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FUTURE A.I.D. DIRECTIONS IN

SMALL AND MICRO-ENTERPRISE DEVELOPMENT

REPORT ON THE

WILLIAMSBURG WORKSHOP

Employment and Enterprise Development Division
Office of Rural and Institutional Development
Bureau for Science and Technology

and

Center for Development Information and Evaluation
Bureau for Planning and Program Coordination

April, 1987

PREFACE

Attention to small-scale enterprise (SSE) and micro-enterprise development is greater today than ever before. A.I.D. staff now recognize that LDC economies need healthy small businesses to generate income and jobs in the private sector. Agency research reveals that small firms fill gaps in production and distribution untouched by larger firms and the government.

The staff of the Employment and Enterprise Development Division of the Office of Rural and Institutional Development (S&T/RD/EED) decided last year that we had enough research and field experience under our belt to hold a major A.I.D. meeting on where we had gone and where we should go in this sector. The Agency needed a careful assessment of recent sector experience and a look at future strategies. We joined forces with the Center for Development Information and Evaluation (PPC/CDIE) to mount a Workshop in Williamsburg, Virginia in December, 1986 on Future A.I.D. Directions in Small and Micro-Enterprise Development.

Proceedings of the Williamsburg Workshop are presented in this report. It is edited from separate Workshop summaries written by Cressida McKean, Consultant, Pragma Corporation, and Jim Cotter, PPC/CDIE, who I wish to thank for their work. Pragma did an excellent job of organizing the meetings in Williamsburg. Jim is also principally responsible for editing a one-hour videotape of the Workshop which is available and complements this written record. There are several other Workshop-related documents, listed in the Bibliography, which can be obtained from S&T/RD/EED or PPC/CDIE.

S&T/RD/EED expects to sponsor other workshops on various small and micro-enterprise issues over the next several years. We are open to suggestions of topics. Williamsburg participants suggested that A.I.D. pay attention to networking, effective communication and diffusion of information on SSE, credit management and SSE project design and monitoring. Case studies of current projects assisted under the ARIES Project (Assistance to Resource Institutions for Enterprise Support, 931-1090), and others prepared by PPC/CDIE, soon will be available for roundtable discussion as well.

I invite readers to compare the results of Williamsburg with their own experience in small and micro-enterprise development, and provide us their thoughts. Our next steps will be guided by your inputs. This is an exciting new frontier for A.I.D. and we welcome your continued involvement in the coming years.

Ross E. Bigelow, Editor
Washington, D.C.
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TABLE OF CONTENTS

-1-

WORKSHOP ON FUTURE A.I.D. DIRECTIONS IN SMALL AND MICRO-ENTERPRISE DEVELOPMENT

I. Questions Facing A.I.D. on Small-Scale Enterprise

Only a few years ago Third World governments, local development institutions and A.I.D. Missions assigned little if any significance to the role of small and micro-enterprises in developing economies. Today, many recognize that in the aggregate the small-scale enterprise (SSE) sector is large, consisting of many little formal manufacturing firms, informal retailers, petty traders, rural non-farm enterprises, and so forth. The facts are now widely appreciated that over half of the employment and often a third or more of the gross national products of less-developed countries (LDCs) come from SSEs; a majority of small non-farm firms operate in rural rather than urban areas; and demand for locally-produced SSE goods increases with the growth of income.

Because of project experience, knowledge building through research and specific country surveys, A.I.D. now sees the potential economic impact of very small businesses which can be made profitable and healthy. Unfortunately, although the seeds for small business success in LDCs have been planted widely, many of A.I.D.'s SSE projects have been unsuccessful. Agency staff want to know what has gone wrong and why. What are the critical factors that allow small firms to succeed? What can intermediaries do to help them? What part should A.I.D. play in this sector? How should projects be designed?

II. A Workshop to Answer the Questions

In December 1986, A.I.D. convened a workshop in Williamsburg, Virginia of staff and other specialists with worldwide expertise in small and micro-enterprise development. The main purposes were to consolidate Agency thinking about key questions and to forge future directions.

In early 1987 the sector gained higher visibility in A.I.D., when the U.S. Congress proposed legislation to encourage the growth of this sector. The Agency testified before several Congressional committees who wished to have A.I.D. devote greater resources to micro-enterprise credit and other sector needs.

The Williamsburg Workshop was, therefore, fortuitously timed. It brought together a wealth of experience in small enterprise planning, design, implementation, management, evaluation and policy formulation. It was co-sponsored by A.I.D.'s Employment and Enterprise Development Division (S&T/RD/EED) and the Center for Development Information and Evaluation (PPC/CDIE). Participants included representatives of several Missions and Washington bureaus, as well as non-A.I.D. experts who had been involved with the Agency's work in this area for many years. See the Workshop Participant Directory, Appendix No. 1 and the Workshop Agenda, Appendix No. 2.

The Workshop was predicated on research done over the past decade on small-scale enterprise development by the Bureau for Science and Technology, as well as evaluations and studies by Missions and other Bureaus. Providing a foundation for the Workshop were the PISCES studies of micro-enterprise, sponsored by S&T/RD in the late Seventies and early Eighties; and the research on small industry by Carl Liedholm, Donald Mead and others at Michigan State. See the Bibliography, Appendix No. 3.

Workshop participants offered strong support but cautious optimism about A.I.D.'s role in small and micro-enterprise development. There was wide agreement among participants that this sector is an important part of the A.I.D. private sector strategy in many countries and that it is critical to achieving the Agency's overall development objectives. However, there was also consensus that the sector should not be considered a "magic bullet." Instead careful consideration of our past learning and future directions is needed. Field trials should continue in different country environments, complemented by thoughtful consolidation and synthesis of that experience.

Workshop keynote addresses were given by Dr. Nyle Brady, Senior Assistant Administrator of the Bureau for Science and Technology, and Dr. Carl Liedholm, Professor of Economics at Michigan State University. Dr. Brady underlined the role of the private sector in stimulating and sustaining development and acknowledged the importance of small-scale entrepreneurs in national economies. He emphasized the need for stimulating non-farm labor-intensive business, especially in the context of a dynamic agriculture-led growth strategy, which can pay off in terms of increased income and employment. Dr. Liedholm reviewed the range of economic benefits that can be derived from small industries and recounted the findings of his research in twelve countries over the past thirteen years. Dr. Brady's remarks and a summary of Dr. Liedholm's paper are appended to the end of this report. See Appendices No. 4 and No. 5.

Five plenary panel discussions were held, with virtually all fifty-plus participants attending each, on (a) scale and target beneficiaries; (b) meeting needs through credit, technical assistance and other means; (c) institutional roles and capacities; (d) cost effectiveness of small enterprise programs; and (e) macroeconomic environment and policy reform. A discussion followed each of the panel presentations. Participants then broke into five small groups to discuss the topics and formulate recommendations. The workshop concluded with representatives of each group reporting back to the full assembly. A summary of the Workshop recommendations is presented in Section IV below.

The key Workshop questions included:

1) What kind and size of small-scale enterprise (SSE) should A.I.D. support?

2) What kind of SSE credit programs work? Should A.I.D. stop all forms of subsidized credit?

3) What kinds of SSE technical assistance work? Under what conditions might they be subsidized?

4) What institutions should A.I.D. work through to achieve enterprise development objectives? How can such programs achieve self-sufficiency?

5) How can A.I.D. and the intermediary institutions best achieve cost-effective small enterprise programs?

6) How can A.I.D. policy dialogue benefit small enterprise development?

The report presented here is an overview, organized by the key questions listed above. It is intended as a snapshot of A.I.D.'s views of the sector in December 1986 and a perspective on future work in this field, usable by interested persons in and outside the Agency.

III. Discussion of the Issues

A. What Kind and Size of Small-Scale Enterprise (SSE) Should A.I.D. Support?

On economic and development grounds A.I.D. should assist intermediaries to promote enterprises at the downscale end (1-20 employees), including manufacturing, retail and service firms, according to the Workshop participants. A.I.D. has no hard-and-fast definitions, but micro-enterprise is roughly 1-4 employees and small firms 5-50 employees. There was strong agreement that the kind and size of enterprises supported under A.I.D. programs should depend upon country-specific development objectives and country-specific analysis. For example, if income enhancement is the goal, service and commercial firms might be targeted; if employment generation is the aim, larger firms principally in manufacturing might better be the focus, although approaches will vary from one country to another. There was consensus that women owner/operators were more likely to be served if micro-enterprises were the target. Participants encouraged A.I.D. to continue to undertake research on SSEs, policy interventions and direct project assistance working through intermediaries.

Carl Liedholm's presentation of the findings of his research was particularly helpful to the Workshop's discussion of SSE scale and target beneficiaries. In the six major countries Michigan State studied (Sierra Leone, Jamaica, Thailand, Honduras, Egypt and Bangladesh), the small manufacturing firms (defined as up to 50 employees) represented important means for meeting A.I.D.'s growth and equity objectives. Liedholm concluded in his paper that firms of 2-49 employees are more efficient than larger enterprises, in terms of capital productivity, labor intensity, and cost benefit. With the exception of one-person firms, SSE employment is increasing because the number of smaller firms is growing in most developing countries.

Liedholm told the gathering that his studies reveal the sad truth that many small businesses fail. Those that succeed display the following "ocular evidence." They employ hired workers; they operate separately from the owner's residence; they operate in larger towns (20,000-plus population) with clear market potential; and they are established rather than new businesses.

Some of A.I.D. SSE project managers debated whether or not assistance should be provided to one-person firms. Some warned against writing off one-person firms without seeking further evidence, pointing to the generally good loan repayment record of these firms. Others said that poor growth of one-person SSEs could be the result of the lack of sufficient support services, and after all many SSEs had begun as one-person firms. Furthermore, many women are involved in one-person enterprises, working outside the home and hiring no workers. Curtailing support for them could defeat A.I.D.'s equity objectives.

B. What Kind of SSE Credit Programs Work? Should A.I.D. Subsidize Any Credit?

Workshop participants generally agreed that most A.I.D.-supported SSE credit projects have failed. Like small businesses themselves, any one of a number of things can kill a SSE project. Revolving loan funds are decapitalized when interest rates are set too low. Poor financial management can result in prohibitively high transaction costs and borrower disincentives. Bankers with the most relevant experience are usually disinclined to lend money to small entrepreneurs. Participants were not surprised that few credit projects are successful.

Liedholm observed that A.I.D.'s financial (credit-led) projects that work appear to consist of: a) loans based on entrepreneurial character not collateral; b) small amounts over short periods which are rewarded by larger loans when repayment is made; c) interest rates high enough to cover operating costs and reflect the true scarcity value of capital; d) loans made for working capital not fixed asset investment.

On the subject of subsidized credit participants spoke with one voice in advising A.I.D. not to subsidize. SSE credit programs should charge market rates of interest, including coverage of the costs of operating the program.

Williamsburg substantially corroborated the results of the earlier PISCES research concerning characteristics of successful micro-enterprise credit programs. Jeffery Ashe, a principal of the PISCES Project, underlined several of the findings:

- The poor will pay market interest rates because they are often much cheaper than those of moneylenders;
- Repayment rates are often 80 to 90% or more, better than LDC banks get on commercial loans;
- Small loans for short periods are more easily repaid;
- Loan application and repayment procedures work if they are simple;
- Character-based references or group-guarantee (solidarity) mechanisms work better than traditional loan collateral;
- No pre-selection of micro or small-scale businesses by type of clients is necessary; let the entrepreneurs decide themselves;
- Decentralized loan offices facilitate access to credit for SSE owners; and
- PVOs serve as effective SSE intermediaries to screen applicants to ensure prompt loan repayment, especially among entrepreneurs otherwise unserved.

C. What Kind of SSE Technical Assistance Works? Under What Conditions Might it be Subsidized?

Williamsburg generated considerable debate about the need for and value of technical assistance for the development of small enterprises. Some felt strongly that credit was the critical missing ingredient in getting smaller businesses going in less developed countries. "Businesspeople know what they are doing, just give them the resources!" Others felt equally strongly that additional credit would be wasted if entrepreneurs lacked business management and financial skills. "Train them first or the loans will be misused!" There was no Workshop agreement on whether A.I.D.-funded projects should be credit-led or technical assistance-led.

There was agreement that most past technical assistance programs for SSE had failed to become self-sustaining or cost effective, although examples of success were cited by a few. Fred O'Regan, another PISCES principal and currently Director of the Kenya Rural Enterprise Project, emphasized the importance of providing technical assistance before credit assistance and reviewed lessons learned to date about effectively delivering such technical assistance. Several participants felt that A.I.D. should accept the blame for often supporting private and voluntary organizations (PVOs) and other intermediaries which were unable to provide adequate assistance, and were also unwilling to collaborate with other institutions who did possess the capacity.

In contrast to credit programs, many participants felt that A.I.D. could justify subsidies for SSE technical assistance in some circumstances. Populations in remote areas might be targeted by A.I.D. for demonstration or equity reasons. In addition, the social benefit of public education, the introduction of a new technology or an attempt to change attitudes toward business might justify temporary subsidies. It was pointed out--to the surprise of many--that Agency policy permits subsidizing technical assistance. Nevertheless, few had stomachs for subsidizing any project or group where the planning was poor or where the thinking through of the strategy was fuzzy. Participants generally felt that most types of training may be difficult to do without subsidies from some source. If the payoff to training or technical assistance is long-term, it might best be looked upon as an investment cost.

Workshop participants recommended that A.I.D. integrate technical assistance into well-designed projects that attempt to recover costs over reasonable periods of time. Finding a viable intermediary appears to be critical in most cases. PVOs, business associations, and even financial institutions need to have their own capacities increased in order to effectively provide technical assistance to individual entrepreneurs. Parastatal organizations were also mentioned in this context, but many felt that they more often than not were subject to corruption and mismanagement, even obstructing viable private sector alternatives in the market place.

Examples of promising new strategies for SSE technical assistance included: encouragement of vertical linkages between small and large firms within selected subsectors/industries, and subcontracting relationships for production of inputs and/or marketing of outputs. It was also generally agreed that A.I.D. projects should be designed so that financial (i.e. credit) and non-financial (i.e. technical assistance) objectives reinforce each other.

D. What Institutions Should A.I.D. Work through to Achieve Enterprise Development Objectives? How can such Programs Achieve Self-Sufficiency?

The Workshop reached consensus that any one of a number of institutions could help A.I.D. achieve SSE objectives. Most of the Agency's experience with intermediaries has been with PVOs. Other institutions have included business associations, intermediate financial institutions, chambers of commerce, development institutes, universities and units of government. A.I.D. staff generally have preferred working with existing SSE institutions, but also felt that most, whether existing or new, needed strengthening. No single intermediary emerged as exceptionally successful in promoting small-scale enterprise development.

PVOs appear to have distinct advantages over governments in promoting SSE development. They are already operating in remote areas of LDCs, are concerned with equity, know local needs, stress local participation, and have experience with skills training. However, they also often lack business expertise, resources and basic management systems; and they may depend on charismatic leadership to sustain themselves.

Participants agreed that financial self-sufficiency is a key measure for intermediaries achieving success. But there is no guarantee. It is essential that projects have built-in incentives for making project activities sustainable and cost efficient. Intermediaries can improve their chances to survive by collaborating with one another; by exchanging information; by recording, evaluating and sharing case experience; and by participating in joint training activities.

E. How can A.I.D. and the Intermediary Institutions Best Achieve Cost-Effective Small Enterprise Programs?

The Workshop group established a clear linkage between cost-effectiveness and long-term sustainability of SSE programs. Michael Farbman reminded participants that A.I.D. has an obligation to give adequate attention to ensuring the cost-effectiveness of the institutions it supports, although some participants noted examples of projects which have been effective in terms of costs per job or accrued income. There was no argument that A.I.D. credit projects should be based on market rates, or the full cost of capital, to help the delivering institution become self-sustaining.

Even technical assistance projects may be seen as cost-effective if the creation of human capital and institutional viability are accurately valued. The problem is that the stream of benefits is often calculated for too short a period of time to demonstrate cost-effectiveness. This is exacerbated by the fact that A.I.D. has a proclivity for short-term projects with inevitable startup cost bulges.

Clearly, demand for credit or technical assistance services must be high enough to ensure survival of any institution. In many instances intermediary organizations can be effective with the support of various mixes of commercial and subsidized component activities, where winners cover losers. Participants agreed that medium and long-term performance standards, consistent with project objectives, must be established to guide institutional advancement and evaluation of performance. However, assessment of performance should not ignore the social and broad economic benefits over time. Financial analysis of costs per unit of output is not enough. In response to a suggestion that A.I.D. do a series of evaluations of SSE projects, Annette Binnendijk of PPC/CDIE said there were plans to do this.

F. How can A.I.D. Policy Dialogue Benefit Small Enterprise Development?

There was little disagreement among participants that "leveling the playing field" for small businesses would enhance their competitiveness with larger firms. Dialogue to improve the macroeconomic environment and policy reform can enhance A.I.D.'s direct assistance through institutions to SSEs. The Michigan State studies show that small manufacturing firms are already frequently more successful than their larger counterparts. Policy reform can further increase the benefit of small enterprises in developing economies, and the cost of not implementing reform can be high.

Evidence presented at the Workshop suggests that there are significant policy distortions in many less developed countries that negatively affect small business development. A much-cited case is Sierra Leone small entrepreneurs who must import sewing machines as "luxury" high-tariff goods, while the large clothing industry has no such tax. Larger firms may also enjoy tax holiday incentives, access to capital, access to scarce resources, zoning, industrial estates, etc. India was cited as perhaps the only country were small enterprise is in ascendance over large industries, even to the point of constraining overall national growth.

Generally, small business is not accorded much significance by decision makers. Small firms generally have small voices. Participants stressed that the political agenda can dictate the economic agenda for LDC decision makers. Furthermore, changes of government can sweep away gains in reforming SSEs policies. Even when SSE benefits are appreciated, there is difficulty in "getting the pen to move" to reform LDC policy. Participants suggested that indirect impact on policy reform might be possible through the provision of training in various public and private institutions interested in promoting small business.

IV. Workshop Consensus on Future A.I.D. Directions in Small and Micro-enterprise Development

After meeting in small groups the Workshop participants returned to plenary to make recommendations on future A.I.D. directions in the sector. It came as a real surprise that so much consensus could be achieved in such a short period. As each of the five groups reported, one expected to hear descent from one corner of the room or another, but the smaller groups were able to capture the sense of the workshop and make recommendations.

The following recommendations were presented in the final plenary session:

A. Scale and Target Beneficiaries

1. Research indicates that SSEs play a major role in achieving A.I.D.'s social and economic goals. As policies adversely affect and often overlook SSEs, greater attention to SSE development strategies is needed.

2. Specific country development objectives and country-specific analysis should guide the targeting of SSE beneficiaries by scale or other criteria. The most important factors in project and program selection (e.g., cost, policy, equity) are those that reflect conditions within the host country.

3. Interventions targeting SSEs should not be limited to manufacturing. For example, if the objective is increasing value added, manufacturing is likely to be the appropriate target subsector. If employment generation is the focus, decisions are likely to be based on firm size and to be in the manufacturing or services subsectors. If income enhancement of the poor is the goal, targeting services and commerce as well as smaller size firms may be the most appropriate.

4. The critical role of women and/or other less-empowered population groups in SSE development should be analyzed in order to maximize impact on these groups.

5. Additional research is needed on (a) non-manufacturing SSE subsectors; and (b) agriculture-led SSE development strategies.

B. Meeting Needs: Credit, Technical Assistance

1. All financial programs should carefully consider overall performance of LDC financial markets, including necessary policy reforms.

2. Drawing on successful prototypes to date, viable financial facilities and services need to be developed through local intermediaries, and include a wide spectrum of institutions, commercial banks, development banks, non-bank institutions and PVOs.

3. A.I.D. small-scale enterprise projects should be designed so that financial and non-financial objectives reinforce each other.

4. Technical assistance needs to be provided to promotional and other intermediary institutions to improve management capacity and financial systems, as well to strengthen market opportunities for small-scale entrepreneurs.

5. Promising new approaches to technical assistance include those based on vertical linkages between small and large firms in given industrial sectors, such as subcontracting relationships and ties with retailers.

C. Institutional Development: Intermediary Roles and Capacities of PVOs, IFIs, Business Associations, Etc.

1. Institutions, both those newly set up and those well established, which support small-scale enterprise need strengthening.

2. Financial self-sufficiency should be a primary goal.

3. Projects should have built-in incentives for making project activities self-sustaining and the intermediary able to become a revenue-generating institution.

4. Information exchange among SSE intermediary institutions should be encouraged to permit greater usage of the growing number of documents providing guidelines on cost effectiveness and other topics, as well as to increase awareness of different management approaches.

D. Cost Effectiveness of Small Enterprise Programs

1. Based on experience of fields missions, there is evidence demonstrating a variety of cost effective project opportunities for achieving the objectives of generating productive jobs and incomes especially for the poor.

2. Direct finance programs involving market-rate credit for micro-enterprises and small-scale enterprises generally deliver credit effectively and can become self-sustaining.

3. Apart from credit, there are other activities such as technical assistance and training that create human, institutional and/or social infrastructure and which may affect systemic performance of the economy. Subsidies may be required for such activities, although demand-driven cost recovery, whether total or partial, is desirable.

4. Projects can be sustained indefinitely through the creation of institutions, resulting in the continued generation of jobs and income for the poor.

5. Evidence suggest that programs giving assistance to private intermediaries (non-governmental organizations, firms, etc.) can be effective with various mixes of commercial and subsidized component activities.

6. Long-term performance standards, based on stated objectives, will be developed for evaluating SSE project "value."

E. The Macroeconomic Environment and Policy Reform

1. The evidence presented in the workshop indicates that there are significant policy distortions that differentially affect small businesses. A.I.D. should place high priority on encouraging countries to remove these distortions.

2. Policy dialogue can and does effectively use a wide variety of methodologies, including policy performance standards; capacity and constituency building within the government and in the private sector; and coordination between A.I.D. and other donors in developing and implementing mutually supportive strategies.

3. In cases where there is substaintial congruence of aims between A.I.D. and key government officials, performance standards can be an effective tool for policy reform to reduce distortions adversely affecting SSEs. In cases where there is a basic asymmetry of aims, persuasion and the capacity-building approach may be more effective.

4. Given the broad range of experiences in the field, it is important that A.I.D. document and disseminate information on the effectiveness of policy reform strategies in varying country conditions.

Appendix No. 1: Workshop Participant Directory

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Appendix No. 2: Workshop Agenda

WORKSHOP ON FUTURE A.I.D. DIRECTIONS IN SMALL AND MICRO-ENTERPRISE DEVELOPMENT

December 16-18, 1986
Williamsburg, VA

Tuesday, December 16

2:00PM	Participants' Bus departs Rosslyn
5:00PM	Bus arrives at the Fort Magruder Inn, Williamsburg
6:45PM	Registration and Reception
7:30PM+	Individual Panel Groups Meet Together
8:00PM	Dinner/Evening - Open

Wednesday, December 17

8:00AM Opening/Introductions - Employment and Enterprise Division, S&T/RD, Ross Bigelow, and Center for Development Information and Evaluation, PPC/CDIE, Annette Binnendijk

8:10AM Welcome - Dr. Nyle Brady, Senior Assistant Administrator, Bureau for Science and Technology

8:45AM Keynote Address: Dr. Carl Liedholm, Michigan State University, "Small Scale Industries in Developing Countries: Empirical Evidence and Policy Implications"

9:30AM Response of Panelists:
Chair: Cressida McKean, Pragma Consultant
Jeffery Ashe, Consultant
Thomas Timberg, ARIES Project Director
Maria Otero, Consultant

10:15AM Liedholm Response to Respondent Comments

10:30AM Coffee

11:00AM Presentation and Plenary
Scale and Target Beneficiaries
Chair: James Cotter, CDIE Consultant & American Univ.
Robert Blayney, Consultant, Presentor
Steve Ryner, LAC/DR/PS, Discussant
Scott Smith, USAID/Zimbabwe Dep. Director, Discussant

12:30PM Lunch

1:30PM Panel Discussion:
Meeting Needs: Credit, Technical Assistance, Etc.
Chair: Ross Bigelow, S&T/RD/EED

Wednesday, December 17 (con't)

Fred O'Regan, Kenya Rural Priv. Enterpr. Proj., Presentor
Jeffery Ashe, Consultant, Presentor
Andrea Mohn-Baumann, FVA/PVC, Discussant
Robert Hunt, Consultant/Illinois State Univ., Discussant
Herb Wegner, PRE/PPR, Discussant

3:00PM Panel Discussion:
Institutional Development: Intermediary Roles and Capacities of PVOs, IFIs, Business Associations, Etc.
Chair: Bish Sanyal, MIT/Ford Foundation Consultant
Galen Hull, Consultant
Pat Carmichael, SEA Proj., Reg. Coord., USAID/E. Caribbean
James Finucane, USAID/Ecuador Priv. Sector
Elisabeth Kvitishvili, USAID/Honduras, Priv. Sector

4:30PM Coffee

4:45PM Panel Discussion:
Cost Effectiveness of Small Enterprise Programs
Chair: Michael Farbman, S&T/RD/EED
Bud Munson, AAA/AFR, Private Sector Development
James Boomgard, USAID/Indonesia, Cent. Java Enterprise Proj.
Jan van der Veen, S&T/RD/EED

Evening Open

Thursday, December 18

8:20AM Announcements/Housekeeping, Carol Pearson, Pragma

8:30AM Presentation and Plenary Discussion:
The MacroEconomic Environment and Policy Reform:
Chair: Robert Young, S&T/RD/EED
David Cahn, ANE/PD/PRE
Carl Liedholm, MSU and Employment and Enterprise Policy Analysis Project (EEPA)
Neal Zank/Tom Dailey, PPC/PDPR

10:00AM Small Group Discussions of Critical Issues and Specific Recommendations, in separate breakout rooms

11:15AM Coffee

Thursday, December 18 (con't)

11:30AM	Presentation of Small Group Findings and Plenary Discussion: Directions for the Future of Small Enterprise Development, Cressida McKean, Pragma Consultant
12:45PM	Wrap up, Ross Bigelow
1:00PM	Check out/Lunch
2:30PM	Bus Leaves Williamsburg
5:00PM	Bus Arrives in Rosslyn

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(12) Kilby, Peter, and Liedholm, Carl. "The Role of Nonfarm Activities in The Rural Economy," Employment and Enterprise Policy Analysis Discussion Papers, No. 7 (PN-AAW-048). Agency for International Development, Washington, D.C. November, 1986.

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Appendix No. 4: Opening Remarks of Dr. Nyle C. Brady, Senior Assistant Administrator, Bureau for Science and Technology

I am pleased to open this Workshop on AID's Future Directions in Small and Micro-Enterprise Development. I see that we have an excellent cross-section of Mission representatives present from Asia, the Near East, Africa and Latin America and the Caribbean, as well as AID/Washington colleagues and experts from outside AID in the small-scale enterprise field.

We especially appreciate the attendance of those of you who have travelled great distances from our field missions. The collaborative research co-sponsored or funded by missions has helped make possible many of the important findings and experiences to be shared at this workshop.

As you well know, the Administrator has stressed the role of the private sector in development and has emphasized the importance to U.S. policy makers of mobilizing an "LDC Entrepreneurial Revolution", especially involving LDC small-scale entrepeneurs. This workshop comes at an opportune moment for AID.

Small-scale enterprise development has been taking on an increasingly important role within many Missions' action plans and portfolios. Small enterprise development reinforces existing Agency strategies in private sector promotion, income generation, technology transfer and agricultural development.

I recently returned from the Tidewater Meetings on Asian development in Islamabad, Pakistan where major donor representatives concluded that while significant progress has been achieved in overall economic development, this has not been accompanied by similar progress in education, health care, family planning and incomes for the poor. Progress in rural areas, where most of the poor live, has lagged behind that in urban areas. Where social development has been especially disappointing, such as in the Philippines and India, the donors' felt that less encouragement has been given to the growth of small-scale, labor-intensive enterprises than desirable.

One idea that was seriously reviewed by the donors was the so-called "Mellor Model." Dr. John Mellor has recently suggested using agriculture to stimulate both growth and income, as well as rural employment. One important step in this process, he notes, is to encourage domestic demand for food by stimulating labor-intensive non-agricultural enterprises run by private entrepreneurs. Appropriate LDC policies, institutions and incentives are needed to accomplish this. Most donors feel that agriculture and economic development generally have been greatly inhibited by excessive regulation of industry and subsidization, over-valued exchange rates, and inefficiencies of public bureaucracies. There was wide agreement that priority must be given to steps to deregulate and privatize many sectors currently handled by governments. However, even effective donor interventions to encourage privatization and to "get the prices right" need to be reinforced by strong local institutions and infrastructure to advance the development process and provide for equitable distribution of the benefits.

We can see that small enterprises have a key role to play in the overall development of most of the countries AID works in, providing productive employment and earnings for men and women. Indeed, small-scale enterprises generally constitute the largest employment sector after agriculture in LDCs. In rural areas where most LDC people live, nonfarm employment makes up a quarter to a half or more of all employment. This has been demonstrated through the small-scale enterprise work sponsored by the Bureau for Science and Technology, and cooperating field missions. This work includes the PISCES Project and the Michigan State University research which Carl Liedholm will present today, as well as many other useful studies by other bureaus.

Nonfarm rural enterprise is recognized as a significant direct contributor to economic growth. Findings of studies conducted by Carl and others suggest small firms (often well under ten employees) generate more output per unit of capital than their large-scale counterparts. Carl Liedholm's recent paper provides empirical support for John Mellor's agriculture-led growth strategy and demonstrates the rural nonfarm sector's income-generating and equity advantages. Other recent work by Carl demonstates that small-scale enterprises stimulates agricultural growth through increasing demand for farm commodities and by enhancing farm productivity through backward and forward linkages.

The workshop documents underline that there are numerous problems faced by informal sector businesses in LDCs--such as lack of access to formal credit, limited market and technology information, and often lack of management skills. Finding ways to work effectively in this sector has been the challenge that has faced A.I.D. Mission project designers and other development specialists.

AID's appropriation account for agriculture will be used as a key resource in the attack on rural poverty and achieving increased incomes. In developing a new vision for this account, AID is making more explicit its concern for "income generation for the rural poor," not just farmers. Rather than stressing investment primarily in factors affecting agricultural production, emphasis will be given also to programs and projects that demonstrate a direct impact on income generation. Increased family income increases the demand for both food and nonfood items in developing countries. AID assistance can benefit both the target countries and the United States, the latter through greater world food demand. For example, in Asia it has been shown that the more equitably income is distributed, the greater is the demand for food. An income strategy should ultimately increase world food demand.

Our workshop here in historic Williamsburg is especially important because it will help the Agency to learn the lessons from the small enterprise experience to date and to lay out SSE priorities which you feel the Agency must include in its overall strategy for achieving equitable and long-term economic development in LDCs. I hope you will sort out the issues in this sector, review what has been learned, evaluate the benefits and costs of small-scale enterprise assistance compared to other possible sectoral approaches, and make recommendations for future small-scale enterprise directions for A.I.D.

I wish you an interesting and productive two days and look forward to seeing your conclusions.

Appendix No. 5: Summary of Paper by Dr. Carl Liedholm and Donald Mead

"SMALL-SCALE INDUSTRIES IN DEVELOPING COUNTRIES: EMPIRICAL EVIDENCE AND POLICY IMPLICATIONS"

International donor agencies and governments of many developing countries have become aware in recent years of the important role that small industries can play in providing productive employment and earnings opportunities. Yet not a great deal has been known about small private firms in most developing countries, particularly those at the lower end of the enterprise size spectrum. Most elude the standard statistical nets and frequently exist unobserved in the underground economy. Consequently, government policymakers and donors charged with formulating policies and projects to foster small scale enterprises have often been forced, of necessity, to make decisions "unencumbered by information."

This paper has sought to fill some of the missing pieces of the small industry mosaic. It has drawn primarily on the findings from a set of studies, conducted jointly by Michigan State University and host country scholars, that were designed to examine the magnitude, the anatomy and the growth of small scale industrial enterprises in a dozen developing countries.

The most detailed, in depth studies were conducted in six countries — Sierra Leone, Jamaica, Thailand, Honduras, Egypt and Bangladesh. To obtain the necessary data from the small producers, who generally kept no records and frequently were invisible from the road, a unique two-phase data collection stategy was used. In phase I, a careful census of the entire population of small firms was conducted in the selected survey areas. In Phase II, a random sample of firms was interviewed at least once a week for one year to generate many of the flow variables. The continuous interviewing was necessary to keep the "measurement" errors resulting from the proprietors' inaccurate memory recall within reasonable bounds.

The major findings from these and other small industry studies as well as their policy and project implications have been considered in detail in the body of the paper. A summary of the main points follows.

What are the most salient characteristics of these elusive small scale industrial enterprises? First, small scale industries, which for the purpose of the paper are defined as those establishments with fewer than fifty worker engaged in manufacturing activities or related repair work, form a significant component of the industrial sectors of most developing countries. Although these establishments are small, collectively they account for the vast bulk of industrial employment. They are generally engaged in the production of light consumer goods, primarily related to clothing, furniture, food and beverages.

A second significant finding is that in most developing countries the majority of industrial firms are located in rural areas (i.e. all localities with less than 20,000 inhabitants). These are the private producers that are most frequently invisible. Employment in these rural units frequently exceeds that generated by all urban industrial firms.

Third, the overwhelming majority of the industrial firms are not just small, but are very small. Indeed, there are a plethora of one person firms and most employ fewer than five persons. In terms of their large numbers and relatively low incomes, they constitute a potentially important target group for policymakers concerned with the low end of the income distribution spectrum.

Fourth, virtually all of these small firms are privately owned, mainly organized as sole proprietorships. In many countries, significant numbers of the small industrial entrepreneurs are female.

Fifth, proprietors and family workers generally form the largest component of the small industry labor force. Apprenticeship labor, however, is important in some areas, particularly in West Africa.

Sixth, in most countries, the average person engaged in small scale industry does not work full-time in that activity over the entire year. In many cases, these individuals are working part-time in other activities, frequently farming; nevertheless, there is evidence that many are simply "waiting for customers" for significant periods.

Seventh, the amount of capital used by most of small scale industrial firms is rather modest, as is their initial capital stock. Although low, however, the capital entry barriers to small scale industry are not insignificant, especially when compared with the capital required for petty trading or unskilled service activities or with per-capita income levels in those countries.

Eighth, the overwhelming bulk of the funds either for establishing or expanding the small firm is from personal savings, relatives, or retained earnings. The paucity of funds obtained from either the commercial banks, governments, or even informal financial sources such as "moneylenders" is striking.

Ninth, small scale industrial activity appears to have been increasing in absolute terms in most developing countries. Although systematic information on growth is limited, the available evidence indicates that it has even been growing at a faster rate than large scale industries in a few countries. Since small scale industries account for such a large portion of total industrial employment, however, the absolute increase in employment absorbed by the small scale private sector is substantial in virtually all developing countries. Among small producers there is evidence that the slowest growing segment is the one-person firm.

What are the main determinants of the existing and future patterns of small scale industry activity? Some illuminating insights can be obtained by focusing on the set of factors influencing the demand for and supply of small industry goods and services.

The overwhelming bulk of the items produced by small industries are light consumer goods sold directly to urban and rural households. Consequently, a key issue is whether or not the demand for these types of goods and services increases as household income increases. Although some have argued that these are "inferior goods" (i.e. their quantity demanded would decline as income increases), recent studies have revealed without exception a strong, positive relationship between changes in household income and changes in the demand for a range of small scale industry goods and services.

A second source of demand for small industry products stems from their backward and forward production linkages with other sectors of the domestic economy, particularly with agriculture and large scale industry. Although empirical evidence on the linkages with agriculture is sparse, it appears that these linkages are often important. Their magnitude is related to the size distribution of farms and the type of agricultural strategy adopted. The small farm equipment producers' capacity for "idiosyncratic design adaptation" to meet the equipment and tool needs of small farmers is particularly noteworthy. The evidence of linkages with large scale industry is also limited and is usually discussed in terms of sub-contracting arrangements between large and small firms. Sub-contracting is particularly prevalent in Asia, where it tends to be concentrated in certain product lines.

Government and foreign customers provide the final sources of demand for small industry goods and services. Although sometimes important for particular product groups or for individual firms, overall these sources of demand are relatively minor.

With respect to supply, the key issue is whether or not small scale industrial firms in developing countries are efficient users of economic resources, particularly when compared with their larger scale counterparts. Both partial and comprehensive measures of economic efficiency have been used in attemping to answer this question.

The labor-capital (labor intensity) and the output-capital (capital productivity) ratios are the economic effiency measures most frequently used in empirical studies. These partial efficiency measures are based on the assumption that labor is abundant and capital is the only scarce resource. Virtually all the aggregate and most industry studies reveal that small scale industries generate more employment per unit of scarce capital than their larger scale counterparts. The available evidence on relative capital productivities is somewhat limited and more mixed. Yet, in the majority of countries where such comparisons have been made, the overall output generated by small industry is found to exceed that generated by large industry.

Only a few studies have used one of the analytically more correct comprehensive economic efficiency measures, in which all scarce resources are included in the analysis and are evaluated at "shadow" or social prices that reflect their scarcity values in the economy. Their findings are mixed. To assist in filling this void, a social benefit-cost analysis, which is one type of comprehensive economic efficiency measure, has been used to compare the relative efficiency of small and large industries in three of the in-depth survey countries — Sierra Leone, Honduras, and Jamaica. The key finding from this analysis is that in 10 of the 12 specific industrial groups examined, the social benefit-cost ratios of the small firms not only exceed one, but also are greater than the comparable ratios for the large scale firms in those particular industries. Consequently there is now accumulating evidence on several fronts that at least for a significant range of products small scale industry is indeed economically efficient.

What types of small industries are most efficient and what are their characteristics? A review of the findings from five countries where in-depth surveys were conducted yields some useful insights.

Although the small scale industries in the aggregate are shown to be economically efficient in all five countries, there are wide variations in this efficency by major industry groups as well as by more narrowly-defined product types. Efficiency is also shown to vary by the firm's production characteristics, particularly firm size, input composition, and location. Nevertheless, some important patterns emerge. A particularly striking finding is that the one-person firms are frequently on the margin of economic viability. The small firms most likely to be economically efficient tend to possess a number of characteristics, many of which can be discerned on the basis of ocular evidence. Such firms generally: 1) use hired workers; 2) operate in workshops away from the home; 3) operate in localities with more than 2,000 inhabitants; and 4) are involved in selected product lines with better economic prospects, such as tiles, furniture, baking and repair activites. Judiciously and cautiously applied, these indicators can provide the analyst with useful insights into those types of small scale industries most likely to be economically viable.

In light of the many favorable characteristics of small scale industries and the potential contributions they can make to the future growth in income and employment in developing countries, what can governments and donor agencies do to further enhance the role of small producers? Two major avenues are available. The first is through seeking changes in the general policy environment that broadly affects small private enterprises, while the second is through the implementation of specific projects designed to provide direct assistance to individual firms.

There are two major ways that the general policy environment can be more supportive of small scale private enterprises in developing countries. The first is through instituting a policy environment that is at least "neutral" with respect to enterprise size. In most developing countries general policies are biased against the smaller firms. Frequently, these biases result from the unintended side effects of investment, trade, credit and other policies implemented with the goal of promoting an expansion of large scale industries. Investment incentive laws frequently formally restrict the special tax concessions to large scale firms, or where such overt restrictions do not occur, small firms are ignorant of the concessions available or are unable to undertake the protracted bureaucratic procedures required to obtain them.

The credit policies of most developing countries have also tended to discriminate against smaller private firms. Governments either explicitly or implicity have imposed on the banking system interest rate ceilings or credit controls that have tended to keep interest rates artificially low. Faced with excess demand for funds, the banks have responded by rationing the scarce funds to their traditional large scale clients. Consequently, small enterprises have been forced to obtain funds either from family or from the "informal" market, where rates frequently exceed 100% per year. Efforts should be made to remove interest rate ceilings as a step towards ensuring that interest rates for borrowers of all sizes more closely approximate the opportunity cost of capital.

The second major way that general policies can effectively be used to support small scale private enterprise growth is through enhancing the demand for their products. Most studies have made clear that one of the key constraints facing small enterprises, particularly those located in rural areas, is the limited demand for their products. Since a significant share of the low-cost consumer goods sold in rural markets is produced by small firms in that same area and the demand for these products as well as agricultural inputs is particularly high among the small scale farming households, policies that promote rapid increases in agricultural income provide a powerful stimulus for small scale enterprises. Consequently, agricultural policies such as pricing and other measures aimed at increasing the income of small farmers are important not only in their own right, but also because they can contribute in a major way to the growth of small scale activities. The result also demonstrates that in reviewing the general policy environment for small firms, it is of crucial importance to transcend the traditional sphere of industrial policy and include agricultural, trade, foreign exchange and other polices as well.

Projects rather than policy reforms, however, have been the primary vehicles used by governments and international donor agencies for fostering small enterprise growth. Small enterprises, however, are difficult targets to reach through direct project assistance. The firms are numerous, widely dispersed and not easy to assist in a cost-effectve manner. Indeed, virtually all small enterprise surveys reveal that only a tiny fraction of the entrepreneurs have heard of the programs intended for them and even fewer have been aided by them. Moreover, these same studies have indicated that the constraints facing these small firms and thus, the types of direct assistance needed vary from industry to industry and from country to country.

Finance projects have been the most commonly used category of direct assistance to small industries. Although special credit programs have been designed specifically to reach the small and medium size firms in several developing countries, the smallest firms generally end up receiving very little of the funds. Moreover, the administrative costs have generally turned out to be quite high.

Several innovative credit schemes, however, appear to have been quite successful in providing financial resources to even the smallest private enterprises. What are their common characteristics? First, loans are provided primarily for working capital rather than for fixed capital. Second, loans are screened in locally-base institutions on the basis of the borrower's character. Third, loans are initially made for small amounts and for short periods to encourage and facilitate high repayment rates. Since these lending practices are closely akin to those of the informal credit institutions, it would appear that the nearer banks and other formal institutions can come to the operating procedures of informal lenders, the more likely that they will be successful in making loans to small producers.

Nonfinancial direct assistance to small enterprises involves the delivery of such things as technical, managerial, marketing and infrastructure inputs. It is frequently argued that the small firm's demand for such service is generally quite small and that a large volume of resources end up being concentrated on a relatively limited clientele.

A review of the limited number of evaluations of nonfinancial assistance projects indicates that most were not particularly sucessful in terms of benefit-cost analysis. Nevertheless, some were successful and possessed several common characteristics. First, the projects address situations where a single "missing ingredient" needs to be supplied to the firm rather than an integrated set of multiple ingredients. An implication of this finding is that projects assisting existing firms are more likely to be successful than those attempting to establish new firms. Second, the successful projects are industry and task specific. Third, before these projects or schemes are launched, prior surveys were undertaken to uncover the demand for the activity and the number and type of "missing ingredients." Finally, successful projects tend to be built on proven existing institutions, even "informal" ones.

Small scale industry can be an important vehicle for meeting the growth and equity objectives of developing countries. The accumulating empirical evidence, in fact, indicates that much of what is small is indeed beautiful. Improved policies and more carefully crafted projects can play an important supporting role in ensuring that the small industry's potential contribution to the development process is fully realized.

Appendix No. 6: Summary of Workshop Participants' Views,
by Jim Cotter

SUMMARY OF WORKSHOP PARTICIPANTS' VIEWS

The following questions and answers express the consensus of opinion of participants attending the SSE workshop. These opinions should be adjusted to fit different circumstances in LDCs conducting SSE projects.

Q. Should AID devote more resources to micro and small scale enterprise (SSE) development and why?

A. Yes. SSEs are a significant and growing factor in AID's private sector development strategy. In most LDCs, only the agriculture sector creates more jobs and earnings. Off-farm enterprises provide important additional income.

Q. Why should LDCs make SSEs a top development priority?

A. An agriculture-led growth strategy stimulates rural jobs and income as a result of increased farm productivity which attracts SSEs to serve an expanding rural market. When SSEs use local agriculture or raw materials to make products and local services to improve their value, more jobs and higher earnings result. This is especially true among the poorer half of the population.

Q. Do some LDC policies constrain the success and growth of SSEs? How can AID be helpful?

A. Yes, LDC policies and procedures frequently discriminate against small businesses by granting tax, price and other incentives to large-scale competitors. AID policy dialogue can set performance standards, coordinate donor assistance and build public and private resource institutions to promote SSE policy reforms. The purpose is to "level the playing field" to promote fairness.

Q. Why do some SSE credit programs work better than others?

A. Credit programs which set loan interest rates below the prevailing commercial market rates become decapitalized and cannot be sustained. SSE borrowers become discouraged when loan application procedures are overly complicated, slow or require collateral rather than character-based references or co-signers. These programs are ineffective.

Many good credit programs have shared characteristics. They provide small loans for a short time. When loans are repayed fully and on-time, they make larger, longer loans. In many cases, SSE owners willingly pay much higher interest to money-lenders to avoid delays and red tape. Loans should be for SSE working capital not fixed assets.

Q. Is access to credit the major constraint limiting the growth and effectiveness of small enterprise development?

A. Not always. Many SSEs also do not know enough about money management and business skills such as inventory control. They also lack information about markets and technology.

The workshop assessment of the cost-effectiveness and impact of SSE training and T.A. programs is that it has been uneven. There was guarded optimism that enough has been learned to bridge the gaps and improve performance.

There was also a consensus that some training should be provided before SSE owners receive credit. Credit recipients must be persuaded that prompt repayment can provide access to larger loans and that these are loans and not a political give-away program in which repayment is not expected.

There was also consensus that T.A. and training should be "demand-driven" responses to the specific needs of SSE owners. Do not impose an inflexible pre-packaged program.

Q. Do AID-funded programs help disadvantaged entrepreneurs?

A. Yes. There is a high involvement of women in SSEs who often lack access to credit, training, T.A. and existing employment opportunities. The loan repayment rate of women has been exceptionally high. SSE programs also help men who lack access to jobs in LDC industry or business.

Q. Should AID's funding be targeted to a specific size SSE?

A. Yes. The consensus was that large, profitable firms able to qualify for bank loans should not get AID funds unless there are special circumstances justifying an exception. Emphasis should be placed on funding smaller firms (up to 20 workers). But caution was expressed about funding SSEs that are sole proprietorships and "pre-entrepreneurial" activities because they have a poor track record.

Q. Should AID funding be targeted to certain types of SSEs?

A. No. Consensus was that AID should target SSE funding on the basis of a country-specific feasibility analysis of how best to fulfill each mission's program objectives. The workshop did not advocate a blanket policy specifying the type or size SSE that AID should fund

AID-funded research by Prof. Carl Liedholm of Michigan State University generated the best available data on employment and income-generation from manufacturing. The data comparing SSEs to large scale manufacturers showed that the smaller firms outperformed them consistently. The data also support the viability of an agriculture-led development strategy. Workshop participants expressed a need for similar AID research on retail and service SSEs.

Jim Cotter
Washington, D.C.
March, 1987

Appendix No. 7: Summaries of Plenary Panel Discussions, by Cressida McKean

SCALE AND TARGET BENEFICIARIES

This workshop gathering addressed the issue of scale and other criteria for identifying target beneficiaries to promote small enterprise development. There is no common agreement in the research literature about what constitutes a small-scale firm. For example, a small firm in India may be considered large in Honduras. Liedholm arbitrarily defines small-scale as those enterprises with less than fifty workers, but 85 percent of the firms surveyed for his study employed fewer than six workers.

Not surprisingly, the varied field experience of workshop participants stimulated a similar diversity of views about target beneficiaries. Despite these differing viewpoints, the plenary agreed that SSEs can play a major role in achieving AID's social and economic development objectives. However, determinations about target beneficiaries are fundamentally a question of country-specific strategy.

In some developing countries, primary attention is given to policies favoring generation of export earnings; in others, government policy endorses direct support to the promotion of small-scale enterprises. These different policy contexts have to inform and shape SSE development strategies on a country-by-country basis. Policy or project interventions have to focus their efforts to relieve a specific constraint in the policy environment or facing a preselected target group. In some cases, municipal zoning policy limits the capacity of small-scale enterprises to operate effectively in urban areas and could be an object of policy reform. On the other hand, small firms' lack of access to formal credit and pent up demand for financing may be a basis for a lending program for micro-enterprises. The point is that the objective of the policy or project intervention should be the appropriate starting point for identifying target beneficiaries.

The development of such programs does not take place in a vacuum independent of AID missions and intended beneficiaries. Past experience suggests that an effective, long-run SSE strategy involves the direct participation of AID staff in the formulation of country-specific SSE development strategies. Informal community-based systems, using character references, are an important basis for the identification of SSE beneficiaries in such programs. Information needs to be disseminated to small-scale entrepreneurs to increase awareness of their environment and to ensure effective use of project benefits.

Taking into account these considerations, the consensus opinion of most attendees was that an appropriate ceiling for targeting beneficiaries in terms of size was the 25-person enterprise for most AID country programs. The plenary agreed not to eliminate one-person enterprises as potential beneficiaries. The rationale for targeting this firm size was that assistance may have the greatest impact in the "informal sector", which tends to include those enterprises in the 25-person or fewer category. Firms in the larger range are more directly influenced by government regulations and assistance.

Manufacturing has commonly been the targeted sector for small-enterprise support for several reasons, principally its longer term effect on value added and employment generation. However, the workshop participants were not in favor of limiting SSE interventions to manufacturing since the objectives of SSE development efforts are often diverse. For example, services and commerce may be appropriate target sectors if the objective is income enhancement of the poor. Manufacturing is likely to be the most appropriate target subsector, if the objective is to increase value added. As a result, further research is needed on nonmanufacturing SSE subsectors to support projects with differing objectives.

Equity concerns given the prevalence of women heads of households, as well as the concentration of economically active women in very small enterprises in services, commerce and household manufacturing, are important targets of SSE assistance efforts. The role of women and disenfranchised populations in SSE development should be analyzed in order to maximize impact on these groups.

The importance of agricultural development and backward linkages to SSE development suggests that research is needed on agricultural-led SSE development strategies.

Meeting Needs: Credit, Technical Assistance

A continuing debate in the literature and among managers of SSE programs is the extent to which credit is the primary constraint to small and micro-enterprises and the extent to which technical assistance is the principal constraint. Two viewpoints on project approaches, one emphasizing technical assistance and the other emphasizing credit, were the basis for this panel discussion.

Endorsing the technical assistance approach first, the manager of the experimental Kenya Rural Enterprise Project reflected on the critical need for human resource development and institution building to reach small- scale entrepreneurs in an African context.

This rural enterprise project supports an umbrella organization whose purpose is to respond to the needs of nongovernmental organizations serving the informal sector through provision of grants and training activities. In this case, the most serious obstacle to effective delivery of credit and technical support to small enterprises has been the deficient capacity of nongovernmental organizations in the areas of credit and financial management. Services to the rural poor in Kenya are not yet commercially sustainable or banks would have been there already, but the potential of such initiatives once underway is considerable. Keys to the success of this project to date have been flexibility and a capacity to respond to local initiatives as targets of opportunity. Therefore, a mix of technical assistance to participating institutions and simplified enterprise management training to entrepreneurs, in addition to credit, are essential inputs for this SSE development program.

Presenting the credit first approach, a designer of a number of successful lending programs for micro-enterprises outlined a series of indicators of "what works" in such such lending programs. Banks are usually reluctant to lend to small scale firms, but bank programs which reach SSEs successfully have simplified lending procedures and have a specialized staff with both commitment and a sense of mission about this type of lending. Social programs typically have little capacity to manage credit funds and often have complex objectives, but social programs able to reach SSEs effectively tend to have clear goals, a simplified approval process, and adequate financial management systems.

What are the common features of successful credit programs? First, the programs are responsive to community capacities and requirements. Second, they do not pre-guess the loan applicant nor a particular type of business as an ideal target group. Third, they target established businesses. Fourth, they have developed extremely simplified loan application and repayment procedures. Fifth, they do not require traditional guarantees, rather they rely on the use of group guarantee mechanisms. Sixth, they structure the loan based on the owner's plans. Seventh, they extend small loans at short intervals. Eighth, they generally charge above market interest rates to borrowers.

Recent experience with such programs explodes the myths that these programs are "necessarily expensive" and that the "poor can't pay". Rather, several evaluations suggest that the best of these programs are increasingly cost effective and repayment rates may be as high as 80 to 90 percent.

In terms of SSE credit projects, the challenges now are: (a) to upgrade the financial and general management capacity of private voluntary organizations to better serve SSEs in a cost-effective manner; (b) to incorporate special windows in banks to ensure effective attention and access is given to small firms; and (c) to develop new financial intermediaries. The problem in many developing countries is not a lack of liquidity, but to channel financing into potentially profitable areas in which banks are not currently operating. A key is developing innovative, financial intermediaries with the incentive to lend to SSEs.

Respondents drew attention to the danger of getting bogged down in false dichotomies. Creating a polarity between credit versus technical assistance as approaches to SSE development ignores, for example, that engagement in a credit relationship inevitably promotes human resource training and skill development. Similarly, making a distinction between fixed versus working capital is often irrelevant in small firms given the confusion in its usage in actual working situations.

Moreover, credit is often necessary for SSE development, but it is not always sufficient. Marketing can often be the more critical problem. Technical assistance programs which attempt to address the marketing constraint, such as their building on the linkages of small producers with retailers in given product areas, are important departures from traditional technical assistance programs.

In both credit and technical assistance programs, the consensus of the plenary was that accountability and cost effectiveness need to be integrated into the operations of these intermediary institutions serving SSEs. Human resource development is best directed at the implementing institutions.

Institutional Development: Intermediary Roles and Capacities of PVOs, IFIs, Business Associations and Others

One of the principal vehicles for promoting small-enterprise development in recent years has been private voluntary organizations (PVOs). Disillusionment with "growth" as the dominant development paradigm in the early 1970s gave way to greater concern with "redistribution with growth" leading to an emphasis on the informal sector and small-scale enterprises. The shift away from working with governments to working with PVOs or other local institutions promoting growth from below was based on a belief that host country governments may have been part of the problem.

Advantages of this type of intermediary institution are commonly cited to be their ability to reach the poorest of the poor; their localized operation and grass roots approaches; their emphasis on participation; and their low public profile. However, recent studies on such institutions indicate that PVOs are not always successful in reaching the poor. Some of the more successful PVOs are headed by powerful, charismatic individuals, and decision-making is not decentralized. Private intermediary institutions find it difficult to remain outside of the political arena if they hope to expand in scale and have an impact on policy.

The question becomes: what is the comparative advantage of AID in working through PVOs? The success of several micro-enterprise credit programs and innovative technical assistance programs suggest that AID has had a comparative advantage with PVOs in these areas. However, AID project designers should consider a range of intermediaries, including PVOs, business associations, and a variety of financial intermediaries.

The field perspective on working with intermediary institutions supporting SSEs raises a series of practical issues concerning effective implementation of SSE development projects. Development of capable, skilled intermediary institutions from the national population is a critical input to effective project implementation and sustainability. Local intermediary institutions supporting SSE development need to be involved in the initial design efforts. A manager of a small enterprise project underway in seven Caribbean countries reflected on a critical limitation which has given inadequate attention to ensuring the participation and training of those local managers of intermediary institutions subsequently involved in project implementation.

Macroeconomic policy considerations can have a direct and critical influence on the scope of activity of private intermediary institutions. In Ecuador, government economic policy and relationships with commercial banks have affected profoundly the implementation of a small enterprise development project. While some claim that SSEs are outside the policy reach, the Ecuador experience indicates that credit allocation, interest rate policy, financial markets, and exchange rate determinations have important effects on the capacity of intermediaries to serve SSEs.

Lack of coordination among intermediary institutions and inadequate exchange of information is a problem in SSE development programs. The experience of a number of umbrella projects, linking a group of intermediary institutions, suggests that this may be an alternative in some cases. The rising availability of handbooks and guides on critical issues such as cost-effectiveness indicate the need for more information exchange.

Finally, there are insufficient mechanisms to make intermediary institutions supporting small firms self-sustaining. Attention has to be given to developing built-in incentives for SSE projects as a means for making project activities self-sustaining and the intermediaries revenue-generating institutions.

Cost Effectiveness of Small Enterprise Programs

One of the more debated issues in the area of small enterprise development is the cost effectiveness of such programs. As a sympathetic, but severe critic of many SSE projects explained, events have raised the cost-effectiveness awareness of AID. Smaller congressional appropriations are requiring AID to obtain a greater return on its investment in order to maintain its current level of activity. From this perspective, developing cost-effective SSE programs means that more attention should be given to: (a) preparing well designed projects, with work plans and schedules, performance standards, and monitoring devices; (b) building on existing institutions and systems; (c) redirecting funds from projects not achieving their goals; and (d) institutionalizing self-sustainability particularly in projects involving the extension of credit.

Another perspective on cost effectiveness of SSE projects was that analysis of costs per unit tends to rely on nominal financial calculus. Few attempts are made to incorporate the economic value of services extended over time. The contribution of institutions in promoting SSE development and social benefits of such activities are often overlooked. These limitations have represented a constraint in evaluation of SSE projects.

Noting that a recent review of costs and benefits of SSE programs concluded that economic benefits of such programs are extremely high (see Kilby and D'Zmura in Bibliography, Appendix No. 3), one panelist argued that this analysis ignored the displacement effect of such activities, the opportunity cost of materials, as well as the benefits/costs of assisting small versus large firms. He also contested that subsidies are necessarily inevitable components of SSE development programs, evident in the high success rate of several well known Asian credit programs for SSEs. Directly targeted technical assistance programs are often ineffective, but technical assistance can be valuable and innovative in supporting policy reform or making use of subcontracting arrangements, export-oriented businesses, agroindustries, or even apprenticeship systems. Large firms can develop marketing and product development systems of use to smaller firms. Such approaches may yield significant economic benefits in the long term.

Another panelist cited the difficulty with evaluating many SSE programs in so far as the bulk of the benefits of such programs are evident only in the medium to long term, i.e., in the span of seven years or more. A panelist introduced the notion of "transaction cost subsidies", which are defined as subsidies extended for one business cycle or until a commercial relationship is established by the firm, a relationship providing alternative sources of funds to subsidies. Several participants reacted negatively to the use of subsidies in this context. It was proposed that CDIE consider undertaking five to seven year ex-post evaluations of SSE projects.

There was consensus as to the need for subsidy, particularly of technical assistance and training for SSE projects. New technology can be transferred to industry, if subsidies are extended to cover risks and administrative costs. Technological and organizational changes resulting from technical assistance can increase industry's competitiveness. A PPC representative explained that the private sector policy recognizes that direct technical assistance and training to LDC private enterprises are areas in which subsidy is acceptable. The consensus of the plenary was that programs supporting SSEs can be cost effective, but attention must be given to fully clarify the components of a cost effective program for SSEs. There is also a need for standardized evaluation criteria so that cross project comparisons can be made.

The Macroeconomic Environment and Policy Reform

The policy mix of a given country critically affects enterprise development. While small-scale enterprises have performed relatively well compared to large-scale firms in many countries and industries, SSEs commonly face highly discriminatory policies which restrict their ability to live up to their potential. However, realigning such policies presents its own set of dangers. Free market policies in Taiwan and Korea with extensive state intervention yielded considerable development; however, more orthodox free market policies in the Southern Cone countries have encouraged a process of deindustrialization.

A review of AID's Private Sector Policy clarified that the policy is based on the premise that free markets are desirable and that inappropriate public interventions often create distortions which adversely affect SSEs. From this viewpoint, the greatest disadvantages for SSEs are capital market distortions, parastatals introducing excessive public borrowing, foreign trade barriers, and tax policy — all of which favor large scale firms.

Attempts to introduce policies to reduce discrimination against SSEs, or "leveling the playing field", soon becomes a question of evening out the political playing field on which economic policy decisions are made. There is a need to look for political solutions that achieve economic ends. In project design, it is important to separate projects into three distinct categories: (a) those that can succeed despite policy constraints; (b) those that can succeed only if policy constraints are overcome; and (c) those that cannot succeed. Adequate recognition should be given to the extent of leverage with LDC governments in terms of policy reform.

While the magnitude of policy distortions affecting small firms adversely is considerable, there is a surprising array of policies that have a direct effect on small firms, though many are commonly overlooked. For example, municipal zoning regulations create problems for SSEs desiring to be close to their customers. Again, the key issue in terms of policy reform is: how do we implement policy change? While the methods for effecting policy change vary, building LDC government capacity to assess the impact of policy and undertake policy reform on an informed economic basis is a preferred method, demonstrated by the Harvard Institute for International Development's experience in this area. A potentially effective strategy recognizes the context of the country's political economy and ideally makes its case by illustrating the cost of not implementing a given policy reform measure relative to the cost of making a change. However, it was recognized in the plenary discussion that this is not an easy or short-term proposition.

Appendix No. 8: Participant Evaluation of Workshop-- A Summary

At the close of the meeting, participants received a brief evaluation questionnaire concerning the content and structure of the workshop. Approximately one-third of the participants, eighteen in all, submitted completed questionnaires. The following is a summary of the responses.

1. Did the workshop meet your expectations? Please explain.

The majority, 15 of the 18 respondents, said that yes, the workshop was worthwhile. The principal reasons cited were: the considerable and diverse expertise of the participants; the relevance to SSE projects which the participant was currently managing; the exchange of ideas with field and Washington-based personnel; developing of valuable contacts; as well as the organization of the workshop itself.

The balance of respondents (3) were lukewarm about the relevance of the workshop. The principal complaints were that the discussion in the plenaries was too unfocused and anecdotal to develop general findings or conclusions. Rather, there was too much attention given to tactics, i.e. how to implement SSE direct credit and technical assistance. A problem mentioned was that there was insufficient time devoted to meeting the objectives of the conference in terms of developing guidelines for the Administrator.

2. Was the workshop format (i.e. panel followed by group discussion) useful ?

While the majority of respondents were positive (15) about the format of the workshop, nearly all respondents (17) said they would have preferred greater use of small group discussions ensuring greater involvement of participants. They were critical of the lengthy panel presentations and plenary discussions.

3. What recommendations should be made to the Administrator that were not covered during the small group sessions ?

Many expressed the view that the groups seem to have covered most of what needs to be passed on to the Agency leadership.

Additions were to :

a) Examine how AID procedures and regulations could be modified so that private enterprise programs can operate more efficiently.

b) Find ways to reduce the gap between perceived risk and real risk of lending to SSEs as seen by LDC financial institutions. The problem is the diffusion and replication of SSE credit "technology" as developed by existing AID SSE programs.

4. Which sessions were most useful? Why?
5. Which sessions were the least useful? Why?

It was widely agreed that the first session introduced by Dr. Nyle Brady, followed by Liedholm's address and the panel discussion was most useful. However, responses demonstrate no pattern or consensus about which were the most or least useful.

6. What should future workshops dealing with SSEs focus on?

Topics included:

a) Increasing cost effectiveness of technical assistance to SSEs.

b) How to .. How to... Regional workshops for AID people and representatives of the projects they fund.

c) Examination of two or three success stories with host country participation to determine generalizable lessons.

d) Case studies of what works and what doesn't and why.

e) Evaluation methods.

f) Institutional Development, training and extension.

g) Alternative approaches to SSE development, such as technical assistance through larger firms, infrastructure development, education.

h) New financial project approaches.

i) The effect of policy changes on SSE development, based on actual cases, not just including success stories.

Finally, a uniform suggestion was that the worshop's findings and recommendations be written up and sent to participants. This report is a response to that suggestion. In addition, a videotape of the workshop is being prepared for dissemination to interested Mission staff and other people working in this sector.