability to collect, analyze, report and utilize financial and management performance data. It will also flag those projects that are decapitalizing or requiring intolerable levels of subsidization, and will avoid support of short-lived projects that may, in the long run, prove more detrimental to the beneficiaries.

C. PROGRAM STRATEGIES: ALTERNATIVES FOR REACHING SMALL AND MICRO-ENTERPRISES

1. Macro-economic Environment and National Policy

It has been noted that policy changes that promote the flow of resources and address the needs of small and micro-enterprises may have as significant an impact on these firms as direct project assistance efforts (Ashe, 1985). Yet AID's emphasis on policy dialogue as part of its private sector development initiative has seldom included policy reforms that relate to small and micro-enterprises.

There are indications that missions are looking more closely at this gap, and requesting assistance from AID/Washington. The current project coordinated by S&T/RD/EED, "Employment and Enterprise Policy Analysis (EEPA)," is an attempt to develop a methodology for assessing the impact of national policy on

employment and enterprise development. Within this framework, it is possible to consider specifically the effect of policy on expansion and development of small and micro-enterprises.

We recommend that AID consider expanding its policy analysis capability with respect to small and micro-enterprises--through establishing central projects based in the regional or supporting bureaus--in order to respond appropriately and swiftly to all mission requests for assistance.

There are additional steps that can assist the missions to strengthen both their understanding of policy as it relates to small and micro-enterprise promotion, and their ability to influence government policies and regulations:

- coordinate macro-economic analysis with other donor institutions in order to better define the problems and identify the policy constraints, gaps or omissions;
- develop guidebooks for missions on how to address national policy questions. This is different from guidebooks that focus on how to design a small and micro-enterprise project, an initiative already underway in AID's Center for Development Information and Evaluation (PPC/CDIE);
- missions should support and encourage efforts of governments to plan and create a national strategy for addressing small and micro-enterprises. There are examples of donors that are already working closely with governments in this area, such as the IDB's efforts in Mexico and Colombia.

2. Project Design

a. Framework:

The overall strategy guiding our recommendations on project design embodies a concern with approaches that make use of private sector resources and instrumentalities to reach small and micro-enterprises. Ultimately, the idea is to leverage private sector financing and combine it with grant or "soft" money. Underlying all our suggestions is a movement away from exclusive

provision of grant monies for micro-enterprise promotion (because of all the limitations we have noted: dependence; inability to grow; lack of incentives to run cost-efficient programs, etc.), and a search for ways to blend creatively the use of private sector monies with donor money. This way, one can promote small and micro-enterprise projects through financial packages that balance hard debt financing and grant funded equity financing, and treat organizations implementing micro-enterprise programs as serious financial institutions.

Two crucial considerations underline this framework:

- small and micro-enterprise projects are not going to become self-sufficient overnight; they will continue to require concessionary monies in order to operate. The questions to ask are what level of subsidy is acceptable, and what the subsidy is used for.
- small and micro-enterprise projects may never reach significant numbers of entrepreneurs unless financing from banks and other commercial institutions is leveraged.

Recommendations on project design are divided into three categories discussed below.

b. Utilization of NGOs and PVOs as Implementing Institutions:

This document has discussed the importance of NGOs and PVOs in assisting small and micro-enterprises, and AID should continue to work through them. However, institution-building, as a general consideration in small and micro-enterprise development, is not enough. There are at least three ways AID can focus its support for NGOs and PVOs.

The first way AID can work with NGOs/PVOs is by assisting them to address the institutional constraints which affect their performance in small and micro-enterprise project implementation. We suggest three ways AID can assist NGOs and PVOs:

i. **Build training for NGO and PVO staff into small and micro-enterprise projects:** NGO and PVO staff is seldom well versed in financial and business matters, and yet it is called upon to assist small businessmen and women in planning their entrepreneurial activities. Enhancing a staff's business and

banking knowledge is key to effective programs, and can be done through short-term overseas training, completion of specified courses prior to a salary increase, visits to projects and others mechanisms.

From the point of view of the local institution, this training becomes one incentive for attracting qualified and competent staff, and retaining it. Training opportunities are one alternative to raising employees' salaries beyond what an institution can or wants to support, especially if it creates disparity in its salary scale for all employees. From the point of view of the funder, training addresses a limitation identified in this study--low management skills--which contributes to higher administrative costs of projects. Finally, from the point of view of the beneficiary, training of staff improves continuity and therefore the quality of technical assistance he/she receives.

PISCES Phase II went a long way in addressing this issue, and we now can identify more succinctly the links between staff performance, institutional capacity, and project effectiveness. The next step is to address these issues in project design.

ii. Assist NGOs and PVOs to scale-up small and micro-enterprise projects: Although NGOs and PVOs are reaching large numbers of entrepreneurs, they are small in comparison to the existing demand. Efforts to expand NGO and PVO projects require: (1) institutional analysis of these local entities that assist small and micro-enterprises; (2) development of a measurement scale to determine the comparative levels of management and implementation capacity among these entities, in order to determine their appropriate role in working with small and micro-entrepreneurs; (3) design of a strategy that utilizes experienced PVOs and NGOs to assist those institutions that may be initiating projects with small and micro-enterprises, or expanding existing projects. Some approaches to achieve these objectives include:

- establishing geographic divisions among implementing institutions that extend beyond the capital cities to avoid duplication of efforts in some regions, and ensure that the harder-to-reach clients are included in service delivery;
- considering decentralization of operations among experienced NGOs and PVOs, with creation of regional or local branches, similar to the model used by many development banks;

- creating "umbrella" organizations that coordinate the project implementation efforts of many NGOs and extend customized financial and nonfinancial assistance to member NGOs (the Kenya Rural Enterprise Programme, underway since 1984 is a good example of the latter);
- determining the maximum capacity to extend credit and technical assistance of each NGO and PVO, and using these maximum capacity performance levels as guidelines for establishing goals for scaling-up efforts.

iii. **Assisting NGOs and PVOs to become financially more self-sufficient:** The above section on AID's monitoring role has included recommendations on how to help NGOs and PVOs address this key issue. As has been noted, some of the newer generation projects are demonstrating capacity for far lower administrative costs than earlier designs, and should be studied to glean lessons applicable to other settings.

AID can assist NGOs and PVOs to operate self-sustaining credit funds by emphasizing:

- market interest rates;
- high rates of recuperation;
- an interest rate spread that covers administrative costs;
- means to lessen fund decapitalization due to inflation;
- timely disbursement of grant funds to avoid liquidity shortages in credit funds;
- savings mobilization schemes;
- once the NGO or PVO has established a "credit rating," tapping into the private capital market.

A second way AID can strengthen NGOs and PVOs as vehicles of small and micro-enterprise promotion is by encouraging creative collaboration between commercial lending institutions and NGOs and PVOs. There are many unexplored ways in which private sector institutions and funds can be used to strengthen and expand projects administered through PVOs. The mechanisms devised will depend in part on the degree of receptivity demonstrated by the private sector, which AID also can seek to influence through policy dialogue and incentives. Some possible arrangements are:

- encourage banks to allow overdrafts to NGOs and PVOs which provide extra liquidity and enable the project to continue until additional funding is provided. A local

NGO in Ecuador has such an arrangement, which of course requires credibility and respect within commercial institutions;

- supplement the interest rate charged by a private bank when it on-lends to an NGO or PVO;
- use AID funds to guarantee private sector loans to NGOs and PVOs;
- assist NGOs and PVOs to engage commercial institutions in some of the administrative tasks, such as loan collection and disbursement. A local NGO in the Dominican Republic has instituted this approach successfully.

These NGO/commercial lending institution schemes are one way to elicit increased private sector participation. A second way--working directly through banks and financial institutions--is discussed in more detail below.

A third way AID can best incorporate NGOs and PVOs into an overall small and micro-enterprise program strategy is by differentiating among the many international and national NGOs to determine their potential contribution to small and micro-enterprise promotion. This point expands on issues discussed above but merits some additional remarks.

There is a tendency to lump all PVOs and NGOs into one broad category and to assume their operating philosophies, levels of expertise, target populations and breadth are similar. In fact, these entities are a mixed bag. The capacity to elaborate and implement a small and micro-enterprise project--which has been pointed out is much more complex than most community development efforts--is not acquired easily. Developing countries are littered with the debris of failed efforts, many of which can be traced to the implementing institution. AID should:

- differentiate between PVOs and NGOs that engage in a wide range of activities and those that specialize in one or two lines of action;
- develop a system for determining institutional capacity vis-a-vis small and micro-enterprise promotion;
- continue promoting collaborative efforts among NGOs and PVOs (internationally and locally) that lead to more uniform standards for designing and evaluating projects, and allow organizations to learn from each other.

3. Promote Small and Micro-enterprise Lending Among Private Sector Financial Institutions:

The second phase of PISCES, recently completed, implemented small and micro-enterprise demonstration projects through PVOs and NGOs. The model of demonstration projects proved successful in both reaching small and micro-enterprises, and in yielding the data and lessons to shape current projects.

We recommend that AID design and implement small and micro-enterprise demonstration projects through commercial, financial institutions, such as banks, credit unions, financieras and cooperative banks. This strategy responds particularly to the need to scale-up project efforts, and to involve the private sector in small and micro-enterprise promotion.

There are important constraints to this strategy. As Table 10 below shows, the private sector institutions vary in their "level of commitment" in addressing the needs of small and micro-enterprises. Concerns with risk versus return and high administrative costs are among the factors that inhibit private sector involvement. Banks and other financial institutions have established procedures and security requirements (collateral, review process), and it is difficult to induce them to make substantial changes in their operations. Finally, lack of experience working within this subsector and a bias against the small borrower as "uneducated" and time-consuming also prevail.

The following are suggested ways of leveraging private sector participation:

- i. Use AID funds to guarantee directly or through bridge institutions, such as international PVOs or local NGOs, loans to small and micro-enterprise. The recent PRE Bureau loan guarantee project with ACCION International is an example of this approach.
- ii. Reward those financial entities that lend to poor through monetary incentives such as:
 - share a percentage (30 percent) of administrative costs. AID could utilize existing local currency reserves (such as PL 480 commodity impact funds) for this purpose;
 - encourage local public institutions to deposit their accounts in financial entities that participate in credit projects to small and micro-enterprises (e.g., India);

TABLE 10

LEVELS OF PRIVATE SECTOR BANKING INSTITUTION COMMITMENT
AND
LENDING TO SMALL AND MICRO-ENTERPRISES

- COMMITMENT LEVEL I: Bank with standard operating procedures obligated by government to lend to sub-sector (e.g., percentage of portfolio set aside by law with differential interest rates--India).
- COMMITMENT LEVEL II: Bank with special department or unit with government incentives to lend to sub-sector (e.g., International donor funds at favorable interest rates and guaranteed by Central Bank--El Salvador).
- COMMITMENT LEVEL III: Bank utilizes a blend of its own capital and international donor funds; bank utilizes its capital with guarantee and/or rediscount facility with central bank, and has a special department--(e.g., Guatemala, Ecuador).

- encourage financial institutions to set aside a percentage of their overall credit portfolio to be earmarked to small and micro-borrowers. AID could assist these institutions by providing assistance in adapting proven credit delivery methodologies.
- iii. Encourage financial entities to "package loans" to groups of small and micro-entrepreneurs which would increase the size of each loan the entity must process and thereby lower administrative costs. AID could assist financial entities new to small and micro-enterprise lending by disseminating information on known credit models to these entities, and by providing them with start-up funds for credit lending.
- iv. Contract for production of a step-by-step guide--a loan packaging kit--for administering credit funds while reducing administrative costs in lending to small and micro-enterprises, and present this material to collaborating financial institutions. This is one concrete way of applying the experience gained through PISCES to future project initiatives.
- v. Participate in efforts underway by other donors to form a regionally linked lending institution which includes similar loan packaging models (kits), and involves private sector capital. AID should take the initiative to :
 - develop and experiment with software packages for administering a loan fund and monitoring project output and inputs;
 - disseminate "lessons learned" to other donors, developing countries, and participating institutions, in order to garner their support in increasing private sector involvement in small and micro-enterprise promotion.

4. Pursue Effective Approaches for Working with Public Institutions:

There are proven models of small and micro-enterprise assistance through development banks and other public sector institutions which should not be discarded. The replicability of models like the BKZ and the Grameen Bank should be carefully studied. Factors that make development banks attractive, and can also be explored with other institutions are:

- a geographic outreach through regional and local branches which allows them to reach very large numbers of clients.
- where there are established procedures for repayment, the repayment rates are extremely high, and could be replicated in other countries, or with commercial institutions.
- staff performance is tied to remuneration and incentives.

D. OTHER INITIATIVES

Two areas of activity round out this policy and program strategy: research and evaluation.

One cannot emphasize enough the importance of continuing to support research in small and micro-enterprise promotion. While there is a large body of literature on these subsectors, it has been observed that this material, when stacked together, resembles an inverse pyramid, with documents written from secondary data, such as this one, at the top, and field research and primary data collection at the bottom.

There are gaps in our knowledge about these subsectors which should be researched. Among these are:

- knowledge about the long-term impact of projects. Longitudinal studies that follow the evolution of firms and entrepreneurs will help donors to understand better the impact of projects and the bottlenecks that impede growth and expansion of small and micro-enterprises;
- the capacity of projects to "graduate" clients into formal commercial lending institutions. While many projects aim at this objective, there is little if any evidence that it is happening, and little understanding of the opportunities or constraints;
- factors that contribute to firm expansion, including the linkages or transactions between the formal sector enterprise and small and micro-enterprises in the informal sector;
- knowledge of the capital markets systems which currently interact with small and micro-enterprises, including moneylenders and informal entities that operate like credit unions;

- the technical assistance needs of implementing institutions as they evolve from establishing an effective project delivery system, to increasing the system's efficiency, to expansion of the delivery system;
- the impact of technical assistance and training on the assisted beneficiaries. Application of acquired learning in the firm and training techniques that are low cost and reach a greater number of beneficiaries need to be researched;
- the rural/urban linkages that are developed through small and micro-enterprises, which create a complex economic development dynamic beyond the primary personal or individual enterprise gains;
- the rural/urban dynamic of rural production that can provide insight into small and micro-enterprise opportunities in rural, small towns and market centers of rural regions.

In the case of evaluation, there is need to standardize how projects are evaluated and what data are collected and analyzed. There have been efforts to assess the state-of-the-art of evaluation which have given guidance to many evaluations, and which should be updated periodically.

We recommend that AID develop a series of "Standard Scopes of Work" for evaluation of small and micro-enterprise projects, which can be used, depending on level of resources available, to guide all evaluations in these subsectors. A uniform approach to evaluation would provide one basis for more adequate comparison among projects. AID can elicit assistance in this effort from the U.S. PVO community, which has developed considerable expertise in this area.

These recommendations are provided as an initial step towards defining and operationalizing an agency-wide policy and program strategy on small and micro-enterprise promotion. Their applications will depend on the degree of centrality small and micro-enterprise promotion enjoys within AID overall development strategy, and on how important small and micro-enterprises are considered to be in promoting private sector growth in developing countries. Ultimately, AID's support for this subsector will depend on how much of a priority small and micro-enterprise development is for AID policymakers, and the level of resources policymakers decide to allocate to this subsector.

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