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ECUADOR
MICRO-ENTERPRISE
SECTOR ASSESSMENT
Alternative
Strategies for
USAID/Ecuador
Support to Small-Scale
Enterprise Development

GEMINI

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ECUADOR MICRO-ENTERPRISE SECTOR ASSESSMENT:

Alternative Strategies for USAID/Ecuador Support to Small-Scale Enterprise Development

by

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USAID/Ecuador's Small Enterprise Development Project, initiated in 1986, was one of the pioneer donor-supported efforts in the country. While the IDB and IAF were providing limited support to a number of local institutions at that time, none of the major international development agencies were involved in comprehensive sector-wide programs. Only a few local organizations -- primarily the FEE and the FED -- had active programs of small-scale enterprise assistance. Neither had the Government of Ecuador demonstrated a major interest in the sector. The USAID project, therefore, was conceived as an experimental program, and designed to test a variety of techniques for providing assistance to small-scale enterprises.

The four years between 1986 and 1990 have witnessed a rapid increase in the number of institutions and programs providing support to the sector. More than 10 international donor agencies, three government ministries¹, and between 35 and 50 nongovernmental organizations are now involved in micro- and small-scale enterprise support activities. The World Bank has approved its fourth industrial development credit line, earmarking a significant portion of the \$50 million line for small enterprises. The Government of Ecuador has developed several initiatives to help microenterprises, including a major program designed to coordinate government efforts in the Ministry of Social Welfare. The Inter-American Development Bank is concluding negotiations for a \$20.0 million package of support, including \$16.4 million for credit lines, directed toward micro- and small-scale enterprises.

USAID/Ecuador commissioned this microenterprise sector assessment in response to the changing environment of support to the sector and the approaching completion date of its Small Enterprise Development project. The general objective of the assessment was to develop a broad-based description of the micro- and small-scale enterprise sector that could be used by donors, the GOE and local institutions to plan better approaches to assisting small-scale enterprises. The specific objective was to help USAID/Ecuador identify and determine its future role in micro- and small-scale enterprise development, based on both the needs of the sector and the roles of other donors and agencies.

CONCEPTUAL FRAMEWORK

Designing a small-scale enterprise strategy must take place in the context of a variety of factors that influence both what is possible and what is practical. Among those that have particular relevance for planning USAID/Ecuador's future role in the sector, and that were specifically raised by the Mission, are: concerns over potential saturation of the market for donor assistance, given the large-scale interventions planned by other donors; a desire to avoid duplication of and competition with other donor and GOE efforts; the Mission's desire to have a demonstration or catalytic impact on activities in the sector; a desire to maximize the beneficial impact of Mission-provided resources; and the relatively small amount of resources available to the Mission to implement any selected strategy.

Concern over Saturation.

USAID/Ecuador was initially concerned that the increase in the number of donor agencies interested in supporting small-scale enterprise development, and the relatively large amounts of

¹Social Welfare, Labor and Human Resources, and Industry and Commerce.

development funds programmed, might reduce the need for USAID involvement in the sector. In particular, the approved World Bank fourth credit line of \$50 million (with its announced intention of servicing small enterprise clients) and the planned \$20 million IDB program for micro- and small-scale enterprises, appeared to dwarf the potential USAID program and raised the question of whether or not further USAID involvement was necessary or meaningful.

As the background studies have demonstrated, saturation of the market in terms of resources available to the sector is unlikely to occur. Even if all donors meet their planned obligations, resources that would be available for MSEs represent only a small portion of those required to promote and sustain a dynamic small-scale enterprise sector. There is opportunity for considerable expansion of assistance without saturating the market.

Need to Avoid Duplication

Of even greater concern is the need to avoid needless duplication of activities supported by other donors. USAID/Ecuador needs to find a unique niche in which its resources complement the activities of other donors, but do not compete with or duplicate them. Since the World Bank and the IDB appear destined to become the major providers of capital inputs, attempting to provide credit lines may not be the best use of USAID resources in the future. Programs that target special groups, regions or activities that are not covered by other donor programs may represent a more effective strategy for future USAID/Ecuador activities in the MSE sector.

Relative Small Amount Programmed

USAID/Ecuador has tentatively discussed MSE program support in the range of \$4.0 to \$5.0 million over a four-year period. This would be a relatively small program compared to both the overall need of the sector and the amounts planned by other donors agencies. For example, with estimated loan demands of approximately \$1,000 per enterprise, a loan fund of \$4.0 to \$5.0 million would reach less than 2 percent of the microenterprise sector. Or, it could fund an average of 4 person-years of technical assistance annually for the five-year period. Or, it could cover the annual operating costs of between 10 and 15 local NGOs.

The point to recognize is that the amount of resources available to USAID/Ecuador for investment in the MSE sector is limited. The challenge is to design an intervention strategy that would maximize impact by leveraging these resources in such a way as to produce the most significant possible results.

Catalytic or Demonstration Role

Recognizing these limitations, USAID/Ecuador recognizes the need to play a catalytic role in the small-scale enterprise sector. Rather than trying to be a generalist provider of support services, it needs to target resources toward interventions that have a significant demonstration effect -- that either demonstrate significant alternatives to traditional micro-enterprise support approaches, or that produce a significant, visible impact on the sector.

USAID/Ecuador's past approach to MSE assistance can best be described as a high-cost and low-impact approach. It is high cost because a large proportion of the funds provided are used to support

intermediate institution operations. Since only a small proportion of the resources provided to the project actually reach the intended beneficiaries, the cost-per-beneficiary-reached is high. At the same time, the approach has been an inherently low-impact one. The number of beneficiaries reached has been relatively small, and there have been few indirect beneficiaries.

To have a significant catalytic or demonstration impact, USAID/Ecuador needs to design a small-scale enterprise strategy that leverages its scarce resources. This can be achieved by focusing USAID/Ecuador resources on activities that affect large numbers of microentrepreneurs (as opposed to the one-on-one approach currently practiced) or on activities that enhance the effectiveness of other donor resources.

STRATEGIC OPTIONS

Seven major options for USAID/Ecuador's future role in the MSE sector emerged during the course of the study. These are:

1. **Do Nothing.** USAID/Ecuador could allow the current project to terminate as scheduled on April 30, 1991, allow ESF funds to phase out as current agreements expire, and plan no new interventions in the sector — recognizing that other donor activity will take up the slack, freeing USAID/Ecuador resources for other programs.
2. **Continue Current Program Activities** (perhaps with some modifications). Recognizing that the foundation programs established with USAID/Ecuador encouragement during the Small Enterprise Development project are not currently sustainable, USAID/Ecuador could elect to continue support to some of these institutions.
3. **Focus on a Policy Dialogue.** Since policy constraints form a major impediment to needed improvements in the MSE sector, USAID/Ecuador could focus its resources on establishing a policy dialogue among the GOE, donor agencies, local intermediaries and other relevant parties in an attempt to bring about the reforms needed to free up the sector.
4. **Help the GOE Rationalize the Institutional Support Structure.** a program to streamline the service delivery systems for MSEs, focusing on the role of government and the problems of an excess number of small, ineffective organizations.
5. **Focus on Institutional Development.** The rapid proliferation of institutions involved in providing MSE support services presents at least two distinct options for program interventions: (a) a generalized strategy to upgrade the capabilities of the organizations in key technical areas (such as financial planning and management, portfolio management and preparation of field personnel); or (b) a targeted strategy to improve service capabilities in selected institutions.
6. **Focus on Specific Resources.** This option would concentrate on identifying key resource gaps — such as credit, technical training and skills, or market information — and concentrate on providing resources to bridge the gap.

7. **Focus on Specific Beneficiary Groups.** Often called a "subsector" approach, this intervention strategy would attempt to leverage resources by focusing attention on addressing the constraints, impediments and opportunities facing all participants in a given beneficiary group, or subsector.

DISCUSSION OF SPECIFIC OPTIONS

Option 1: No New Interventions

Having no specific micro- and small-scale enterprise project at all is certainly a justifiable option in the Ecuadorian context. The sector is large, dynamic, and probably growing, with or without program assistance; official programs will continue to reach only a tiny fraction of the potential beneficiaries; credit unions and informal financial markets actively serve a large segment of the sector. In addition, there are a large number of other actors to take up the slack: the major new IDB program through CONAUPE will provide a significant level of resources to the sector; the IAF most likely will continue its microenterprise programs at the current \$1.0-2.0 million level per year; and other donors, such as the Konrad Adenaur Foundation and SWISSCONTACT, will certainly continue activities in the sector. In short, no new initiatives may be needed from USAID/Ecuador in this particular field.

Furthermore, with probable changes in the GOE with the next national elections and the initiation of the announced new IDB program, the termination of USAID/Ecuador's current project in April provides an opportunity to reflect on both the institutional and resource needs of the sector before committing any new resources. Finally, although this is not a popular conclusion, there is little empirical evidence to indicate that assistance programs really have an impact on the beneficiaries.

There are negative consequences to such a course of action, however. Several of the foundations that initiated micro- and small-scale enterprise activities under the aegis of the Small Enterprise Development project are not self-sufficient, and would be unable to sustain activities in the absence of continued support. While CONAUPE proposes to continue institutional support through funding provided by the IDB, it is not definite that CONAUPE's priorities would entail continued support, or that it would be able to sustain needed funding levels, for all institutions. Even more important, failing to fund activities in the sector would reduce USAID/Ecuador's participation in policy dialogues, its ability to influence or assist in the planning and design of intervention strategies, and its ability to influence reforms for the chaotic institutional situation in the sector.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Recognizes the increasing participation of other donors in the MSE sector. * Allows USAID/Ecuador to focus resources in areas that are not receiving such a high level of attention from other donors. * Would allow USAID/Ecuador to assess the impact of changes brought about by the upcoming national elections and by the injection of major new donor resources into this sector. 	<ul style="list-style-type: none"> * Good possibility that nothing new would happen, and that donor agencies and delivery institutions will continue to work as now. * USAID/Ecuador would be, in a practical sense, be eliminated from policy and operational decisions involving the MSE sector. * Would reduce USAID/Ecuador's leverage or influence on streamlining the institutional delivery system (especially regarding the proliferation of new, highly marginal institutions) for MSEs.

In the short run USAID/Ecuador will not be directly involved in the MSE sector because of the termination of the Small Enterprise Development project and the lead time needed to begin new initiatives. USAID/Ecuador should allow the current project to expire as planned; allow the ESF-funded program to continue as is, with no new increase in funding levels; and spend the year planning a new intervention strategy for approval in FY1992 or FY1993.

Option 2: Continue Current Programs

Few of the programs started (or funded) by the Small Enterprise Development project have reached maturity or sustainability. Of the foundations and other NGOs specifically examined in the course of this study, only one or two can be considered self-sufficient.² None of the four foundations working with Fundación Carvajal are covering more than 30 percent of their operating costs from self-generated income. Inflation has seriously eroded the asset base of all of the local intermediaries.

The Carvajal-supported foundations, in particular, were organized during the course of project, in response to the project design developed by USAID/Ecuador. Institutional development, especially for new institutions, is a long-term process, and these institutions require additional time and assistance to reach acceptable levels of sustainability. Donor agencies should not sponsor the creation of institutions and programs without a corresponding intent and commitment to provide the time and resources necessary to develop them into sustainable organizations.

Continuing to fund at least some of the organizational programs initiated under the Small Enterprise Development project would underscore USAID/Ecuador's long-term commitment to institutional development. It would also protect the past four years' investment in developing programs in secondary cities, and maintain beneficiary confidence in the institutional programs initiated under the

²According to financial statements provided by the various foundations, only the Fundación Ecuatoriana de Desarrollo is covering most operating costs from internally generated income.

project. Finally, it would sustain USAID/Ecuador's position as a credible donor in the microenterprise field.

There are drawbacks to this approach, however. It allows the local intermediaries to postpone needed internal changes and modifications, and fosters continued dependence on donor financing. Also, following this option, even in the short run, can lead to a mere project extension, with no redirection of the USAID/Ecuador program.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Keeps USAID/Ecuador at the "playing table" for a future role in policy dialogue and influencing intervention strategies. * Continues institutional development so that present investment is not wasted. * Provides opportunity to focus on those project components that have been most effective and eliminate less successful components. * Provides opportunity to make a strategic statement about preferred ways to provide MSE development assistance. * Provides a "bridge" measure until a more complete design can be developed or a "no-go" decision is made. 	<ul style="list-style-type: none"> * Problem of falling into conventional "business as usual" approach in which ineffective approaches are perpetuated. Danger that needed modifications or improvements will not be made. * USAID/Ecuador might continue programming along present lines without re-thinking or re-designing its strategies. * Limited USAID/Ecuador resources may be dissipated quickly, without exploring other options.

If USAID/Ecuador is satisfied sufficiently with program accomplishments under the Small Enterprise Development project, providing bridge financing until a final determination on USAID/Ecuador's future MSE strategy is reached offers the opportunity to sustain existing operations and make some modifications in existing programs. Through negotiations for additional funding, USAID/Ecuador would be able to encourage ACCION/AITEC, Carvajal Foundation, and INSOTEC to develop strategies for streamlining the present MSE delivery system.

Option 3: Policy Dialogue

As pointed out in Chapter Four, local and national government policies and programs have a strong impact on the current and future success of micro- and small-scale enterprises in the country. Among the major policy issues that have been identified as having a particularly negative impact on small-scale businesses in Ecuador are:

- High and variable rate of inflation that reduces the economic returns to small businesses;

- Arbitrary and artificial interest rates that lead to severe credit rationing;
- Exchange rate policies that discriminate against small producers;
- Cumbersome administrative procedures that increase the cost of business, especially for small firms;
- Onerous labor laws that significantly increase the cost of labor;
- Trade policies (including differential tariffs and protected transportation monopolies) that distort factor markets and make it more difficult and costly for small businesses to obtain needed inputs and equipment;
- Absence of export promotion programs and incentives; and
- Absence of adequate municipal infrastructure.

Focusing on a policy dialogue would provide a forum for discussing major policy issues with the GOE and other institutions, and provides assistance to research and initiate reforms in the policy area. While USAID/Ecuador should continue to support improvements in all of these areas, two issues (financial market policies and disincentives to legalize small business operations) are more significant than others, and warrant special focus.

The distortion in domestic financial markets caused by high inflation and the GOE's efforts to control inflation through a restrictive monetary policy is the single policy issue that has the most adverse impact on MSEs. Current GOE domestic monetary policies have the effect of restricting the flow of financial resources to the sector and increasing the cost of those financial resources. The objectives of any policy dialogue effort in the area of financial markets should be to:

- Encourage the GOE to continue its readjustment policies;
- Unify exchange rates;
- Reduce distortions introduced by preferential interest rates;
- Permit higher-than-market interest rates for small enterprise loans to increase the profitability of these to banks
- Increase the allowable interest rate on social-purpose loans that are discounted through the Central Bank;
- Improve rediscount procedures to encourage use of this mechanism for micro-enterprise loans; and
- Increase incentives for local capital formation and retention.

Second, if legalization of informal sector businesses is viewed as a necessary objective, steps must be taken to make it easier to register a business, make it advantageous to do so, and reduce the direct and

indirect costs of being a legally registered business. Most of the respondents to this survey who were not registered indicated that they saw no benefit from being legally registered. Objectives of policy dialogue and reform in this area would include:

- Establishing different classes of legally recognized business ownership (such as the sole proprietorship, partnership, limited partnership, and incorporation as used in the United States) with significantly reduced paperwork, procedures, fees and licenses for sole proprietorships and partnerships;
- Establishing a gradation of taxes and labor law requirements for different sizes and kinds of businesses to reduce the negative burden of becoming legally registered;
- Establishing positive incentives for legally registering businesses by making these eligible for special training programs, export and import licenses, simplified tax procedures, and a special discount on credit rates for legally incorporated small-scale businesses.

Achieving positive modifications in these two areas would significantly improve small enterprise access to needed resources and services, and would help create a positive foundation for small enterprise growth in the country.

The major disadvantage to concentrating USAID/Ecuador's involvement in the MSE sector on policy issues is that the policy issues, while affecting small-scale businesses, have much broader implications for the economy and larger business community. Thus, they cannot be addressed effectively from the perspective of micro- and small-scale businesses. A second disadvantage to this approach is that USAID/Ecuador's limited resources would probably not provide sufficient leverage to induce or influence major policy decisions.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * By emphasizing policy dialogue, USAID/Ecuador makes a statement of the importance of streamlining the MSE system as a whole rather than continue to support the relatively ineffective and unwieldy MSE delivery system in its present state. * Policy dialogue fills a gap that is now missing among the different interventions and complements well the interventions of other international donors. * Resolving major policy issues will have a broad impact on the performance of the business and industrial sectors of the country. 	<ul style="list-style-type: none"> * There is a possibility that policy dialogue alone will not have desired results. * USAID/Ecuador does not have resources to support implementation of recommended changes. * Major policy issues must be addressed on a broad perspective -- they do not just affect MSEs and cannot be addressed adequately from an MSE perspective. * There are other vehicles for addressing the policy agenda.

While achieving changes in policies that affect micro- and small-scale enterprises may be a worthy objective, it appears that policy dialogue must be addressed through a broader perspective than that afforded by a project-type of intervention focused exclusively on micro- and small-scale enterprises. Resolving policy issues is a long-term process rather than a project-achievable objective. Furthermore, USAID/Ecuador already has a number of efforts underway that can address the policy issue. Existing USAID/Ecuador-sponsored activities with ANDE-FEDEXPOR, IDEA, or the INCAE Policy Dialogue Support Project offer a better platform for resolving general policy issues. For these reasons, a micro- and small-scale enterprise project that focuses exclusively on policy issues is not recommended.

Option 4: Streamlining the Institutional Situation

The rapid proliferation of institutions — international, national and local — in the small-scale enterprise field gives the impression of a chaotic, overlapping, redundant and wasteful array of programs attempting to provide services to the sector. However, the international donor community is not as redundant and overlapping as it appears. Most of the donor agencies are supporting very distinct groups and sectors within the local setting. The World Bank, for example, provides resources primarily to medium-scale and larger small-scale enterprises: funds and services supported by the Fourth Credit line are generally unavailable to truly small-scale enterprises, especially in the commercial and service sectors. The European donors are focused on specific, small-scale interventions through particular intermediaries, while the IAF and small-projects division of the IDB distribute their largesse indiscriminately to a variety of specific institutions. Of the major programs, only USAID/Ecuador's Small Enterprise Development project, which is ending, and the proposed IDB loan program would have duplicated efforts in that they were channelling similar resources through the same institutions to the same beneficiary population. The government programs are in a flux, and will likely change again within the next two years. For the moment CONAUPE is firmly entrenched. UNEPROM is underfunded, and struggling to find a role for itself. Elections next year will probably result in major shift in program emphasis and institutional players.

The local situation is much more chaotic with the rapid proliferation of largely similar, overlapping local institutions. This is the direct result of GOE policies facilitating the formation of foundations and the availability of donor financing. In general, the existence of many small and competing institutions tends to increase the cost of service delivery, limit impact and decrease efficiency. Although there is no justification for more than one general-purpose NGO per community, however, the limited coverage achieved by the existing institutions suggests that there are clients in need of services that either cannot or will not be covered by existing programs. Allowing multiple entrants does serve to reach additional client groups.

The objectives of rationalizing the institutional support structure should be to (a) increase the level of resources devoted to microenterprise development, (b) reach a larger number of microenterprise beneficiaries, (c) increase the effectiveness of support provided to microenterprises, (d) reduce redundancy, duplication and competition in the provision of services, and (e) reduce the costs of providing services to this sector of the population.

Options to promote rationalization of the institutional support structure would include:

- Dialogue sessions with the various international donors, GOE agencies and major local intermediaries to coordinate geographic coverage and specialize in services;
- Roundtables and work-shops to share experiences and techniques for reaching microentrepreneurs effectively; and
- Publications to keep all participants informed of program outreach, technologies and initiatives.

Program attempts to rationalize the situation are unlikely to be very successful, for a variety of reasons:

- Donors have to spend their money, and many of the programs are aimed at developing friendship and political linkages rather than program efficiency;
- Prestige and recognition — both within the GOE and within the donor agencies themselves — come from starting new initiatives, not from imitating or improving on successful ones;
- The national programs are directly tied to politics and patronage: rationalizing the structure is not in the interests of the political parties and coalitions that use these relationships as power bases;
- At the local level, not only is the proliferation of these institutions a symptom of political patronage, the individuals running the organizations earn income from the staff positions, and have little interest in eliminating redundancy; and
- Finally, as in the case of policy dialogue, rationalizing the institutional support structure is not particularly amenable to a project-type of intervention — it is more appropriately part of a process of negotiating a project, or an on-going policy dialogue.

Apart from continued discussion between USAID/Ecuador, the IAF, the IDB, and the GOE, there does not appear to be a logical role for a project intervention in attempting to rationalize the institutional support structure.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Institution-building is a traditional A.I.D. activity * Implementing an institution-building project is probably easier to manage than alternative project designs * Would build on prior accomplishments and help sustain institutions that need additional support * Could help improve coordination, reduce duplication of efforts and improve the impact of existing programs 	<ul style="list-style-type: none"> * Some of the alternatives, such as streamlining the institutional support system, do not lend themselves to project-style interventions * Lack of specificity in objectives could result in a low impact project. * Focus on building institutions may lose sight of the overall objectives of supporting MSEs * Project could attempt to become "all things to all people" and thus not be of benefit to anyone. The option certainly attempts to provide change in many institutions with the possibility that nothing changes in reality. * Uncertainty of willingness of NGOs and others to collaborate in a general-purpose, cross-cutting activity (such as broad-based training) that does not have other resources associated with it

Option 5: Focus on Developing Intermediate Institutions

Most development assistance projects involve elements of institutional development. To the extent that projects leave behind on-going, sustainable institutional programs, benefits can be produced beyond the relatively short timeframe of the project itself.

General NGO Strengthening

This study identified a number of issues and problems that cut across institutional lines — affecting a large segment of the NGO and foundation community.

- Lack of credit management concepts and skills;
- Inadequate record keeping;
- Lack of a clear vision of the clients they are attempting to serve;
- Weak financial and economic base; and
- Inability to provide adequate technical training and support.

Other donor efforts and programs will provide loan funds and general budget support to the NGOs, and the IDB-CONAUPE project includes provisions for technical and other support to the NGOs, but no other program is dealing directly with any of the above issues on a systematic basis. One strategy USAID/Ecuador could adopt would be to focus on general institutional development for the NGOs — addressing any or all of these deficiencies in the existing universe of NGOs, foundations, and other private sector organizations. Such a program could focus on training of institution officers and staffs, providing scholarships or special seminars on a variety of topics, or serving as a "train-the-trainer" model.

This approach would allow USAID/Ecuador to concentrate its resources on activities that complement and enhance the effectiveness of other donor resources. To the extent that program interventions could be coordinated among the donors, such an approach allows a comprehensive and systematic application of resources for MSE development.

The major disadvantage is that coordination is often difficult, and programs with substantial loan funds tend to be more visible and influential in any kind of joint project. Unless carefully planned, USAID/Ecuador's participation in such an effort might be perceived as peripheral by the NGOs.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Would complement other donor resources * Could help improve coordination, reduce duplication of efforts and improve the impact of existing programs * Would fill gaps in current MSE development activities * Would strengthen services delivery systems 	<ul style="list-style-type: none"> * Lack of specificity in objectives could result in a low impact project. * Uncertainty of willingness of NGOs and others to collaborate in a general-purpose, cross-cutting activity (such as broad-based training) that does not have other resources associated with it * USAID/Ecuador resources might be viewed as peripheral

Develop Specific Institutions

Alternatively, USAID/Ecuador could select a strategy of helping to strengthen a limited number of specific intermediary organizations. USAID/Ecuador could select a limited number of specific intermediary institutions — based on geographic location, sector of the population served, or other strategic criteria — and focus its resources on developing those into effective, sustainable programs.

Continuing support to select institutions helped by the Small Enterprise Development project (see option 2 above) would be one example of this strategy. Other options might include support to selected small industry chambers of commerce, support to one specific institution's program, or support to women's organizations, bank foundations, or others

The Ecuadorian credit union system would be one obvious target of an institution-specific focus. With virtually no external assistance, and relying on internal savings mobilization as the primary source of capital, the credit union system appears to be the most significant source of financial services for

small-scale entrepreneurs in the country. There are notable problems — interest rate policies, savings mobilization, development of new and more effective financial instruments, delinquency control and portfolio management — in the credit union system that, if corrected, could significantly expand this role and the positive impact of the credit union system on small-business lending in the country. These problems are amenable to improvement through a low-intensive project intervention involving technical assistance in financial and portfolio management, strategic planning and savings mobilization. External funding for loans is not needed for the credit union system to significantly improve its role in the MSE lending.

A program focused on the small industry chambers of commerce and their associated specialized interest grouping is another likely candidate for an institution-specific development project. Such a strategy could be patterned after USAID/Bolivia's project with FEBOPI and the ADEMI's — similar small industry chambers that appear to be effective in promoting and implementing programs for their members with relatively modest assistance from the USAID project. These associations are surprisingly strong in Ecuador, and have a stable membership. Institutional development of the small industry chambers might be an essential component of a subsector approach (discussed later) focusing on an industry grouping such as metal workers, wood products, garment making or food processing.

INSOTEC and its subsector programs in leather, carpentry and clothing represents a third medium for an institution-specific project intervention. Such a project could seek to expand the client base of INSOTEC's existing pilot projects, develop specific programs for other subsectors within existing facilities, or open new facilities in other secondary cities.

The major advantage of focusing on the institutional development of a relatively small number of institutions is that USAID/Ecuador could identify a potentially strong institution (based on either the service it provides, the approach it follows, or the client base it serves) and work with that institution to design and implement a model, high-impact MSE development program. The major disadvantage would be that such a strategy may generate a negative form of competition between USAID-supported institutions and those supported by other programs.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Would permit USAID/Ecuador to focus resources on a workable number of institutions * Specialization would allow USAID/Ecuador to differentiate its assistance from that of other donors * A project intervention limited to a small number of institutions would have a greater chance to make a significant impact on those institutions 	<ul style="list-style-type: none"> * Possible overlap and duplication of effort with other donor programs * Selection of institutions to assist may be difficult * Assisting credit unions might divert resources from assisting MSEs * Local institutions may be unwilling to make internal changes if they have the option of securing resources from multiple sources

Develop Specific Relationships or Services

Likewise, USAID/Ecuador could choose to focus on developing a particular set of relationships or service capability within institutions. One key area in which such an intervention might be valuable is in the development of effective working relationships between the private banking community and NGOs. As mentioned throughout the sector assessment, most MSE projects are based on the assumptions of (a) developing private bank involvement in MSE lending, (b) developing a symbiotic relationship between banks and NGOs in such a way that the transaction costs of small-scale credit activities can be lowered, and (c) establishing a foundation for graduating clients from subsidized NGO programs to the formal financial system. Also as pointed out repeatedly in the documents, this seldom occurs in practice, and is certainly not occurring in Ecuador. USAID/Ecuador could focus on identifying the constraints to such relationships, developing a number of pilot efforts to test alternatives for generating such a successful approach to establishing effective relationships between the formal financial system and small-scale enterprises, and disseminating findings to a broad audience.

As an alternative, USAID/Ecuador could concentrate on developing several of the stronger and more dynamic NGOs into effective financial intermediaries.³ In the absence of effective linkages with the private banking system, most of the NGOs are implementing or committed to developing small-scale credit programs, even though they are poorly prepared to do so. Several of the institutions are contemplating adding a savings component as a way to meet a broader spectrum of the clients' financial needs and to generate additional resources. And, experiences in other countries (notably the Dominican Republic) suggest that it might be feasible and desirable to develop a specialized micro-enterprise bank to service the sector. Technical and financial assistance to study, develop the plans for, and implement one or more of these financial alternatives might help address the issue of developing long-term sustainable access to financial resources for micro- and small-scale enterprises.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Focus on a single concrete objective might be more successful than a general strategy * Could focus on key constraints to effective organizational and system development 	<ul style="list-style-type: none"> * Selection of institutions to assist may be difficult * Difficult to conceptualize this type of intervention in terms of a project or discrete activity * USAID would become involved in trying to get institutions to work together rather than in a specific program context

³Elisabeth Ryne and Maria Otero, "A Financial Systems Approach to Microenterprises," in *Frontiers of Financial Assistance to Microenterprise Development*, (Washington, D.C.: GEMINI) 1990.

Option 6: Focus on Specific Resource Gaps

Peter Kilby's studies on the impact and benefits of development assistance programs concluded that the most successful projects are those that have identified a key, missing resource, and supplied it.⁴ Concentrating on providing a single resource well, as opposed to an integrated package of services, appears to have been a more successful strategy for international donor assistance projects.

The sector assessment has identified a number of key resource gaps. Access to reliable financing sources is clearly one major problem; there is an estimated need for working capital of between \$100 and \$250 million dollars. Even with the credit programs of the World Bank and IDB, there will still be a sizeable shortfall in credit to the sector. As pointed out, however, the potential level of funding that USAID/Ecuador has available will not make a significant contribution toward satisfying credit requirements in the sector.

Technical knowledge and skills represent another problem area, as the microenterprises are characterized by poor technical quality and skills. Few, if any, of the present NGO programs are qualified to provide skill training or technical assistance in industry-specific activities. Providing scholarships or other funding for MSE clients of NGO programs to attend technical courses in SECAP or other institutions might be a program intervention that would fill a void in the current portfolio of services offered by the intermediary institutions.

Lack of export market information, experience and contacts has been identified as a major constraint to expanded export market opportunities for micro- and small-scale entrepreneurs. Providing a contact between potential buyers in major U.S. and European markets, and providing design assistance to critique existing products from the perspective of their marketability and to help local producers develop products that meet international standards, are two intervention alternatives that might help overcome this constraint.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Allows USAID/Ecuador resources to complement those of other donor agencies, filling in gaps left by other assistance efforts * Provides direct support in areas where there are gaps in the delivery system to MSE clients 	<ul style="list-style-type: none"> * Difficult to build a coherent project strategy around a single missing key resource when, in fact, resource requirements differ by sector, age and status of the business, and even business cycle * Difficult to coordinate a single resource with programs of other donors and agencies

⁴Peter Kilby, "Evaluating Technical Assistance," in *World Development*, Vol 7, No. 3, (London, Pergamon Press Ltd.), 1979. See also Peter Kily and David D'Zmura, "Searching for Benefits," A.I.D. evaluation Special Study No. 46, (Washington, D.C.: Agency for International Development), 1985.

With the single exception of credit, focusing on one or more of these key resource gaps offers the opportunity to provide a service that is not being rendered by any of the other donor agencies.

Option 7: Target Specific Beneficiary Groups

The final alternative would be for USAID/Ecuador to concentrate its resources on specific beneficiary groups. This option affords the best possibility for defining a unique niche in the MSE sector — apart and distinct from the generalist approaches of the other donor agencies — and the best possibility of leveraging resources to achieve a catalytic or demonstration impact.

The term "beneficiary groups" can be interpreted broadly: specific groups of people (such as women); specific geographic regions (such as secondary or tertiary cities, or remote provinces); specific types of enterprises (such as those having strong export potential, or those with strong backward linkages to the farm sector); specific subsectors (such as metal products, leather goods, wood products, market women, or clothing manufacturers); specific segments of the populations (such as people below the poverty level, the poorest of the poor, or rural indigenous groups); or specific sizes and classes of enterprises (such as subsistence, low-micro, small, or even medium-scale firms).

Several of these areas appear, at first glance, to offer less promise than others.

- **Women-owned Businesses.** Data collected in the course of this study suggests that the similarities between men- and women-owned businesses outweigh their differences. While assisting organizations that specialize in women's development problems (such as CORFEC) would be feasible, forcing a distinction between men- and women-owned businesses on organizations that service both would introduce unnecessary distortions and administrative problems on the organizations, especially when these are receiving funding from a variety of international donors that make no such demands. USAID/Ecuador would probably be more successful and more effective in building a greater awareness of gender issues into existing programs than in limiting its support to only women-owned businesses.
- **Secondary Cities and Remote Areas.** The rationale for this focus is less apparent now than when USAID/Ecuador initiated its Small Enterprise Development Project in 1986. The new GOE program is taking a country-wide focus, and the rapid proliferation of foundations and NGOs involved in the sector are providing a greater coverage to secondary cities. Furthermore, the absolute numbers of people involved in small-scale enterprise activities in these areas are rather low, in spite of the fact that they comprise a larger percentage of the economically active population, which means that the unit cost of serving MSEs would be higher. Finally, the fact that such an intervention strategy would have to cover a wide range of producer groups with a wide range of services would require USAID/Ecuador to continue a high-cost, low impact service approach.
- **Focus on Specific Business Size.** A strong argument has been made to the U.S. Congress that A.I.D.'s focus in micro-enterprises should be on very poor clients. The goal of such a program strategy would be to raise minimal living standards. Data collected for the sector assessment suggests that a much greater and sustainable impact (in terms of both employment and income) can be best achieved by assisting businesses that have the capacity to expand and grow. These are not necessarily the smallest or the poorest businesses.

Establishing eligibility criteria would be difficult; advantages of scale are lost when a program must work with a disparate variety of entrepreneurs that share only their poverty in common; and such a strategy mistakenly focuses attention on the status of the owner of the firm rather than on the firm's potential for growth and development.

Focusing on other kinds of specific beneficiary groups seems to offer more promise from the standpoint of developing an effective program or project.

- **Export-Oriented Businesses.** Focusing on businesses that have an export potential could enhance a number of USAID/Ecuador and GOE objectives, including increased foreign exchange earnings and expanding market outlets for MSE-produced goods and services. The major drawback to focusing on this group is that it is not a homogeneous group, but a highly diversified set of firms with distinct products, problems and opportunities. Certain subsectors — such as leather, wood and metal products — may offer sufficient opportunities to focus a development effort on the export potentials of a large number of producers, but even among a given subsector the number of individual producers and vendors that might become involved in export-oriented activities is small. A generalist strategy of supporting export-oriented businesses could run into the problem that plagues most of the current MSE programs of attempting to offer common solutions to a myriad of specific problems. Finally, such a strategy would be limited to the production sector, to the exclusion of service and commercial businesses. Still, this is a potentially significant group of producers — from the standpoint of both the national interest and potential for business growth.
- **Linkages to the Rural Sector.** Focusing on businesses that create demands for rural-produced goods and services would also contribute toward broader USAID/Ecuador and GOE objectives. Again, this is a heterogenous rather than homogeneous group of firms. It would be difficult to establish eligibility criteria and locate qualified participants efficiently. Because it would have to be generalist in nature, such an approach would also tend to duplicate efforts by other donors and programs.
- **Focus on Specific Subsectors.** As pointed out in the background papers on marketing and the characteristics of MSEs, there are strong sectoral differences among MSE enterprises. Export marketing potential is limited to a few manufactured and semi-refined products. Domestic markets provide a favorable environment to a relatively limited range of products. There are strong income and employment differences among the subsectors, so that achievement of these objectives is strongly influenced by the nature of the beneficiaries. In addition, certain subsectors (such as wood products) involves a vertical set of relationships that involve small-scale producers at all levels of the vertical chain — from cutting trees to marketing the final products.

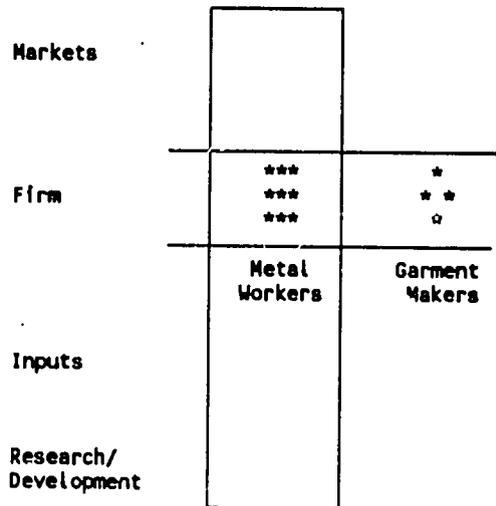
A Subsector Approach

Focus on "subsectors" as an approach to MSE development is a relatively new concept in the MSE field.⁵

As pointed out in Chapter Three of the *Summary Report*, the current institutional approach to providing services for MSE development is a horizontal one based on offering a set package of services to a cross-sector of the MSE sector. This is an inherently high-cost and relatively low-impact approach as it focuses on problems at the firm level, offers a stock set of generalized solutions, and has an impact only on direct beneficiaries. This is a direct result of the fact that they draw clientele from the entire spectrum of the MSE sector, and lack sufficient concentrations in any one subsector to make the development of subsector-specific interventions cost-effective.

The major problems facing MSEs, either in general or within a specific industry subsector, may not be at the firm level. As can be seen in the figure below, any firm is located within a vertical (rather than horizontal) set of relationships ranging from initial product design and conceptualization through procurement of inputs and supplies, elaboration of the product, and sales. Overlying these are a broad set of issues related to policies, the general economic and business environment, transportation and infrastructure. Problems in any one of these areas may pose far more of a constraint to the growth of an MSE than anything internal to the firm itself. In the area of markets, for example, problems with competition and product saturation, opportunities for new market development through new product designs, or developing an awareness among potential importers of the availability of products may be much more important to the overall success of a firm than providing it a loan or improving its accounting, booking and internal procedures. Resolving some of these issues may have a far more significant impact on the growth potential for the firm than any expansion of working capital, improvements in accounting and business skills, or improvements in marketing. Traditional approaches to providing services to MSEs are generally unable to deal with these broader issues.

⁵See, for example, James J. Boomgard, Stephen P. Davies, Steven J Haggblade and Donald C. Mead, *A Subsector Approach to Small Enterprise Promotion and Research*, GEMINI Working Paper No. 10, January 1991.



The two basic concepts underlying this subsector approach, therefore, are "verticality" and "leverage." "Verticality" is key because small enterprises are involved in vertical production and distribution systems. Major impediments to success may lie at any point in this vertical chain, and unless an intervention strategy addresses the key constraints it will have only a marginal impact on the success and growth of the businesses that it does assist. "Leverage" is essential to cost-effective interventions. Intervention strategies that resolve issues that affect large numbers of small producers increases the beneficial impact of the intervention and reduces per-unit costs. Reducing a tariff barrier on chain saws and other equipment imported for resale, for example, will benefit every small-scale lumber worker in the country, not just the one or two who have joined a particular MSE program.

A "subsector" approach to micro- and small-scale enterprise development assistance would appear to best meet USAID/Ecuador's strategic objectives.

- Unlike the more general traditional approaches to MSE assistance, the subsector approach is vertical, allowing interventions to be targeted at key bottlenecks or constraints.
- Unlike traditional approaches to MSE assistance, the subsector approach focuses on leveraging resources, so that interventions have a large multiplier effect. The impact of the intervention is not limited to the small number of beneficiaries that are participating directly in the project. Resolving a significant bottleneck affects all participants in the sector.
- Unlike traditional approaches, subsector interventions are not focused on the business enterprises of the individual entrepreneurs participating in the project. The project can look at the entire vertical (and horizontal) spectrum of issues and concerns that affect a given industry or commercial group, and focus resources on those issues and problems that are the real constraints.
- Unlike traditional approaches, the subsector approach is demand driven. In traditional approaches, the NGO or other agency has a stock set of services and resources that it uniformly offers to all clients. Intervention strategies and resources in the subsector

approach are based on an analysis of the major problems, and will be different for each situation.

- Under a subsector strategy the implementing institution only works with the subsector until the major constraints are identified and resolved. At that point it is free to work with a different group, rather than having to service the same clients year after year, as is the case with traditional approaches to working with small-scale enterprises.

Several different examples of subsector approaches can be found, both within and outside of Ecuador. Within Ecuador, the various studies carried out on specific subsectors by INSOTEC, and INSOTEC's involvement with women in "*corte y confección*" (dress making), carpentry and leather represent at least initial subsector intervention approaches. In AID/ROCAP, the regional nontraditional agricultural export project (PROEXAG) works with growers and exporters of specific nontraditional products through national exporters' guilds. Interventions related to specific problems with specific products can involve any stage of the inputs-production-marketing chain in which a bottleneck or problem is identified. The use of short-term consultants and the ability to shift from one product to another as the need arises, keeps interventions short and specific. Major breakthroughs have the potential of benefitting everyone involved in the product chain — input suppliers, growers, packagers and exporters.

Still a third example is the Central Java Economic Development Project (CJEPD). Operated as a separate project management unit (much like the ROCAP PROEXAG project), this activity focused on limited-scale, specific interventions that addressed key problems in several different subsectors. The project worked through a variety of local organizations, building a local capacity for sustained activities, but was not compelled to continue working with a given client base once the need for an intensive intervention ended.

STRENGTHS/ADVANTAGES	WEAKNESSES/DISADVANTAGES
<ul style="list-style-type: none"> * Interventions more focused on resolving specific impediments to MSE growth and development; assistance provided is determined by the need of the beneficiaries rather than an a priori judgement as to which services to offer * Better possibilities for leveraging resources and extending benefits beyond limited number of direct clients * Ability to adopt a focus that is different than other donor-assisted programs * Better opportunity to play a catalytic, high-impact role in the sector * Increased ability to merge MSE sector objectives with other Mission priorities or objectives (such as increasing exports) 	<ul style="list-style-type: none"> * Extent of subsector issues and constraints are largely unknown; uncertain ability to predict success or impact * Would require additional research and studies to define issues and objectives * Would require working with a different set of institutions that have historically performed different functions; might require a major institution-building effort * Requires a flexible project design that can be adjust to meet changing requirements, conditions and opportunities * Well-informed choice of beneficiary group is critical to success

SUMMARY AND CONCLUSIONS

In summary, there is a positive role for USAID/Ecuador to play in the micro- and small-scale enterprise sector, should it choose to do so. Even with the anticipated entry of other donors into the MSE field, and the proliferation of GOE and local institution programs, only a small proportion of potential beneficiaries will be reached through existing and planned activities.

Although the six options discussed in above were presented separately, they are not necessarily mutually exclusive. Combinations of approaches are both possible and probably desirable. For example, USAID/Ecuador could focus on market information and contacts (a resource-oriented strategy) for high export-potential firms in the wood products, leather and metal products subsectors (a subsector strategy). Or a USAID-assisted program could combine an institutional focus (such as a few selected NGOs) with a resource strategy (credit funds or technical training assistance). The variety of possible combinations that could be programmed is such that it is difficult to describe potential alternatives in an abstract or theoretical perspective. Specific options involving multiple strategies could be developed and analyzed as part of a project design effort.

If USAID/Ecuador is to continue program assistance to the MSE sector, it should identify a strategy, approach or target audience that is separate and distinct from those served by other programs. Even more important, it should strive to shift from the high-cost, low-impact strategies it has experimented with in the past (and that the other programs are continuing), to a high-impact, leveraged strategy that has the potential of producing a major effect on large numbers of people. This is possible, but will require working with different intermediaries and different intervention approaches than it has in the past.

Of the alternatives discussed, three appear particularly appropriate to meeting one or more of USAID/Ecuador's strategic objectives:

1. **Assist MSEs Through Developing the Credit Union System.** The lack of access to financial resources is the largest single problems facing small-scale enterprises, and the Ecuadorian credit union system appears to be the only financial approach capable of reaching large numbers of microentrepreneurs successfully. In spite of all of their problems, credit unions are the major formal-sector source of finance for the MSE sector — dwarfing all other donor-assisted and private sources. Moreover, they will continue to be the major source of funding for these activities in the future, regardless of the activities of other NGOs, the GOE programs, or the level of funding provided through the banking system by the international donors.

Credit unions have other advantages. Unlike the banking system, credit unions want to draw members from among the social classes that microentrepreneurs represent — these are their natural clients. Furthermore, the credit union system is independent, self-sufficient, operating on domestically generated capital, and does not require operating subsidies or cheap external capital to carry out its lending activities. What it does need is assistance in straightening out misguided policies and antiquated operational procedures. Improvements in these areas would greatly enhance the effectiveness of the credit union system as effective financial intermediaries, and these can be achieved at a relatively low cost.

2. **General NGO Strengthening.** NGOs appear to be the vehicles that will be used to channel resources to MSEs. Both the UNEPROM and CONAUPE programs are designed to support and build on NGO activities in the field. Most of the NGOs face problems of financial management, managing credit portfolios, providing effective support to small-scale enterprises, and others. Strengthening NGO capabilities in these areas would complement other donor activities and make the programs more effective.
3. **Focus on One or More Subsectors.** Subsector-specific interventions offer the potential of a low-cost, high-impact assistance program, offering advantages of targeting high-impact problems areas, adjusting priorities to meet changing conditions, and targeting interventions to address major bottlenecks or constraints. Success in a subsector intervention would benefit a large number of MSEs and provide a highly visible demonstration of a new approach technique to other donor and GOE programs.

FUTURE STEPS

Planning future USAID/Ecuador involvement in the MSE sector requires a series of actions on the part of USAID/Ecuador. The following discussion is based on the assumption that USAID/Ecuador will develop a project to implement its strategy in this area.

Preliminary Activities

It is important that USAID/Ecuador establish, from the beginning, its own agenda and strategy for its involvement in the MSE sector. In other words, project design should reflect rather than determine Mission strategies and objectives. The preliminary steps outlined below are designed to give USAID/Ecuador controlling direction over future planning and design activities.

Review and Critique the Sector Assessment

The first step in any design process is to review and critique the sector assessment. Not all of the conclusions and recommendations will be equally appropriate, or equally relevant to USAID/Ecuador's future role in the sector. USAID/Ecuador must extract from the sector assessment the findings, conclusions and recommendations that appear to be most applicable to USAID/Ecuador's resources, policies, and strategic objectives, and use those as the basis for a rational intervention strategy.

Decide on Basic Objectives and Strategy

USAID/Ecuador then needs to establish its own definition of the strategy it wishes to pursue and the proposed goals, purpose and major outputs for any proposed project. The strategy statement should specify which of the six options (or other alternative) the Mission wishes to concentrate its resources on and its rationale for doing so. Goal, purpose and major outputs should be identified to both (a) ascertain that the level of expected results justifies anticipated program inputs, and (b) provide a frame of reference to any future design team.

Determine Overall Project Parameters

The Mission should also determine any parameters that it wishes to place on the project — geographic focus, target beneficiaries, types and magnitudes of inputs, or special objectives — in advance. This helps assure that the work of any project design team is consistent with Mission policies, strategies and constraints.

Draft Detailed Scope of Work

The Mission would then draft a detailed scope of work for the Project Paper design Team. (Note: this step should be completed regardless of whether the project paper is written internally, with assistance from AID/W, or through a contract with a private firm.)

Project Design Activities

USAID/Ecuador is a relatively small Mission that probably does not have sufficient personnel to develop a project paper internally. In the event that the Mission does decide to develop a project, it would probably require the assistance of an outside project design team.

Composition of the Project Design Team

At a minimum, the project design team should consist of a microenterprise program specialist (as team leader), a financial and economic analyst, an urban sociologist or anthropologist, and a women in development specialist. Other specialized skills required to complete analyses and draft a project paper will depend on the strategy, objectives and parameters determined during the preliminary phase. For example, a credit program might require the participation of a financial institutions specialist, a training program the services of a microenterprise or institutional training specialist, an export-oriented program the services of a marketing expert, or a subsector program the services of a subsector research specialist.

Draft Terms of Reference

The design team will assist USAID/Ecuador in drafting a complete Project Paper (PP) of form and substance acceptable to USAID/Ecuador and sufficient to permit USAID/Ecuador and, if necessary, AID/W review and approval (see exceptions noted below). As part of this task, the design team will draft all of the required feasibility studies to be annexed to the PP. A summary of these studies will be included in the main body of the PP. The feasibility studies will include, but not be limited to:

- An economic analysis
- A recurrent cost analysis
- An institutional analysis of any and all participating institutions
- A social soundness analysis

Other technical analyses may be required in the course of the design work. The design team will also be responsible for drafting a logical framework and a monitoring and evaluation plan. These will provide management information on the progress and impact of the project at the goal, purpose and output level.

The financial plan and possibly other minor sections of the PP, which would compromise the ability of the consultant to participate in future consulting activities under project financing, will not be prepared by the consultant.

Special Studies

Depending on the objectives and strategies selected by the Mission, the project design effort may require special studies beyond those normally carried out by a project design team. For example, a decision to support the credit union system should include a detailed examination of credit union policies, portfolios, delinquency patterns and MSE members. Similarly, a decision to support a subsector approach should include at least a preliminary study of key subsectors to serve as a basis for designing the project's initial intervention strategy and resource mix. In all cases these should be operational rather than academic studies, designed only to specify project intervention requirements and strategies. They could be carried out as part of, or in advance of, a design team's effort.

Other Activities

Other activities that can be carried out, regardless of the Mission's future strategy in the sector, include:

- Make sure that policy issues specific to MSEs are included in the Mission's various policy dialogue activities, including the INCAE macroeconomic policy seminars;
- Continue discussions with the GOE and other donor agencies about the structure of support services for micro- and small-scale enterprises.