CSM/No. 56

COMMITTEE OF DONOR AGENCIES FOR SMALL ENTERPRISE DEVELOPMENT

World Conference on "Support for Microenterprises"

Washington, D.C. U.S.A.

June 6th - 9th, 1988

Microenterprise: The Most Profitable Social Investment

By Jaime Carvajal
Chairman of the Board of the Carvajal Foundation of Cali, Colombia

Hosted By

U.S. Agency for International Development

Inter-American Development Bank

World Bank

Participating Agencies

African Development Bank; Asian Development Bank; Caisse centrale de cooperation economique (France); Canadian International Development Agency; Commission of European Communities; Export-Import Bank (Japan); Finnish International Development Agency; German Agency for Technical Cooperation; German Ministry for Technical Cooperation; International Labour Office; Inter-American Development Bank; Kreditanstalt für Weiderauffbau (KFW) (Germany); Netherlands Ministry for Development Cooperation; Norwegian Agency for International Development; Overseas Development Administration (U.K.); Overseas Economic Cooperation Fund (Japan); Swedish International Development Authority; Swiss Development Cooperation; United Nations Industrial Development Organization; U.S. Agency for International Development; The World Bank.

Secretariat and Mailing Address: 1818 H Street, N.W., Room N-9033
Washington, D.C. 20433, USA
Telephone: (Area Code 202) 676-1695/676-0354
Cable Address—INTBAFRAD

MICROENTERPRISE: THE MOST PROFITABLE SOCIAL INVESTMENT

PRESENTATION BY DR. JAIME CARVAJAL,

CHAIRMAN OF THE BOARD OF THE CARVAJAL FOUNDATION OF CALI, COLOMBIA,

TO THE WORLD CONFERENCE ON MICROENTERPRISES

SPONSORED BY THE COMMITTEE OF DONOR AGENCIES FOR SMALL ENTERPRISE DEVELOPMENT

WASHINGTON, D.C., JUNE 1988

MICROENTERPRISE: THE MOST PROFITABLE SOCIAL INVESTMENT

To talk of the informal sector in Latin America is to speak about the way of life of most Latin Americans. There is a formal industrial sector, with varying degrees of state-of-the-art technology, competition, dependency on imported inputs and growth. Surrounding this formal sector is a marginal disorganized throng of small-scale intermediary and productive activities, verging on bankruptcy, relying on rudimentary technology but, nevertheless, creating more employment than in any other sector of the economy and generating income for over half the labor force.

Thus, the answer to the question of whether it is socially necessary to promote the organization and development of these informal activities is that it is, in fact, the region's most heart-felt social need.

Moreover, experience has shown that it is in the informal sector that social investment has the highest returns, that entrepreneurial activities are pursued most ardently and that more people are put to work in its various enterprises.

After the family, small business, whether it be a repair shop, a small-scale industry or a neighborhood convenience store, is the most common Latin American institution.

Without much support and, clearly, with much less aid than has been channeled into the development of the industrial sector, the informal sector has absorbed a large share of the huge supply of labor produced by the population explosion.

Workers in Latin America's informal sector endure low wages and little job security. But the fact remains that they do have some form of income and

employment, which is what distinguishes them, almost like a "privileged class" from the ranks of the unemployed.

Thus, the goal of turning these miniature or microenterprises into efficient units and enabling them to expand in terms of their size, organization and ambitions can have highly positive economic, social and political effects by making it possible to reduce unemployment, increase household income and strenghen democratic institutions.

THE CARVAJAL FOUNDATION PROGRAM

What distinguishes the Carvajal Foundation program operating in Cali, Colombia, is its focus on business administration. In my opinion, this approach has been a decisive factor in its success and has led 12 private foundations to extend the program to 26 intermediate cities and 15 smaller towns and villages (with less than 50,000 inhabitants) throughout Colombia, with the invaluable assistance of the Interamerican Development Bnak.

The explanation for this approach goes back to the very beginnings of the Carvajal Foundation. Created in 1961 in an effort to help integrate the growing numbers of poor in depressed areas of Cali into the social mainstream, it began by offering educational and health services. But it was not long before we realized that is was more important for these people to have jobs and a means of earning at least enough to survive through various forms of productive activities.

Dismissing further academic investigation, we concluded that finding a means of generating employment through the organization of such efforts was the most effective and least costly means of pursuing our goal of social integration.

And so it is. The average cost of creating a job in the microenterprise

sector is $1,000, a figure which can be compared only in theory with the much higher cost of creating employment in the manufacturing sector, since the latter has failed to generate any measurable amount of employment in Colombia for the past decade.

In academic terms, what we did was to create a business administration curriculum addressed at participants with little formal education managing small-scale enterprises, in other words, the opposite type of training to that offered in university programs of study oriented to big business management. The training program, developed over the course of eleven years of work, consists of ten courses in accounting, costs, marketing and sales, investment projects, production, financial analysis, personnel management, quality control, principles of business administration and business law.

Slightly over 30,000 microenterprise owners throughout the country have been trained under the program, of which 8,542 have received a total of $10,000,000 in loan funds. Although part of the program cost is presently subsidized, there is, however, a sizeable income from the 12% IDB interest earmarked for training, as well as from tuition fees collected from microenterprise owners.

Training is complemented by follow-up advisory services for microenterprise owners to enable them to successfully apply the general concepts taught in the aforesaid training courses to the management of their respective businesses.

If necessary, both these activities are reinforced by credit programs operated by an outside agency, or a financial intermediary.

PRACTICAL LESSONS FROM THE COLOMBIAN EXPERIENCE

I would like to follow up my brief description of our program of work with a few comments which I believe might be of use to foundations interested in supporting microenterprise development programs.

1. It's easy to get the impression that the greatest need of microenterprise is that of access to credit. Microenterprise owners believe this to be the case and, when considering the technological constraints and the shortage of working capital hindering their growth and development, it's easy to be convinced of the validity of this argument.

However, experience has shown that, while credit is oftentimes necessary, it should come at a later stage, after first training microenterprise owners to properly manage their businesses.

Owners of microenterprises generally know their trade, but know nothing about running a business. As soon as they set up an accounting system, more than half realize that they had been heading straight for bankruptcy. Certain owners convinced of their need for credit get on without it after completing their training. At the same time, owners benefiting from management training who do take out loans prove to be excellent credit risks, meeting all their payment obligations. According to our experience in Colombia, losses from loan defaults in well-run programs are virtually nil.

2. You cannot teach business administration solely through the conduct of training courses, but must also provide follow-up assistance at the field level to teach business owners how to apply the skills and knowledge acquired in the classroom to their own specific context.

Thus far, virtually all advisory services have relied on field visits to microenterprise owners at their place of business, which is not only costly,

but is also relatively inefficient since the advisory session is being constantly interrupted by the innumerable incidents arising in the course of the day's work, claiming the owner's attention.

Thus, we are currently testing a new approach with a fair amount of success, under which such sessions are being conducted at the Foundation's advisory services office. Naturally, from time to time, the advisor must still visit the microenterprise owner at his place of work to familiarize himself with the business per se. But 80 to 90% of such sessions can easily be held at Foundation headquarters, with microenterprise owners coming duly prepared for their appointment, armed with their accounting ledgers.

This new approach means sizeable savings for training programs per se and, most likely, more efficient advisory services as well, since the microenterprise owner is not distracted by other concerns and is in an atmosphere more conducive to assimilating the advice received at such sessions than at his place of business.

3. Although we talk about the need for self-sustaining programs, this goal is feasible only for programs focusing exclusively on the provision of credit. Programs providing training could cover the cost of their courses, but it is impossible for microenterprise owners to pay the cost of corresponding advisory services, which is extremely high in light of the large amount of time devoted to each individual.

We need only consider how education is subsidized in every country in the world to realize how impossible it is for training and advisory programs to ever be self-sufficient, particularly when we consider how these services are targeted at persons of humble means.

In Colombia, for example, while all programs collect some sort of fee

from microenterprise owners, they generally start out charging very little and may gradually raise their fees as they become more popular. Their cost is spread among different sources, namely tuition fees collected from microenterprise owners, government subsidies and the 1% monthly interest earmarked by the IDB for the use of foundations in subsidizing training and advisory services.

Fortunately, the interest aroused by microenterprise throughout the country has generated sufficient private support, oftentimes supplemented by official grants, to sustain subsidized microenterprise development programs. However, it is not always sufficient to ensure consistent program quality. In any event, there has always been enough funding to operate both program components, namely formal training courses and follow-up advisory services, although the latter have had to be cut back severely when adequate funds have not been forthcoming.

Thus, these programs must invariably be subsidized to remain in existence, which fact underscores the importance of a forum like the present conference attended by the very donors financing small enterprise development.

4. The informal sector is, by definition, a sector marginated not only from social benefits, but from society per se. Thus, it lies beyond the scope of legal formality, not out of any desire to break the law, but rather because it is unable to obey the law. Laws simply weren't made for the informal sector. The cloak of legality just does not fit. Commercial law is concerned with governing the operations of large-scale enterprises capable of complying with complex regulatory codes.

There is no legislation made specifically for microenterprises. Nor are they accorded any special treatment at the initial stages of their

development. Nor, in general, do microenterprise owners benefit from any form of government support.

Logic dictates creating special regulations for microenterprises, which would gradually begin to comply with legal formalities as they progressively develop. In other words, businesses under a given minimal size, employing less than a given minimum number of workers or, even better yet, with under a given minimum sales volume or turnover, should be exempt from observing certain regulations until reaching and/or surpassing the statutory limits making compliance mandatory.

This has never been tried and, the little I know about foreign legislation leads me to believe that nothing particularly promising has been accomplished in this area. Colombia has done virtually nothing in this direction, despite the fact that the government is firmly convinced of the need to support microenterprise and despite the existence of a national plan for microenterprise administered by the National Planning Department, a government agency which has been performing an extremely important if limited task in coordinating the country's various microenterprise programs run by private voluntary organizations, or PVO's.

The best argument for special legislation for small-scale enterprises is that microenterprise owners themselves are highly motivated to legalize their activities to become a legitimate national institution, which is precisely what has been happening as soon as they find themselves in a position to do so.

THE IMPORTANCE OF AID

Thus, our experience has convinced me that the reason microenterprise owners enroll in personal training and business development programs is because such programs promote their entrepreneurial spirit, because this kind

of progress is not something being handed them, but rather something they are doing for themselves, through hard work and effort. Through these programs, microenterprise owners are made to feel that the community appreciates their enormous social value as productive members of society.

The cost of the educational process furthered by training and follow-up advisory services through which microenterprise owners gradually attain this feeling of self-worth is only a fraction of the cost of a university education or of formal technical training.

Just as formal education is largely subsidized and such subsidy is viewed as a positive and enduring social investment, the preparation of microenterprise owners should also be subsidized, and with even greater reason in view of its impact on much larger numbers of individuals.

Thus, all of us involved in these programs are duty-bound to encourage the foundations attending this conference to pursue their self-imposed task of promoting the development of microenterprise. They have chosen an extremely useful and profitable area of work, one with high social returns. In fact, it's difficult to imagine anything more important. Through their efforts, they are supporting one of the most valuable tools for combating unemployment.

They are aiding microenterprise owners on a one-time basis, who generally expand or are at least able to put their businesses on a sound footing which, instead of ending in bankruptcy as is normally the case of microenterprise owners receiving no such training and assistance, become a source of income and wellbeing for their respective proprietors.

This has been our experience with numerous microenterprises throughout Colombia. Such aid furthers the development of microenterprises, some of which, within a short period of time, employ as many as 25, 30 or even more

workers and gradually become an integral part of the formal sector of the economy. They are the seeds of future big businesses, and it is highly satisfactory to know that our aid has contributed to their germination and growth.

Thank you very much.