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ARIES

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ARIES WORKING PAPER NO. 1

SMALL LOANS FOR MICRO ENTERPRISE: ANTI-POVERTY
AND PRO-PRODUCTIVITY

By

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"For forms of government let fools
 contend;
 Whate'r is best administered is best"
 Alexander Pope, An Essay on Man,
 Epistle II, l. 303 (from John
 Bartlett, Familiar Quotations.
 ed. E. Beck. 14th edition.
 Boston: Little Brown, 1968,
 p. 409.

SMALL LOANS FOR MICRO ENTERPRISE: ANTI-POVERTY
 AND PRO-PRODUCTIVITY

Hoary Tradition

Both small rotating loan funds and micro enterprise promotion have a hoary history as anti-poverty devices. Medieval churches ran small pawnbrokerage or loan operations. The Twelfth Century Jewish philosopher Maimonides prescribed the giving of small loans to help establish the poor in business as the highest form of charity. One of the forms in which the Koranic Zakat funds are now used is in interest-free loans to the poor. I know of one such interest-free scheme run very successfully, for example, by the Islamic Bank in Jordan -- but have heard of a number of others.

In the nineteenth century, during the industrial revolution, those concerned with the small craftsmen and farmers' economic survival promoted a variety of credit cooperative and credit union operations, and even colonial authorities, concerned about the supposed immiserizing effects of money-lending, did likewise.¹

Solutions for the Poor

The problem of the poor, that they have no money, can be remedied by getting some to them. Simple reliance on the overall buoyancy of the economy is unsatisfactory, both because its effects are necessarily very slow and to quote the 1978 World Development Report, because "the process of overall growth often bypasses the poor." One alternative, a perpetual dole, is both hard to sustain on a large scale and morally suspect. Thus, solutions have been canvassed for securing the able bodied poor employment, including self-employment, based on some credit scheme for the needed capital.

For example, following Dandekar and Rath's Poverty in India in 1964, Indian anti-poverty efforts now are focussed either in public works employment (NREP) or in support for micro enterprise (NRDP). Actually, the NRDP is a case work approach in which employment, small enterprise loans, and grants of pensions to the infirm are discretionary alternatives for those charged with administering the program.

Small-scale economic activity also recommends itself as serving other societal objectives besides that of greater equity. Small-scale units are more flexible, use surplus labor supplies, preserve folk production techniques, etc. Though there is no logical link, small-scale units are often felt to use traditional or "intermediate" technologies which are believed to be preferable as well. Names as varied as William Morris, Mahatma Gandhi, and Tolstoy have advocated a society based on small units using these appropriate techniques as suited to remedy society's social evils. "Appropriate technology" can best be pursued, it is felt, in "small but beautiful" units.

Despite the traditions, and rather considerable social movements influenced by these ideas about technology, almost no society has permitted these ideas of small-scale production to dominate its state-promoted development efforts. I say this advisedly because in many societies the vast majority of economic activity remains "intermediate" technologically, and small-scale, by default. In Bangladesh, for example, many estimates are that small-scale industrial production employs three times as many workers as large-scale production. The non-agricultural informal sector often accounts for 10 to 20 times as much of the work force as does the formal -- larger scale, more technically sophisticated one.

Recent Successes

In the very recent past, the successes of several relatively large schemes have refocussed attention on the potential of small savings and loan schemes in support of micro enterprise to assist the very poorest people in the poorest countries of the world.

By far, the best publicized and most intensively studied scheme is the Grameen Bank which, at last report, had a rapidly expanding 300,000-plus enrolled in a group savings and lending scheme, with social improvement overtones.² The clientele were poor, largely landless, and predominantly female (61 percent) laborers who many thought could not be served by such a credit scheme. After a period of attending group meetings (several five-member groups are associated in one meeting), pledging to follow certain social practices (practicing birth control, not to be involved in dowry taking, etc.), and contributing regularly to a saving scheme, one by one, members of the groups are permitted to take small loans

for various activities, either on an individual or group basis. The overwhelming number of loans have been taken by individuals, the bulk of them for small-scale trading, animal husbandry, and industry. (In 1985, according to one survey, 37 percent of loans were for livestock raising, 25 percent for manufacturing and agro-processing, and 28 percent for trading. About 5 percent of loaned funds went for collective enterprises in 1985. The average size of loan was about \$100.)

The loans have been repaid regularly, the incomes of the participants have increased, disproportionately to others in their village who did not participate, and similar people in adjoining villages.

Only .5 percent of the money lent was found to be more than one year in arrears, and only 3.3 percent was in any arrears. But non-repayment is higher among those who have been with the Bank for longer periods, though these are still a small proportion of those surveyed, and, thus, few enough perhaps not to be representative. Two-thirds of those who had taken four loans (and likely had been with the Bank for more than four years) had some arrears, often simply indicating that they were repaying on a seasonal basis.

Grameen Bank members had 50 percent higher income than those in matched "control villages" and 25 percent higher than similarly poor non-participants in their villages. However, even after participating in the project (still typically for a short time), 51 percent of Grameen Bank members were below the absolute poverty line (enough income to buy 2,200 calories to eat a day) versus 71 percent for bank eligible people in their villages as a whole, or 76 percent for those eligible to participate in control villages.

Sixteen percent interest is charged on Grameen Bank loans, plus a surcharge of 4 percent which goes to the Emergency Fund, primarily to cover defaulted loans. One taka a week must be deposited in personal savings, and a charge of 5 percent up front to a Group Fund which is available for group projects. Neither of these funds has yet been much used.

Costs have been under 10 percent of the amount lent, though the costs of funds, as critics have noted, are less than the average in the general banking system by 2-4 percent, depending on how we count. To be precise, the branches that are over two years old, and thus have some maturity, break even at the present cost which they are charged for funds from the head office. The overall operation runs at a loss because of new branches. The loss is covered by the fact that half of the Bank's funds are kept in interest-bearing accounts with the Central Bank. However, beyond this, the bulk of the funds used are from IFAD and are provided to the Grameen Bank at 5.8 percent versus the 8.5 percent charged by the Central Bank on advances to the rural sector by commercial banks and an estimated 10 percent cost of funds to the banking sector as a whole.

Two other roughly similar schemes in Bangladesh have over 100,000 participants and numerous smaller ones exist.³ In Indonesia, a government scheme has succeeded in getting money to several hundred thousand villagers and got them to repay the monies as well.⁴

An Indian Government scheme, the NRDP, has given several million subsidized loans to the poor for small-scale activities, but the indications are that enough illegal diversion

of funds and mismanagement has occurred that it is by no means clear that the poor were benefitted on any net basis.⁵

A variety of small loan funds and enterprise promotion programs are conducted with varying results elsewhere in the world, but none (among those dealing with the very poor) have clienteles of the volume of the ones described above.⁶ Depending on the country, some large small farmer schemes undoubtedly have had good results in terms of repayment and perhaps income impact with clienteles who may be in the bottom half of the income distribution.⁷

Current Attention

Concern with micro enterprises has been focussed in recent months in the United States by a flurry of proposed legislation in the U.S. Congress. The bills under various auspices mandate \$75-125 million of funds for small loan funds explicitly modelled on Grameen Bank. The bills have been actively promoted by two grassroots lobbying organizations, RESULTS and BREAD FOR THE WORLD, have secured the majority of senators and congressmen as sponsors, and seem to have excellent chances of passage. RESULTS, last year, promoted "The Child Survival Initiative," which secured a similar mandate for that program. The lobbying groups are motivated by a desire to force more of U.S. bilateral aid funds into targeted anti-poverty efforts. This initiative is not likely to have much direct impact in India, since the Government of India has been generally reluctant to permit bilateral donors to be involved in these programs. But, on a worldwide basis, it should increase direct funding for such programs in which the U.S. and other donors are already involved through grants to voluntary organizations. There should also be increased

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pressure on multilateral lenders to support programs in these areas.

The widespread support, popular and Congressional, reflects the fact that these programs are generally popular -- with the right as exemplifying private enterprise, and the left as helping the poor. There is an important group of dissenters who look at the "informal" sector of small producers and traders as a particularly effective institution for exploiting them on behalf of the formal sector.⁸

Merits: Poverty Alleviation

The schemes we deal with here are proposed as having two merits -- that they increase overall the income of the very poor in a sustainable way and that they increase the overall production in the country. Because of possible displacement effects, the former effect can only be tested if a large number of people are assisted and, of course, if the loan program is effectively administered. Unfortunately, this condition is only met, and that marginally, in Bangladesh and Indonesia, where the affected may now be mounting to 5-10 percent of the rural labor force. The Grameen Bank now covers one-quarter of the eligible population in two of the districts in which it works and 7-9 percent in the three others. The effected percentage would be higher in India if the implementation of the scheme was improved, and there are some indications that modifications are under consideration taking into account the Bangladesh experience.⁹

The questions that remain unanswered are the precise extent, in terms of administrative and cultural constraints, within which these programs can be expanded. The failure of

so many such efforts suggests that there are difficulties with organizing small loan efforts in aid of micro enterprise development for very poor constituencies. The successful Latin American and African small loan efforts, so far, have generally had relatively high administrative costs connected with coordinated packages of assistance to beneficiaries.¹⁰ One looks with interest, therefore, at further reports from experiments with providing a much more scaled down assistance package, as in the case of FINCA in Latin America and the proposed Grameen Bank scheme in Malawi.

Merits: Productivity

The productivity impact of micro enterprises is a more controversial matter. We have witnessed several impassioned denunciations of micro enterprise programs in recent months as channeling needed capital to low productivity activities. In the case of India, where government protections and subsidies are available to certain favored small-scale manufacturing sectors, one would expect that this higher productivity would not prevail, and some recent material argues that it does not.¹¹

In the case of the Philippines, one report recently argued:

While the ... Team appreciates the political expediency of livelihood-oriented, employment generating small business programs, short-term considerations cannot prevail forever. The transformation of the industrial structure -- as the manufacturing sector moves to a more efficient set of production relations -- inevitably means that small inefficient

producers get phased out. Government programs which sustain relatively inefficient small producers merely slow down this process of transformation and may make the necessary longer-term adjustments more painful.

Thus:

Financial programming for the less progressive and livelihood group of small firms is more problematic. Foremost, it must be made explicit that the less progressive, livelihood firms need special treatment and are generally likely to be too costly.¹²

However, even the bulk of Indian small-scale activity is not in manufacturing and thus not protected, and much activity survives despite not being protected. In fact, the unprotected Bangladeshi situation is far more typical than the Indian of the situation in the developing world.

In comparative terms, the bulk of activities for which small loans are sought have relatively high returns. An MSU team found that small industrial units were more productive than large ones in Honduras, Jamaica, and Sierra Leone. Per contra, a set of recent studies in particular industries shows the large, more productive in Colombia and India. As I show in an attached note, these findings are not necessarily contradictory. A survey of very small rural industrial enterprises in Bangladesh (the only one of such scope of which I am aware) reported that 98 percent of the capital was employed in enterprises which earned money even if labor was fully compensated at the standard rate for agricultural labor -- and that the modal return was about 50 percent.¹³ All the

information we have indicates that returns to rural trading and transport industries are even higher than to rural industries.¹⁴ While the bulk of this evidence would indicate that micro enterprises (and, in fact, few were covered in the India and Colombia industrial surveys) are more efficient than large, there is clearly a scope for more detailed empirical investigation.

Practically, I am not sure that this academic discussion has much significance, since it is hard to think of an industrial or economic structure without a variety of size units, each well adjusted for the task it performs. And to the extent that any external assistance or promotion is called for, it might clearly be provided to a variety of size classes, provided that they have reasonable levels of productivity and potential.

Dynamic Productivity

A second set of objections to micro enterprise has to do with the dynamic character of the enterprises encouraged. There is no doubt that as societies progress economically, the role for these micro enterprises declines dramatically, both because alternative activities open for workers and competition from larger and more efficiently organized competitors.¹⁵ But within our lifetime, it seems likely that there will be large pools of slack labor and considerable competitive place for micro enterprises in most of the developing countries. Any realistic policy concerned about the overall welfare of those societies must thus concern itself with the productivity and prosperity of these micro enterprise units.

Public Policy and Its Basis in
Measuring Benefits

To endorse small loan funds linked to micro enterprise promotion, either as an anti-poverty measure or for its productivity effects, it is not sufficient to demonstrate its benefits. We must argue that the marginal money spent in this area yields as much in poverty eradication or production as do likely alternatives.

The productivity question is easier to deal with. We have three promising indexes of productivity effects -- financial profitability, value added per unit of investment, and total factor productivity. It is the last that is now the index of choice, but seems to me unnecessarily sophisticated and too dependent on the form of production functions or procedures chosen for the present purpose. Value added per unit of investment -- which assumes that labor is costless -- is a reasonable measure for many of the types of activity undertaken, where from a societal point of view, the labor involved is almost free. However, labor typically has some cost. But profitability has as its merit that it is the factor that controls private decision makers, enables the cash flow from which production can be sustained, and is the only one of the concepts with a real world equivalent. The problems it entails are (1) the correct reporting of the values involved and (2) their calculation when there do not exist market values. (There is typically no market value for family labor and premises.)

Assessing the anti-poverty impact of small loan schemes is more difficult, particularly because of the more numerous indirect effects to be anticipated. Nonetheless, Mahaboob Hossain's Grameen Bank figures suggest that it is possible to

assess an effect in reducing poverty from small loan funds, and that at least in Bangladesh, a powerful effect was recorded. In almost no other case were programs widespread enough or well enough administered, to have produced a noticeable effect. Thus, one can conclude that a well administered, effective program of small loans in support of micro enterprise can make a significant reduction in poverty -- greater, for example, than that recorded in Bangladesh for public works, or that recorded for similar public works employment programs in India.¹⁶

These effects would not be sufficient to justify such programs if the funds were not being productively employed and thus were subtracted in some sense from those needed to buoy the economy as a whole, but that is not, as I indicated, generally the case.

The real problem, about which one can be hopeful but not totally so, is the extent to which well managed programs can be launched and sustained over time in a variety of countries. The very fact that the Bangladesh case alone is well documented leads to some caution in this matter.

Conclusion

Small loan and savings funds directed at supporting micro enterprise seem to be an effective anti-poverty tool, as well as generally contributing to the growth of national income. The speed with which they can be expanded, and the ease with which they can be sustained, depends on some hard work in building the institutions to support them.

FOOTNOTES

1. J. Carroll Moody and Gilbert C. File, The Credit Union Movement: Origins and Development, 1850-1870, Lincoln University of Nebraska Press, 1971, pp. 1-26.

Eleanor M. Hough, The Cooperative Movement in India: Its Relationship to A Sound National Economy, London: P.S. King and Son, Ltd., 1932.

2. The best data on the Grameen Bank comes from a survey conducted by the Bangladesh Institute of Development Studies under the direction of Mahaboob Hossain, "Credit for Alleviation of Rural Poverty: The Experience of Grameen Bank in Bangladesh," Bangladesh Institute of Development Studies, Dhaka, and International Food Policy Research Institute, Washington, D.C. September 1986.

3. Clarence Maloney, "Report on NGO Programmes in Rural Savings and Credit in Bangladesh," unpublished, 1985.

S. M. Al-Hussainy, "Bridging the Gap: Experience of Swanirbar Bangladesh in Self-Actuation and Employment Generation," November 1986.

4. Susan Goldmark and Jay Rosengard, "Credit to Indonesian Entrepreneurs: An Assessment of the Badan Kredit Kecamatan Program," May 1983, Development Alternatives, Inc., Washington, D.C., for USAID.

5. Sandeep Bagchee, "Poverty Alleviation in Seventh Plan: An Appraisal," Economic and Political Weekly XXII, January 24, 1987, pp. 139-148.

Sanjay Sinha, "Poverty Alleviation: Anything Goes," EPW XXI, May 10, 1986, pp. 823-824.

V. M. Rao, "Changing Village Structure: Impact of Rural Development Programmes," EPW XXII, March 28, 1987, pp. A2-A5.

6. "The Informal Sector in Central America: A Preliminary Overview," PADF, Washington, D.C., January 1986.

Donald Rhatigan, "Evaluation of Solidarios and Selected Development Foundations," by Miranda Associates, Washington, D.C., for USAID, January 17, 1986.

Working Paper on the "Prospects for Micro-Enterprise Development in Africa," ARIES Project for USAID. RRNA, Washington, D.C., November 2987 (forthcoming).

Jeffrey Ashe, Vol. I -- The PISCES II Experience: Local Efforts in Micro-Enterprise Development. Vol. II -- Case Studies for Dominican Republic, Costa Rica, Kenya, and Egypt. USAID, December 1985.

7. Gordon Donald, Credit for Small Farmers in Developing Countries. Boulder, Colorado: Westview, 1976.

For India, we note that as of 1978-79, the landless accounted for about 7 percent of all borrowers from cooperatives, including one-sixth of all agricultural labor households; the number of these borrowing from commercial banks is likely to be lower. For farmers with less than one hectare of arable land, only one-eighth as many were accommodated by commercial banks as cooperatives. (Suresh Tendulkar, "Rural Institutional Credit and Rural Development: A Review Article," Indian Economic Review XViii, pp. 101-137.

8. Ray Bromley, The Urban Informal Sector: Critical Perspectives. New York: Pergamon, 1979.

Meera Mehta, "Urban Informal Sector: Concepts, Indian Evidence and Policy Implications," EPW XX, February 23, 1985.

9. Arun Ghosh, "Money Targeting and the Banking Sector," EPW XXII, January 3-10, 1987, pp. 13-16.

Agricultural Productivity in Eastern India, Report of the Committee on Agricultural Productivity in Eastern India, Reserve Bank of India, Bombay, 1984, Annexure 15.2, pp. 238-239.

10. See note 6.

Merilee S. Grindle, Parker M. Shipton, and Charles K. Mann, Capacity Building for Resource Institutions for Small and Micro Enterprises: A Strategic Overview Paper, Cambridge, Mass: HIID, October 1986.

Ignacio Deschamps, "Programas de Financiamiento a Pequenas Unidades Productivas Urbanas: Experiencia en la Reduccion de Costos de Administracion," Inter-American Development Bank, July 1986.

11. I.M.D. Little, "Small Manufacturing Enterprise in Developing Countries," World Bank Economic Review I, January 1987, pp. 203-235.

Mariluz Cortes, Albert Berry, and Ashfaq Ishaq, Success in Small and Medium Scale Enterprises: The Evidence from Colombia, Oxford: Oxford University Press, 1986.

Drawing from I.M.D. Little, Dipak Majumdar, and John Page, Small Manufacturing Enterprises: A Comparative Study of India and Other Countries, forthcoming.

An earlier cut in the Indian case is in J. C. Sandesara, Size and Capital Intensity in Indian Industry, Bombay: University of Bombay, 1969.

Per contra, Carl Leidholm and Donald Mead, "Small-Scale Industries in Developing Countries: Empirical Evidence and Policy Implications," Draft, MSU, December 1986.

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12. Tyler Biggs, et. al., The Small Business Policy Direction Study. EEPA Project, Harvard Institute for International Development, Cambridge, MA, 1987.

13. Ed. Q. K. Ahmad, Special Issue on Rural Industrialization in Bangladesh. The Bangladesh Development Studies XII, March-June 1984.

14. Selim Jahan, "Income Generating Activities of Private Voluntary Organizations in Bangladesh," MIDAS, July 1985.
Carl Liedholm and Donald Mead, op. cit.

15. Dennis Anderson, "Small Industry in Developing Countries: A Discussion of Issues," World Development X, 1982, pp. 913-948.

16. A debate about the impacts of the Indian program between N. Rath and M. Dantwala is found in the February 9 and March 16, 1985 issues of the EPW.

In his "Editor's Introduction" to the Special Issue on Rural Public Public Works Programme in Bangladesh in The Bangladesh Development Studies XI, March-June 1983, Omar Haider Choudhary reports a gain of only 7 to 8 percent in annual income for Food for Work participants, but a lesser impact on consumption (p. 9).

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APPENDIX ON I.M.D. LITTLE, "SMALL MANUFACTURING
ENTERPRISES IN DEVELOPING COUNTRIES,"
The World Bank Economic Review I,
pp. 203-235

I am right,
and you are right,
and all are right as right can be.

Mikado, Gilbert and Sullivan

1.1. The article's primary assertion is that small-scale manufacturing units are not necessarily more labor-intensive, or efficient, in the use of capital than larger units. It should be noted that this assertion is only made about manufacturing units and abstracts from a number of very real data problems, particularly if the data reported by larger units is systematically exaggerated in comparison to that from smaller units.

1.2. The article continues that there is an observed tendency in a number of cases for small units to be more labor-intensive and efficient in the use of capital, but this is only because labor-intensive industrial categories which are efficient in the use of capital are more likely to be characterized by smaller units.

1.2.b. For example, laundry soap makers may tend to be smaller than detergent makers, but among laundry soap makers and detergent makers, size may not be connected with labor intensity.

1.3. Within the same industrial category, the most efficient capital units are often the medium-sized units. The improvement of labor absorption and increases in the efficiency of capital use is likely to come from skewing the pattern of demand toward those products which come from these industrial categories. This might be done, perhaps, by achieving greater

equality of income distribution, since the poor are hypothesized to have a greater demand for labor-intensive products than the wealthy.

2.1. The primary finding of the various studies summarized in Little's argument is in apparent contradiction with the findings of Liedholm in his recent review of the literature. This is due to:

- a. The differing and broader statistical base on which Liedholm draws
- b. The differing characteristics of industrial categories (point 1.3.)
- c. The fact that Liedholm surveyed all industries with under 50 employees as an undifferentiated whole, whereas the Little studies made finer differentiations

3.1. One might note that according to Liedholm, the small-scale sector is growing, often at a faster rate than larger-scale industries.

4.1. It does not follow that manipulating demand patterns is the only means to encourage those industries that are characterized by small-scale units -- they may be constrained on the supply side by lack of access to capital markets and technology, and, consequently, higher production costs. On the other hand, one can hardly be surprised that moderately larger firms are more efficient than very small ones -- because efficient firms would be expected to grow.

4.2. Further, since small and micro units constitute such a large proportion of the total, programs for them do not have to be justified on the basis of special advantages they possess, but may rather be part of the "level playing field" -- to balance those provided to large-scale units.

4.3. The real question is of the sort raised, but not resolved, in Little's discussion of the Indian case -- which measures are efficacious in terms of assisting production and capital and labor productivity as a whole, as distinguished from benefitting small clienteles of protected SSEs.

5.1. The discussions on capital markets in the Little piece are very speculative. It does seem that smaller, especially cottage, units are often charged loan premiums beyond those justified by administrative cost and risks of arrearage and default, despite the considerations the article cites.

**APPENDIX B:
ARIES PUBLICATIONS IN YEAR TWO**

APPENDIX B. ARIES PUBLICATIONS IN YEAR TWO

1. Assessment of USAID/Costa Rica Small-Scale Enterprise (SSE) Support Strategy with Local and International Private Voluntary Organizations (PVOs), November 5, 1986.
2. Institutional Analysis and Recommendations for Kenya Small-Scale Business Association, November 11, 1986.
3. Sourcebook of Income-Generating Projects, December 12, 1986.
4. Honduras: A Small and Micro Enterprise Development Strategy, Volume I, Volume II - Appendices, March 18, 1987.
5. El Salvador Small-Scale Sector Assessment, June 25, 1987.
6. A Joint Evaluation of Foster Parents Plan Income-Generating Projects, December 1986.
7. Evaluation of the Small Business Development Project, Honduras, April 24, 1987.
8. Somalia: An Assessment of SWDO and of the Social and Economic Status of Women in the Lower Shebelle, June 25, 1987.
9. The Forestry Private Enterprise Initiative in Ecuador: An Assessment of INFORDE's First Eighteen Months, July 1987.
10. Small Business Development Project Phase I, Jordan, April 20, 1987.
11. An Evaluation of Meals for Millions Credit Programs, October 1987.
12. Small Loans for Micro Enterprise: Anti-Poverty and Pro-Productivity, ARIES Working Paper Number 1, September 1987.

13. Thomas Timberg, ARIES Project Director's Memorandum on the Grameen Bank, June 10, 1987.
14. Thomas Timberg, Comments on I.M.D. Little's Article, "Small Manufacturing Enterprises in Developing Countries."
15. Thomas Timberg, Memorandum on "Targeted Credit," June 30, 1987.
16. Thomas Timberg Comments on Judith Tendler's report, "What Ever Happened to Poverty Alleviation?" June 10, 1987.
17. Thomas Timberg Memorandum on the VITA/Chad Evaluation, July 14, 1987.
18. Training Needs Analysis Manual, December 1986.
19. Training Needs Analysis Workbook, December 1986.
20. Small Enterprise Development Training Needs Analysis/CARE, October 24, 1986.
21. CARE Small Enterprise Development Regional Training Workshop, Preliminary Design Document, April 27, 1987.
22. Credit Management Workshop Needs Analysis, July 1987.
23. Catholic Relief Services Small Enterprise Development Training Workshop (Final Design Document), July 10, 1987.
24. CRS Small Enterprise Development Workshop, September 1987:
 - . Participant's Manual
 - . Facilitator's Guide
 - . Selected Readings
 - . Handouts
25. Four Small Enterprise Credit Models, September 1987.
26. Catherine Rielly, Improving Rural Financial Markets: Appropriate Design of Saving Projects, Draft, July 1986.
27. Strategic Overview Paper (HIID), October 1986.
28. Heidi Henrich, Evaluations, Manual and Methods: A Guide to Guide, Draft, June 1987.
29. Pia Bumgarten, Refugees: Aid Organizations in Small and Micro-enterprises, Draft, June 1986.
30. HIID Analytical Database.

**APPENDIX C:
ARIES FINANCIAL DATA**

**MISSION FUNDING FOR ARIES PROJECT:
TECHNICAL ASSISTANCE ACTIVITIES**

Table 1. Budget

	Planned Year 1	Actual Year 1	Planned Year 2	Estimated actual Year 2	Projected Year 3	Remain- ing
Total	529,910.00	625,030.00	811,962.00	612,894	928,713.00	1,709,320

Table 2. Level of Effort (Mission)

	Planned Year 1	Actual Year 1	Planned Year 2	Actual Year 2	Planned Year 3	Remain- ing
RRNA	38.0	46.2	60.0	58.7	62.0	93.1
ATI	8.0	0.0	10.0	-	9.0	47.0
CDC	2.0	0.0	2.0	-	2.0	16.0
HIID	7.5	0.0	7.5	-	12.0	15.0
Total	55.5	46.2	79.5	58.7	85.0	171.1

CORE FUNDING FOR ARIES PROJECT

Table 3. Budget

Classification	Planned Year 1	Actual expenditures Year 1	Planned expenditures Year 2	Estimated actual expenditures Year 2	Planned expenditures Year 3	Budget remaining
Salaries and wages	115,964.00	121,586.60	118,059.00	129,188.56	113,150.00	146,814.84
Fringe benefits	28,065.00	29,244.63	28,570.00	31,277.15	27,382.00	35,697.22
Overhead	68,846.00	72,095.40	70,089.00	70,165.45	67,174.00	93,780.15
Consultants	-0-	1,829.86	-0-	2,589.43	-0-	- ^e
Travel/transportation/per diem	70,688.00	12,109.25	15,405.00	10,027.00	47,727.00	168,842.75
Subcontractors	334,942.00	314,374.00 ^a	477,339.00 ^b	435,157.00 ^c	423,262.00 ^d	176,429.00
Other direct costs	18,448.00	42,290.46	13,800.00	41,359.00	15,700.00	- ^e
G&A	55,163.00	51,918.83	62,634.48	82,988.74	60,138.00	30,513.43
Total estimated costs	692,116.00	645,449.47	785,896.48	802,752.33	754,533.00	627,284.70
Fixed fee	33,821.00	32,659.72	39,766.37	40,619.26	36,871.00	28,142.00
Grand total S&T Funding	725,937.00	678,108.72	825,622.85	843,371.59	791,404.00	655,426.80

a. ATI: \$4,000; CDC: \$110,033; HIID: \$200,341.

b. ATI: \$32,585; CDC: \$137,988; HIID: \$306,766.

c. ATI: \$9,674; CDC: \$120,690; HIID: \$304,793.

d. ATI: \$35,000; CDC: \$130,067; HIID: \$258,195.

e. We will approach the Contracting Officer to allocate surplus travel/transportation/per diem funds to these budget line items of expenditure.

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Table 4. Level of Effort (Core)

Firm	Planned Year 1	Actual Year 1	Planned Year 2	Estimated actual Year 2	Planned Year 3	Total Planned
RRNA	37.5	32.8	39.0	49.0	37.0	168.5
ATI	6.0	.5	6.0	.5	6.0	20.0
CDC	9.0	13.8	9.0	11.5	9.0	37.0
HIID	27.0	38.5	40.0	64.0	31.5	94.5
Total	79.5	85.6	94.0	125.0	83.5	320.0

APPENDIX D:
EXCERPT FROM "HONDURAS: A SMALL AND MICRO
ENTERPRISE DEVELOPMENT STRATEGY,
VOLUME 1"

III. CONSTRAINTS ON SME GROWTH

This chapter identifies major constraints on SME growth in Honduras. It discusses the underlying causes of these problems and their implications for SME growth. Because SME support institutions are the most important mechanisms through which to support SME growth as a productive force in the economy, we analyze these institutions, the assistance packages they employ, and the particular constraints institutions face in extending and improving service delivery to SMEs. We discuss financial intermediation and market constraints, policy framework at the macro and municipal levels, and survey relevant research in Honduras. Finally, we discuss problems of attitude.

Problems of Institutional Support

The Sample

Approximately 25 private and governmental organizations offer business assistance services to non-farm SMEs in Honduras (see Appendix G). As part of the SME strategy review, the team analyzed nine implementing institutions with SME program components, six training and technical assistance agencies with business assistance programs, and four "second story" organizations providing services to the sector (see Appendix B). For the purposes of this analysis, "second

story" organizations were defined as those that do not directly implement SME programs, but manage general assistance programs for SME support organizations or, because of their broad resource base, have the potential to do so. The team analyzed these organizations' current capacity to support SMEs and their potential to expand.

The strategy team also reviewed current bi- and multi-lateral donor support to the sector and current USAID support of SME development (see Appendix C and D). The organizations reviewed are listed in Table 5.

Models of Program Assistance

Four program components are widely found in SME assistance programs: financial assistance, technical assistance, training, and social promotion. Having reviewed the literature on SME assistance programs, the Harvard Institute for International Development (HIID) identified six principal models used by a large number of implementing institutions. These six models provide an analytical framework within which we can assess the characteristics, advantages, and disadvantages of the models currently employed by SME implementing institutions in Honduras. Eight of the implementing institutions reviewed are discussed with reference to these six models and the three levels of beneficiaries served -- (1) subsistence with limited potential for growth, (2) micro with some basic skills and limited potential for growth, and (3) micro and small with basic skills and potential for growth (these beneficiary levels are adopted from PISCES).

Table 5. Implementing Institutions

Name	Type	Client focus	Geographic area	SME focus
<u>SME Program and Implementing Institutions</u>				
ANMPI	Private trade association	Small/medium industry	SPS/Teg	Yes
ASEPADE	Private/PVO	Micro: commerce & industry	SPS/Teg Choluteca	Yes
CADESHA	Private trade association	Commerce	Teg.	Not exclusive
CDI Government	Small/medium	National industry	Not exclusive	
CDI/PTR	Government	Agro-industry	National	Not exclusive
FENCIL	Private co-op federation	Industrial co-operatives	National	Yes
FUNADEH	Private/PVO	Small industry	SPS	yes
IDH	Private/PVO	SME farm & non-farm	4 regions	Not exclusive
OEF	Private/PVO	Women's small/medium business	SPS	Yes
Partners	Private/PVO	SME training integ. rural dev.	National	Not exclusive
<u>Training and Technical Assistance Agencies</u>				
CADERH	Private	Vocational ed. trainers	6 regions	Indirect
CIDE ^a	Private university	Students	Teg.	Potential
GEMAH	Private	Large/medium enterprise	SPS/Teg.	No
IDEA ^a	Private for-profit	PVO staff	Teg.	Potential
INCAE	Private	Organizations/enterprise	National	Yes
INFOP	Government	Enterprise/employees	National	Yes
<u>"Second Story" Organizations</u>				
ANDI/PYME	Private trade association	SMEs	National	Yes
CCIC	Private chamber of commerce & industries	Large/medium	SPS	No
CDI	Government	Small/medium industry	National	Yes
FOPRIDEH	Private: PVO consortium	Broad based PVO clients	National	No

a. Organization recently established, not yet in operation.

Table 6 compares the general characteristics of the models with the specific models of program assistance used by the implementing institutions reviewed. Costs of the implementing institutions were reviewed and then rated in comparison to one another. Other categories reflect the organizations' actual operations. The category "overall effectiveness of SME support" compares the following indicators of institutional effectiveness: coverage, organizational objectives, program methodologies and operating procedures, management and administration, cost efficiency and effectiveness, self-sufficiency, major limitations, and capacity to expand.

Table 7 presents more detailed information on the implementing institutions' support service packages and credit operations.

The Models

Model 1: Individual financial assistance, often adopted by banks and large government programs for enterprise assistance. This model can be designed for beneficiaries at all three levels of enterprise development, although it is one easily and successfully directed at level 3 entrepreneurs (those with basic skills and potential for growth). This model, however, does not require a large or highly skilled staff. Its potential for scaling up is considerable.

The weakest point of this model appears to be its limited ability to assist clients in making the best possible use of loan capital. Institutions using this model must take particular care with client selection and the potential for default and failure rates (Grindel, et al., 1986).

Table 6. Models of Program Assistance

Model type	Cost	Beneficiary level	Staff skill	Labor intensity	New or established	Beneficiary commitment	Comparative overall effectiveness
<u>Model 1</u>	Low	1-3	Simple business	Low	Established	Low	
(No organizations in Honduras currently employ this model.)							
<u>Model 2</u>	Mod	1-3	Business com. dev.	Mod	New & established	Low	Mod
ANMPI	High	3 & above	Business	Low	Established	Low	Mod
CADEHSA	Low	2-3 above	Business	Low	Established	Low	Mod
FEHCIL	High	1-3 above	Co-op	High	New & established	High	Low
<u>Model 3</u>	Mod-high	2-3	Business	High	Established	Mod	
FUNADEH	Low	3 & above	Business	Mod	Established	Low	High
IDH	Mod	1-3	Promotion	Mod	Established	Mod	Mod
CDI	High	3 & above	Business	High	Established	Low	Low
(industry)							
CDI/PTR	High	1-3 & above	Business diverse	High	New & established	Mod	Mod
ASEPADE	Low	1-3	Promotion	Low	Established	Low	High
<u>Model 4</u>	High	3 & above	Business	High	Established	High	
OEF	High	2-3 & above	Business	High	Established	High	Mod
<u>Model 5</u>	Mod-high	1-2	Comm. dev.	Mod	New & established	high	
ASEPADE	--	--	--	--	--	--	--
CREDISOL	Low	1-2	Promotion	Low	Established	Mod	High
<u>Model 6</u>	High	1	Specialize	Mod	New	High	
CDI							
(artisan)	High	--	Technical	High	--	High	Low

**Table 7. Nine SME Implementing Institutions in Honduras
1986 Credit Program Operations
In Lempiras (\$051 = 2 mps. 2)**

Name	Years in operation organization	Credit program	In-house		External training	1986 loans extended	Amount	Average	Interest rate	Arrearage	Savings mobi- lization
			T.A.	Training							
ANMPI (2)	15 years	3 months	Yes	No	Yes	24	11,750	500	12%/yr	0	Yes
ASEPADE ^a	10 years					365	185,300	500-600	2%/mo.	16%	Yes
CREME (3)		2 years	Yes								
CREDISOL (5)		2 years	Yes	Yes	No	743	378,300	500-600	2%/mo.	20%	Yes
CADENSA (2)	2 years	2 years	No	No	No	(only commodity credit extended)			0	0	No
CDI (3)	8 years	8 years	Yes	Yes	Yes	187	1,900,000	10,000	11-17%	53%	No
CDI/PTR (3) ^b	6 years	6 years	Yes			54	304,800	5,600	16%	20%	No
FEHCIL (2)	10 years	3 years	Yes	Yes	No	18	295,000	26,800	12-15%	30%	No
FUNADEH (3) ^c	3 years	15 months	Yes	No	Yes	176	1,267,000	7,200	17%	2.3%	No
IDM (3) ^d	7 years	5 years	Yes	Yes	No	196	634,000	3,235	16%	29%	No
OEF (4)	1½ years	6 months	Yes	Yes	No	11	45,000	4,100	16%	11%	No
Partners	SME credit program not yet in operation										

- a. Data for a five-month period: Aug.-Dec. 1986, except arrearage, which is cumulative.
b. Included only loans to SMEs.
c. Data for the 12 month period: October 1985 - September 1986.
d. 49 percent of the loans are for agriculture.

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Currently, in Honduras, no one SME implementing institution uses this model, although FONDEI and FIA were originally intended to operate in this manner. In practice, however, their procedures have become complicated, burdensome, and subject to over-analysis. They have taken a conservative attitude toward portfolio growth to prevent default rates and adhere to credit requirements.

Model 2: Integrated financial assistance and technical assistance/social promotion, designed to provide services to individual entrepreneurs and encourage group action to resolve common problems. According to HIID, Model 2 is similar to the first model except that as part of a credit application or monitoring process, entrepreneurs receive individualized assistance and become members of groups that meet to discuss and resolve similar problems. Community development and group cohesion goals are emphasized and groups may cooperate to acquire access to raw materials or necessary inputs.

Model 2 programs incur lower costs than programs based on more complex models. This model includes income generation components for the institutions involved. It is appropriate for all three levels of entrepreneurs and new or established businesses. It calls for staff trained in basic business skills and social promotion skills. This model has a limited capacity for growth, since staff must be maintained commensurate with the services offered.

Currently, FEHCIL, ANMPI, and CADEHSA utilize an approach to SME development based on this model. However, these institutions emphasize organizing for group economic services, rather than specifically for social services or community development. While Model 2 accommodates all three levels of SMEs, its effectiveness varies with specific subsectors or

industries, due to the varied problems and needs of commerce, service, and industry-based enterprises. In Honduras, institutions employing Model 2 work with established, rather than new, business. No determination can be made on the cost efficiency of this model in Honduras, as compared to others, since only three institutions reviewed use this model, including the most cost efficient (CADEHSA) and one of the least cost efficient (FEHCIL).

Model 3: Integrated and sequenced financial assistance, technical assistance, and training for individuals. Credit, extension, and training are options for borrowers. This model incurs higher cost because of the need to subsidize technical assistance and training. It is most appropriate to entrepreneurs in levels 2, 3, and above (micro and small with basic skills and limited and good potential for growth), and established rather than new businesses. It requires staff trained in business practices and teaching.

According to HIID research, programs based on this model may encounter difficulty in providing effective technical assistance and training, as they have little leverage over the client once a loan has been granted. Drop-out rates for extension and training may be high unless both are of high quality and relevant to the entrepreneurs.

Currently in Honduras, two implementing institutions take an approach to SME development based on Model 3 (FUNADEH and IDH); two combine Models 3 and 5 (ASEPADE-CREME and ASEPADE-CREDISOL, respectively); and one combines Models 3 and 6 (CDI). IDH provides an entire package of technical assistance, training, and credit. FUNADEH provides technical assistance and credit, but organizes training with other institutions in an effort to keep costs down. ASEPADE and CDI

use a combination of models, each directed to different client populations.

While researchers have attributed low administrative costs and default rates to successful implementation of this model in other countries, in Honduras the experience is mixed. Organizations with the highest default rates and highest administrative costs (CDI) and the lowest administrative costs and delinquency rates (ASEPADE and FUNADEH) employ variations of this model. Generally, Model 3 is considered relatively expensive because of the need to subsidize technical assistance and training. However, implementing institutions such as ASEPADE and FUNADEH have the lowest administrative costs of all organizations reviewed in this sample. FUNADEH attributes its lowered administrative costs to the use of outside training resources for both business training and specialized production technical assistance.

Technical assistance provided by these institutions is seen as an integral (and mandatory) part of the loan application and recuperation process. Hence, a degree of leverage over the borrower is maintained and the drop-out rate for technical assistance is negligible. Training in all programs is voluntary and free. It is estimated that over 50 percent of the borrowers avail themselves of these services.

Model 4: Integrated and sequenced training, technical assistance, and financial assistance for individuals, with an emphasis on training as the most important need of SMEs. In this model, only after a required training and technical assistance sequence has been completed do entrepreneurs become eligible for credit. This model also incurs high costs. Riskworthy clients are effectively identified; as a result, credit programs are more able to assist the enterprises more

likely to survive and grow. Model 4 is most appropriate for entrepreneurs in Level 3 and above, and for established rather than new businesses. A relatively large staff is required for each business assisted, which stresses business skills as well as entrepreneurial motivation. This model requires a high level of commitment on the part of beneficiaries.

In Honduras, ASEPADE employs Model 5 in the CREDISOL program, which extends credit to micro entrepreneurs engaged in commerce. The program has been quite effective in reducing its delinquency rate, generating savings, and increasing the credit fund through interest earned. While social promotion is essential to the functioning of the program, staff training in business skills is being sought to increase program effectiveness. If this model is to generate growth in addition to maintaining micro enterprises at their current levels, its ultimate success will depend on a staff with both social promotion and basic business skills.

Model 6: Training, primarily job skills training, is widely used by a number of government training agencies. This model incurs high costs and considerable investments in buildings, equipment, specialized training, and staff salaries. Subsidies by government and donors are usually required. It is most appropriate for reaching Level 1 beneficiaries and new enterprises.

CDI employs Model 6 in its artisan development program, which has had little success in establishing new enterprises for trainees or breaking even on the artisan sales outlets.