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**Bureau for Asia
and Near East**

**Proceedings of the
Senior Management
Seminar:
Micro and Small
Enterprise**

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**Bureau for Asia and Near East
Growth and Employment Through Micro and Small Enterprises
Senior Management Strategic Seminar
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EXECUTIVE SUMMARY

Congressional interest in microenterprise support has focused on "poverty lending", that is, very small loans targeted on the poorest households to encourage the formation and survival of microenterprises. The participants in this Seminar expressed considerable pessimism about the potential for this approach as a tool for poverty alleviation, citing high costs per beneficiary. Efforts to improve the performance of existing microenterprises and their growth into small scale enterprises generally involve provision of credit or technical assistance. TA approaches involve high costs and limited sustainability; credit programs can in principle, become self-sustaining, but only if the implementing agencies or PVOs maintain an uncommonly high degree of organizational efficiency and financial discipline. The importance of credit or technical assistance depends on the characteristics of the target group.

Efforts to promote growth of microenterprises may be misguided, however, as most observed mobility into and out of productive microenterprises has been that of individuals moving between employment and entrepreneurship, rather than growth in the size of small firms.

Regardless of their views on the potential benefits of microenterprise support programs, the participants agreed that the general policy environment plays a key role in influencing the rates of growth of income and employment and in encouraging or discouraging important linkages between smaller and larger firms. As a result, "getting policies right" at the national level--including education, agricultural, macroeconomic, and other policy--remains critically important. In certain countries, efforts to reduce regulatory barriers to the emergence of small, informal-sector firms into the formal economy may also be productive.

Considerable attention was devoted to whether small and/or microenterprises are more or less efficient or labor-intensive than larger firms. This issue, which has significant implications for employment creation, remained unresolved for all but the smallest--one person--firms which have been found not to be efficient. It was argued, however, that as determinants of the overall distribution of enterprises by scale, the large differences in labor intensity among different industries overshadow the much smaller differences in labor intensity among firms of different sizes within particular industries. As a result, policy changes that promote a shift in demand toward the products of labor-intensive industries are more effective than policy changes favoring microenterprises per se; those that avoid inefficient or distortion-causing interventions should be encouraged.

Finally, efficient large scale firms were found to be an important component of a microenterprise strategy, as a source of entrepreneurs, managerial skills, and business services to microenterprises; these firms serve as a market for the labor of skilled microentrepreneurs which is more important than the internal growth of such microenterprises.

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PROCEEDINGS

The seminar was chaired by Norman K. Nicholson, ANE/DP/P&A, and by Eric R. Nelson of Development Alternatives Inc. (DAI) for the S&T/RD/EED Employment and Enterprise Policy Analysis (EEPA) Project. A list of participants is attached.¹

Nicholson opened the proceedings by posing four questions concerning micro- and small enterprise development to be addressed in this seminar:

1. What is the macroeconomic context for the growth of private sector, of employment? This should include the policy framework affecting small enterprises specifically, compared with the private sector in general, and should discuss specific market failures that affect microenterprises uniquely.
2. What is or should be the role of microenterprises in A.I.D. strategy?
3. What is the relative efficiency of the small-scale sector, including capital use, labor use, and technical efficiency? This should be considered both in the absolute sense and within the policy environment.
4. What lessons are available from other, earlier attempts to assist microenterprises or similar sectors? How can these help us establish our new priorities?

These questions were addressed, both directly and indirectly, by the day's speakers and commentators and provided the basis for the recapitulation.

Legislative Mandate

Michael Farbman (S&T/RD/EED) presented the legislative context within which this seminar was taking place, arguing that the legislative debate did not use all available information. As a result, A.I.D. must carry out the congressional mandate while keeping necessary flexibility. The legislation refers specifically to microenterprises,² not to the ME/SSE sector, with the intention of providing "poverty lending"--a term that arose several times later--to poor people. Farbman explained the negotiations on the amount and terms of the earmark and the congressional interest in the credit per se rather than other forms of assistance.

The 1987 budget continuing resolution earmarked \$50 million from all A.I.D. accounts, which were met in FY 1988 with \$54.5 million. However, only \$63.4 million of the \$75 million earmarked for FY 1989 (including \$10 million and the same amount in local currencies for the ANE region) has been allocated. PPC/CDIE

¹ Excluding some participants in only the afternoon session.

² In this document, "ME" is used for "micro-enterprise," compared to "MSE" for "medium-scale enterprise." "SSE" is "small-scale enterprise," and "LSE" is "large-scale enterprise." Definitions vary, and so are not given here.

is conducting a stock-taking survey of ME activities in 10 countries, while PPC has produced Policy Directive No. 17 providing ME guidelines; this directive was presented to the participants. A question was raised about the relevance of the genesis of the earmark (House, rather than Senate), but no useful answer could be provided.

Overview of Some Pertinent Findings

In his presentation concerning the state of the art on microenterprise assistance, James Boomgard (DAI) described the state of the ME stock-taking, which was undertaken to determine whether (and why or why not) A.I.D. ME programs were working, and under what conditions they do or do not work. He presented criteria that differentiate MEs from SSEs (Table 1) and suggested that SSEs enjoy barriers to entry that provide a degree of local monopoly power not available to MEs. On the basis of 100 evaluations (of which 20 were in-depth), it is still unclear whether different sorts of program have different sorts of impact in stimulating ME growth. What is clear is that constraints vary greatly between countries, sectors, localities, and enterprises, and that credit is a constraint only for some.

Boomgard noted that MEs are really one notch up from the "poorest of the poor," since they have some access to markets and resources. He presented a typography (Figure 1) that was later used by several speakers to relate their comments to the ME mandate. In this typography:

- No economically motivated approach can assist the poorest of the poor, except where they also can create and sustain MEs. A **community development approach**--including education and health--may help make some of the poor into entrepreneurs. This approach has a high cost per beneficiary; its proponents generally insist that evaluations place a large weight on social rather than economic benefits.
- A **marginalist approach** within the community of MEs can improve their contribution to development without "graduating" them to the class of SSEs. Several ME development programs (Accion, others) and credit programs (BKK, PVO working capital programs) working to improve repayment of credit show promise here.
- A **business development approach** can be applied to MEs that can potentially graduate to become SSEs (a transition that is not at all automatic, given the differences in Figure 1), usually involving credit and high-cost technical assistance, compared with the marginalist approach.

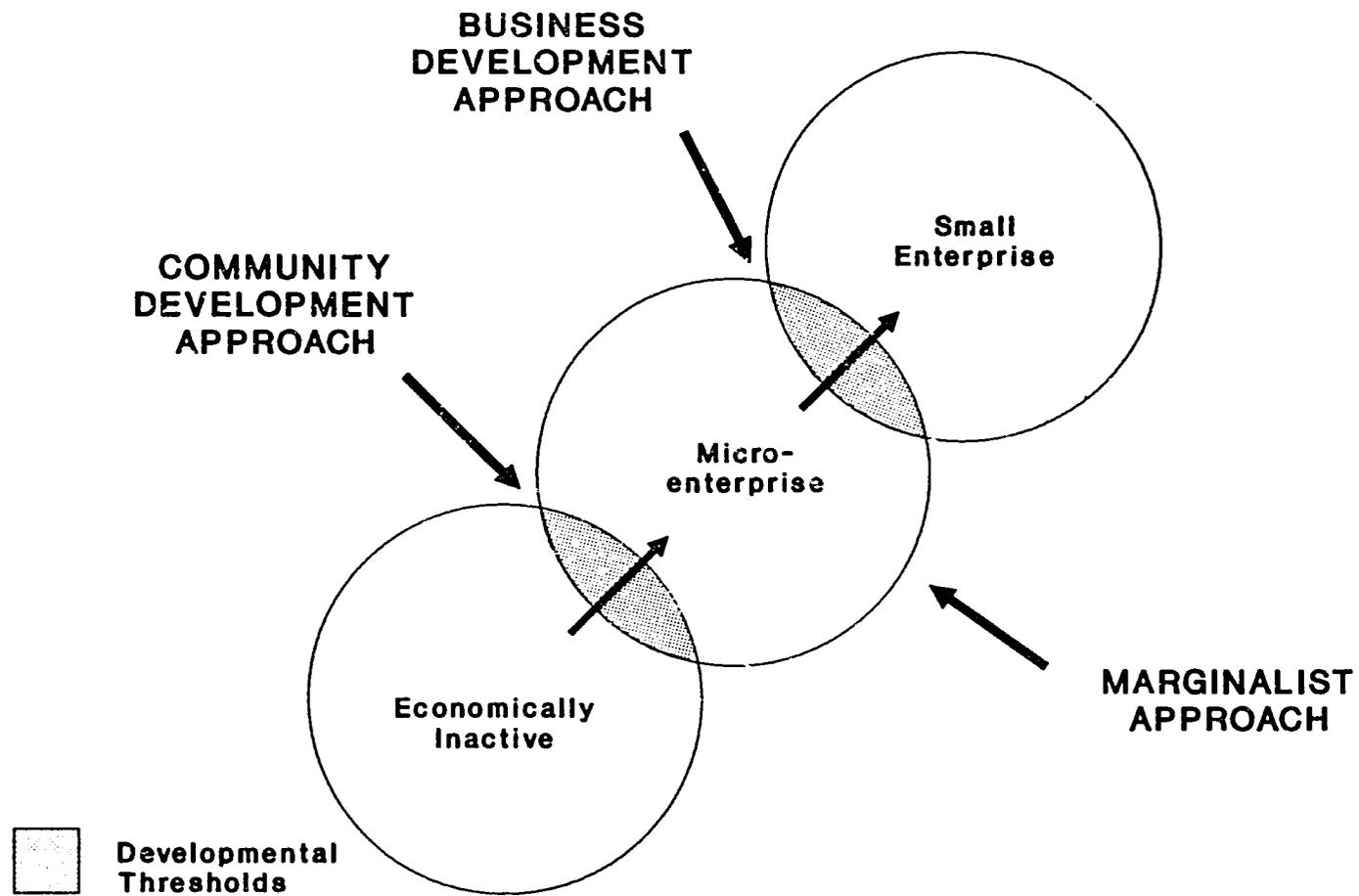
In all cases, increasing interest rates has helped improve the sustainability of the intervention without detracting from the project goal. However, benefits could not be measured in prices charged, but in the developmental impact. Also, the assistance was found to be too costly to be justified unless it contributed to leverage of policy change, to the self-sustenance of service organizations, or both. Finally, the question was raised about whether these interventions increase productivity, because if they do not, the detected increase in sales or employment must come from redistributing existing sales and employment. Boomgard concluded that the burden of proof rests upon those who would propose such interventions.

Table 1
Distinguishing Characteristics of Microenterprises

	Microenterprise	Small Enterprise
Number of Workers	Roughly 10 or less full-time workers.	Roughly 10 to 50 full-time workers.
Work-force	The work-force is comprised primarily of family labor.	Hired workers comprise a significant share of the total work-force.
Sources of Finance	Rely almost entirely on cash transactions, informal credit markets, and supplier credit. Start-up commonly funded by family savings.	Limited access to formal financial markets; commonly rely on informal financial markets, supplier credit and reinvested earnings.
Management	Little management specialization.	Some specialization in management functions.
Technology	Traditional - based on widely existing technical knowledge, existing labor skills and existing raw materials supplies.	Less traditional: innovation required in some aspect of the transformation process.
Products	Products and services are generally simple and unsophisticated; prices are low; cater to "basic-needs" of low-income consumers.	Products and services range from simple to more complex; span a relatively broad range of consumer types.
Markets	Typically serve highly localized markets through simple marketing channels.	Marketing patterns somewhat more complex reflecting innovation in raw material procurement or in output sales.
Competition	Competition intense as a result of ease of entry and localized market area.	Competition somewhat less intense due to barriers to entry.
Earnings	Returns to owners/entrepreneurs generally very low.	Returns higher but subject to greater variation and risk.

FIGURE 1

APPROACHES TO MICRO-ENTERPRISE DEVELOPMENT



The state of the art was further clarified by Tyler Biggs (HIID) in his description of the EEPA studies comparing South Korea, Taiwan, Philippines, and (now) Bangladesh, as to (1) what determines the observed size distribution of firms, and (2) how the size distribution influences the variables of interest to A.I.D., namely employment and productivity. Concerning the "stylized facts" of policy and firm size, he concluded that the observed increase in average firm size with increasing GNP is largely due to the change in product mix demanded, rather than to a change in the composition by scale of firm within particular product categories; that the decreasing role of cottage industries in employment and value added as GNP increases is due to the underlying shift from light to heavy industry with its economies of scale; and that firm size is correlated with total factor productivity.

Concerning the lessons learned for policy and program interventions to aid SSEs, Biggs noted that Korea and Taiwan both had outward-oriented trade regimes but differed strikingly in their domestic aspects and evolution. In Korea, growth occurred through the expansion of existing firms (during the period studied, the number of firms increased by 20 percent while the average firm size increased by 300 percent), while in Taiwan the growth was through the number of firms (315 percent increase from 1956 to 1986, compared with 15 percent growth in average size), with most growth coming in the middle, or 50-200 employee, range. In Korea, incentives favoring "winning" firms serve to provide de facto financial subsidies to expansion of firm size, whereas in Taiwan there are no such incentives, and other government policies serve to keep economic power diffuse.

Applying this analysis to the Philippines, Biggs found that the import substitution policy regime, aided by "cronyism," had created over time a bimodal size distribution with "too many" low productivity firms at the bottom end, a top end producing 80-90 percent of total value added, and a very small progressive middle. He concludes that trade, fiscal, investment, and commercial policy has suspended transformation by subsidizing LSEs and providing barriers to entry to the middle ground, and that a high marginal "tax" (including all costs and loss of benefits accorded to SSEs) rate on growth of small firms has created a "growth trap." Progressive growth-oriented small firms are thus discouraged from growing into middle size, while those firms already in the middle have been squeezed out by competition from LSEs, and excessive vertical integration has been encouraged by the policy regime with little reward to specialization.

Efficient LSEs are necessary to support SSEs, Biggs finds, even in Taiwan with its successful ME policy. SSEs are suppliers to LSEs, which supply in return marketing, especially in export markets; information, supplied by banks to LSEs and passed on to the SSE suppliers; technology, as domestic content regulations have forced multinationals to support SSEs, particularly as original equipment manufacture (OEM) suppliers; and labor, in the form of highly skilled laborers who leave multinationals and other LSEs to establish their own ME/SSE. The last point, or variants on it, was brought out by other speakers and commentators--efficient new microenterprises arise more frequently from trained technical people rather than from entrepreneurial poor people.

This linkage has important policy implications, in terms of means of improving linkages between LSEs and SSEs. These include courting multinationals, in order to profit from their information, marketing, and technology transfer; establishing a policy regime which favors subcontracting; and establishing requirements concerning

local content and export share of production. An outward-oriented policy regime has been important.

Finally, Biggs finds that direct assistance to MEs is difficult because the benefits are external to the enterprise or tend to leak away. Subsidies frequently increase profits, not employment. Nevertheless, about half fail within two to three years, and the majority of the rest cease to expand after three to four years. Biggs suggested that ME support policies based on administrative discretion must be transformed into performance-based incentives so that winners pick themselves.

The discussion covered the tension which this raised for policy prescription, between using the AID budget for sustainable performance based development purposes and emphasizing poverty alleviation under the narrow definition provided. Given the range of interventions presented, some of which are not amenable to rate of return analysis, it is difficult to set priorities for the allocation of the scarce AID budget. In particular, it may be a false priority to target the microenterprise (firm) rather than the individual as the subject for development assistance.

Is Small Beautiful?

Carl Liedholm discussed the empirical research he and his colleagues at Michigan State University have conducted in a dozen countries, with six country studies concentrating on MEs and SSEs. He emphasized the importance of the quality of data used in making generalizations about small firms. MSU researchers have found serious problems in recall and census data, particularly for small firms that do not keep records and are subject to highly variable production and sales. His data, based on cost-route methods developed for farm management studies, showed that in 80 percent of the cases SSEs were more efficient than their larger counterparts. He stressed the importance of looking at the product group, however, since not all ME and SSEs were economically efficient. MEs and SSEs involved in banking, furniture, and manufacturing repairs were more economically efficient than those involved in more traditional types of production such as spinning, weaving, and pottery. Within the ME³ category, Liedholm found that one-person enterprises were not economically viable whereas two to five and six to nine persons firm were economically efficient. In addition, MEs outside of the home were more economically efficient than those in the home; finally, the greater the size of the locality the higher the degree of economic efficiency.

When looking at MEs and SSEs over time, Liedholm found that one-person firms tend to disappear whereas 2-4, 6-9, and 10-50 person firms grew in size and number. Little information exists on the life cycle of these firms, but both the birth and death rates for MEs are higher than those for MSEs and LSEs. The birth rate for MEs is between 10 and 20 percent per year, and the death rate is 10 percent, which is lower than the death rate for U.S. firms. Deaths of MEs are highest in the first four years with only a 50 percent survival rate. MEs that do survive begin to grow after the fourth year. Most MEs, however, do not grow into big firms. They stay MEs, increasing the number of employees from one to two-four or from two-four to five-nine. Liedholm added that a majority of SSEs and MSEs

³ Liedholm defined a ME as 10 or fewer employees and an SSE as 11-50 employees.

started within their current size class, rather than as MEs (Table 2). Graduation from ME to SSE or MSE was higher in Asia than Africa, with East Africa having the lowest graduation rate. In terms of policy implications, Liedholm stressed the importance of looking for the causes of the low rate of graduation.

Table 2

Origins of Modern Small and Medium
Private Manufacturing Firms^a

<u>Region/ Country</u>	<u>Year</u>	<u>No. of Firms</u>	<u>Firm Size (Workers)</u>	<u>Percent with Micro Origin "Graduated"^b</u>	<u>Percent with No Micro Origins^c</u>
<u>Africa:</u>					
Nigeria	1965	64	11-200	43.7	56.3
Sierra Leone	1975	42	11-200	30.1	69.9
Rwanda	1987	28	30-200	10.7	89.3
Botswana	1982	20	11-200	20.0	80.0
<u>Asia:</u>					
India	1979	244	11-200	65.6	34.4
Philippines	1978	47	11-200	48.9	51.1

Data Sources:

Botswana:	computed from data compiled by Government of Botswana, 1984.
Nigeria:	computed from data generated by Harris, 1967.
Rwanda:	computed from data compiled by Ngirabatware, Murembya, and Mead, 1988.
Sierra Leone:	computed from data compiled by Chuta and Liedholm, 1982.
India:	computed from data in Little <i>et al</i> , 1987.
Philippines:	computed from data in Anderson and Khambata, 1981.

- Notes:
- Firms with 11 employees or more.
 - Started with fewer than 11 employees.
 - Started with 11 employees or more.

Source: Carl Liedholm and Joan Parker, "Small Manufacturing Growth in Africa: Initial Evidence." MSU International Development Working Paper, forthcoming, 1989.

Ian Little's discussion centered on his analysis of census data from Korea, Colombia, and India in which most of the enterprises had 10-200 employees. Although many believe small firms are labor intensive, Little argued that the number of employees is a poor measure for defining size of an enterprise; capital is a more predictable measure, but one for which little information exists. Second, it is important to disaggregate across industries. In 160 industries, labor intensity was almost constant in firms ranging in size from 5 to 500 workers. Capital productivity

peaked in firms of size 50-500 two-thirds of the time. In Korea, capital intensity was constant among firms with 10-199 workers; productivity was constant among firms with 5-50 workers, then rose dramatically up to 200 worker firms. The variance within size classes was so great that there was no statistically significant difference between means. In only one case, machine tools, was small size definitely inefficient. The differences in the capital-labor ratios between the most and the least labor-intensive size categories within any given industry were small, varying by at most a factor of three, and were inconsistent across industries. In contrast, the differences in capital-labor ratios among industries tend to be very large, varying by a factor of 100 or more.

Little concluded, as did Biggs, that it is the product mix--not the size of the firms within particular industries--that is the critical determinant of overall labor intensity within the economy. In many or most developing countries, a wide range of policies--including tariffs and trade restrictions, foreign exchange controls, wage and other labor policies, and financial sector policies--bias incentives against labor-intensive industries. To correct these biases, policies have to be corrected, most notably by creating an export-oriented trade regime that stimulates production of labor-intensive products. In the absence of such policy changes, supply-side interventions aimed at supporting the growth of small enterprises makes little sense as a means of attacking poverty.

William Steel discussed the impact of the policy environment on the size distribution of firms and on the differences between the findings of Liedholm and Little. In Sierra Leone, the burden of licensing and other regulatory policies imposed high costs on small firms. The larger firms tolerated these costs better than their smaller counterparts. As a result, there were fewer small and medium-size firms and many large-size firms. Those small and medium firms that did exist, however, had to be extremely efficient to absorb the high costs imposed on them. At the same time, the policy environment attracted too many resources to large-scale enterprises and the efficiency level decreased.

Steel concluded that pushing a lot of resources into MEs and SSEs, as in India, does not make them more efficient. In India, policies to promote MEs and SSEs have reduced overall efficiency. Meanwhile, the observed average efficiency of MSEs increased, because only the most efficient could survive in the adverse policy environment. He also argued that size was not a good criterion for strategy. Choosing an objective such as employment was more effective. No evidence exists that illustrates single-person firms as efficient. Finally, Steel cautioned that efficiency may not be the only critical variable in discussions about microenterprise. In family enterprises run by women, an increase in income will not necessarily be put back into the business. Rather, the women may invest it to enhance the quality of family life, to the benefit of human capital formation.

A discussion followed this section in which two questions were asked by Nicholson. First, would it be easier to design a project based on improving the distribution of income and welfare rather than employment growth? Second, why were data more difficult to get out of microentrepreneurs than farmers? In response to the first question, Biggs replied that there were cheaper ways to get at improving nutritional levels than through the size distribution of income; Berry later noted that income distribution has a terrible inertia, even rarely changed by revolution, and that most policy changes have a small effect on income distribution. Biggs felt that policies targeted toward small firms caused problems by creating a

growth trap and artificially maintaining the survival rates among the least efficient firms. In response to the second question, Liedholm mentioned that many of his techniques were borrowed from agriculturalists, but that it was easier to get data from farmers, in part because their outputs tend to be realized at discrete times associated with the agricultural calendar, rather than continuously as with nonagricultural firms.

Alternative Approaches

Policy

Albert Berry discussed the role of small-scale production and whether microenterprises were efficient. He urged caution in lumping the little available empirical evidence since there were major distinctions between Asian and Latin American settings. In Taiwan, there was low variance in size and factor intensity among firms in any given sector. In Brazil, however, there were tremendous variances in size distribution and even larger differences in factor intensity. In countries poorer than Brazil and Taiwan (such as Sierra Leone), capital tends to be extremely concentrated. The bulk of capital was used in labor saving technologies. Most workers were in the ME sector. In terms of efficiency, one needs to compare the value added with the cost of capital and labor.

Berry then discussed trade policy and its effects on capital use by SSEs and MSEs. A non-interventionist trade regime is beneficial for these firms because an equilibrium exchange rate price-rations foreign exchange by its most productive uses. As a result of a market price of foreign exchange in the 1960s, the number of SSEs and MSEs in Philippine manufacturing increased rapidly, only to stagnate when the regime began to ration foreign exchange quantitatively. In Colombia, in addition to an increase in numbers of SSEs and MSEs--many of which were nurtured by ex-monopolies from the previous import substitution regime--the SSEs were so competitive that they forced the large firms into the export market. The labor market policies in Colombia during the 1970s were favorable for SSEs and MSEs. They enjoyed 10-15 percent annual employment growth in the aggregate. At the micro level, there was a high variance in factor productivity. Colombia also had a good market for used machinery. This permitted firms to start as small operations financed by family savings and grow into decent size firms because the capital was so inexpensive.

In his conclusion, Berry said that education policy is important because education does make a difference. He also stressed the inertia of income distribution and the minor impact that most policy changes have had on distribution, as noted above. One cannot expect fast results from policies intended to change the income distribution, and must be prepared to pursue such policies consistently for a long period.

Legal and Regulatory Climate

Nelson noted that most of the research performed on the importance of the legal and regulatory climate as objects of microeconomic legal policy intervention, rather than as "constraints" to be lamented, has been done by Hernando de Soto and his Institute for Liberty and Democracy in Lima. On the other hand, Nelson cited other evidence, such as McLeod's information on SSEs refusing to join the formal sector because the costs in licenses, extortion, and the like outweigh the credit and other subsidies given to support formal sector SSEs.

This work has redefined the "informal" sector away from its earlier meaning as a residual source of low-productivity employment, toward a meaning of the production of goods and services that are legal to consume or utilize through means that are illegal because of lack of registration (due in turn to the cost of licensing, taxation, or meeting safety, minimum wage, or sanitation requirements, for instance). The concept is difficult to make operational, however, since a firm may be illegal in one context but legal--and hence formal sector--in another.

De Soto's work has shown clearly the importance of market-oriented regulatory analysis, but again his results are difficult to pin down. His estimate of the size of the informal sector is much larger than that made by organizations not directly interested in its importance. His study of the time taken to set up a formal sector enterprise (sometimes exceeding 200 person-days, versus less than a day in the United States) is flawed because he refused to pay bribes or hire professional "expeditors" as would normally be done in such circumstances. His success in Peru in introducing "occupancy insurance," which provides collateral for bank lending and is based on an actuarially based premium "insuring" right to occupancy of squatters, is closely related to threats by the current government of Peru to take over the banking system. The "fair" or actuarial insurance premium is indeterminate given the government's commitment not to expel squatter settlements, and the fact that this commitment which might not outlast the current government. Nevertheless, his argument for establishing and making transparent alienable property rights to reduce the risk of MEs is highly worthwhile.

Finally, "informality" is related to size, but only roughly, because it is easier for the "micro" firm to remain hidden from authority, but more difficult as size increases. As Biggs pointed out, some de jure policies favor small firms and are phased out as size increases, other de facto policies tend to be relevant as size increases and firms can no longer be overlooked in enforcement. Since the policy relevance is not predictable across countries, this calls for an applied research approach to find the subset of policies most relevant to a particular environment. The ability to fail, learn, and get it right was identified by discussants as an important aspect of entrepreneurial development. Support for this in appropriate commercial law would aid MEs and SSEs, though it is difficult to determine whether this would have an employment impact.

Intermediary Organizations

Tom Timberg began by remarking that ME programs will continue to flourish as a result of the interest of Congress and private voluntary organizations. Until now there has been inconclusive evidence on the effects of MEs. Using Boomgard's

model, Timberg classified the community and business development approaches as notch programs in that they are intended to change the client over time. PVOs implementing notch programs typically exhibit two attitudes. First, some exhibit a paternalistic attitude based on the assumption that the individuals do not know what to do, since otherwise they would have already done so. Second, they exhibit a selective attitude, concentrating resources on those who have the capacity to move from the poorest of the poor to a ME or from a ME to a SSE. In contrast, the marginalist approach is a static program in that its purpose is to improve the status quo. MEs will remain MEs but will function more effectively. Institutions do not differentiate between the organizational differences arising from these three types of approach. Timberg feels it is important for an institution to be responsive to these types of differences. Organizations function in terms of efficiency of scale. Those programs that are sustainable and spread geographically are dependent on regularization of approach.

Credit

In terms of credit, Timberg began by asking what were our primary interests. He argued that with the vast majority of donor funds, the primary concern was not to assist the client, but rather that donors were concerned with balance-of-payment support, creating patronage particularly with local elites, and buying admission to the policy table. He further added that there was a symbolic concern for the poor.

Timberg viewed credit programs as repairing market failures and accessing finances. He then raised the question as to why, if they were such good programs, they were not self-sustainable. Timberg believes that ME credit programs are borrower-dominated. They do not seek sustainability unless they are told to do so and often they choose to go under rather than undertake the financial discipline necessary to achieve sustainability. Nevertheless, he feels that it is possible to have an ME program with both impact and sustainability.

In conclusion, Timberg noted that private ownership or charismatic leadership are not essential attributes of ME programs, but the record of success is less consistent when these traits are absent. Second, the failure rate of ME programs was not much higher than that of other development programs; all organizations are subject to institutional degeneration and ME programs are no exception. Finally, most ME programs offer other forms of assistance in addition lending; minimalist credit programs are simple and potentially offer the lowest costs, but may be a disadvantage if technical assistance is needed.

Approaches to the Peri-Urban Environment

In his presentation, John Grayzel noted the renewed interest in the urban challenge. In addition, the burden of urban growth falls on people at the bottom end of the social structure. When poor people can no longer stay in the rural areas, they migrate to urban regions to find employment. There they frequently mix subsistence and income-generating activities. To promote income-generating activities in areas around cities, Grayzel argues that five things are needed: first, an increase in non-agricultural activities; second, an increase in the demand for services, especially transportation; third, intensification and an increasingly diverse land-use

patterns; fourth, an increase of females in non-agricultural labor; and, fifth, an increase in mobility with a breakdown of traditional social barriers of entry.

Technology

Berry discussed technology and how it complements and substitutes for credit. He draws implications from this concerning the advantages of technical assistance programs to aid MEs. To begin with, he feels that three questions must be asked. First, What degree of technological choice constraints do MEs face? Second, To what extent do new firms make technological mistakes which could be avoided or mitigated through the provision of technical assistance? Third, What is the potential for upgrading the technology received by MEs, again through assistance? Berry draws a parallel between small farms and small firms. While policy makers formerly considered small farms to be inefficient, following T.W. Schultz there is increased recognition that small farms are efficient but poor. This has had great implications for policy and programs toward small farms.

A similar question can be asked about small firms. Berry argued that SSEs exhibit a wide range of technologies used, and hence factor proportions, though the range is limited within specific product lines. However, research has also found a wide range in technical and economic efficiency in these firms. In Colombia, average productivity increased by 50-80 percent over 20 years, though it is not clear how much technology had to do with this increase. To increase productivity, however, firms need (1) access to machinery which is (2) cheap and (3) fits their needs. One important source of this is growing firms which sell their old capital to install new capital, which happens more frequently in a growing economy than a stagnant one. Finally, Berry argued that education paid off in terms of helping managers to choose technology that fit their requirements, and to use the capital selected.

Questions included aspects of Colombian experience with possibilities for replication. First, in the USAID Colombia private sector program, Berry related that credit and technical assistance had no role in the establishment of new firms but had a role in their growth, albeit a secondary one to high profitability as a source of funds for expansion. Second, the panel was asked the success of the strategy of Fundacion Carvajal where training is a precondition for credit. Timberg replied that the Foundation's courses are not formally tied to obtaining credit, tuition covers 65-70 percent of the cost of the program, and there is evidence that the impact on entrepreneurs receiving training alone is the same as that on those receiving both training plus credit.

Concerning programs targeting technology, Farbman noted the program with Appropriate Technologies International since 1976 to aid SSE development. In practice, this had been forced to drift away from "engineering" approaches to technology transfer which were difficult and unsuccessful, and toward "soft" technologies, including institutional approaches and design of financial mechanisms. Low-technology interventions had been found to be cost-ineffective. Berry added that unlike technology transfer in agriculture, the heterogeneity of small enterprises discourages technology transfer, as successful ideas can be inexpensively copied ("stolen") by competitors while the full cost of unsuccessful experiments must be borne by the entrepreneur. He posed a question concerning what would constitute appropriate policies to deal with this.

A final segment of the discussion concerned the "notch" programs and the best interventions. One contribution mentioned the use of for-profit businesses rather than non-profit NGOs to implement business plans. Little emphasized that this model may be incorrect: the mechanism for an individual's movement from ME to SSE status is not necessarily the introduction of new technology (soft or hard) within his ME. Rather, the movement results frequently from the individual obtaining a job in a larger enterprise and folding up the microenterprise.

Summing Up

Farbman, Nelson, and David Hagen (ANE/PSD) recapitulated the main points raised or resolved by the seminar. This summary comprises the recapitulation and other major points raised during the seminar.

Concerning the role of microenterprises in A.I.D. strategy, the summary covered private sector assistance, noting that the seminar did not address the important macroeconomic and inter-sectoral question of effective demand that may not be there, or may be shrinking, in some countries. Preliminary study is essential to learn more about the sector. This poses front-end costs on any ME assistance, with no single model providing a short-cut. Among other interventions, targeted interventions on an occupational, subsector, or vertical approach offer a possible role for MEs in A.I.D. strategy.

In summarizing evidence concerning the relative efficiency of the small-scale sector, five themes were detected in this seminar. First, if A.I.D. is being required to do poverty lending instead of business promotion, it is irrelevant whether the small-scale sector is efficient; AID has the responsibility in this case, in its role as technical advisor to Congress, to promote policies favoring efficient enterprises. Several speakers had defined the pressure to help the poorest of the poor and the difficulty of identifying them; Boomgard's approach, picked up by Timberg and others, suggested that both approaches are relevant for different groups.

Second, the question of size versus efficiency reached consensus that the smallest (one-person firms) are not efficient, perhaps due to lumpiness of both capital and labor. Liedholm pointed out that entrepreneurs undertaking more than one activity are less productive. Concerning larger enterprises, the participants had less consensus. Little demonstrated that it is impossible to find consistent differences in productivity by size within industries, and the observable negative relation is due to aggregation of data from different industries. Liedholm also found that the relation between size and efficiency varies by sector, with SSEs not necessarily more efficient within all sectors. There was consensus on the importance of an efficient large-scale sector for the growth of MEs. Liedholm found in particular that there are few "seedbeds" with MEs growing into larger classes; rather, most large firms started large, and "graduation" from MEs to larger firms is more likely to be achieved by the former entrepreneur taking a job in a large firm than by the ME growing.

More generally, efficient large scale firms were found to be an important component of a microenterprise strategy. Biggs found that many ME/SSE entrepreneurs come from the LSEs, bringing management skill. Little noted the reverse mobility of ME entrepreneurs folding their companies to move to jobs in large firms rather than attempting to expand their firms. Berry, Biggs, and Little

presented evidence that LSEs provide informal credit, marketing, and export services to MEs in the successful programs or phases they have studied.

Third, serious questions were raised concerning the productivity of ME interventions and whether they raise productivity or redistribute employment and value added. Little found a difference between sectors comprising only SSEs and those that contain a mixture of firm sizes, with productivity gains in the latter but not the former; Biggs found gains not from increased productivity within firms but from workers shifting to higher productivity firms and posts. Bankruptcy laws and access to used machines were proposed as means to get the appropriate capital-labor ratios, while Berry suggested technical assistance is necessary to use capital efficiency, speaking for the role of education in technology choice and for firm break-up as a means to efficiency.

Consensus was reached on the possible perverse effects of strategies which attempt to target assistance to MEs and SSEs in an economy where LSEs are also favored by the policy regime. This was seen to lead to a growth trap which prevents rather than aids growth in income and employment through microenterprises.

Fourth, barriers to entry have not only their expected effect, permitting economic inefficiency, but were identified by Boomgard as a significant identifying characteristic of SSEs that differentiates them from MEs.

Fifth, policies are important. The import-substitution argument was turned on its head by Little, who ignored the usual argument of resource draw to point out that firms which survive with zero or negative effective protection are the most efficient by necessity. Nelson discussed the need for bankruptcy laws to increase efficiency, and Steel noted that the most efficient can absorb the costs of regulation. Biggs stated that policies must be performance based, so that "winners pick themselves." Little argued that we must change incentives (capital subsidies and wage policy) so there is not a bias against labor at the time an enterprise is established.

Five lessons learned from earlier attempts to assist microenterprises were detected. First, we know very little in a complex area of redistribution versus growth; the solutions depend on the country context, and we have often applied what worked elsewhere without looking at differences in the policy, legal, and sectoral constraints. Second, institutional capabilities are important. Third, policies must be export-led and market-driven. Fourth, A.I.D. must focus on constraints to development of MEs and the private sector. Fifth, the front-end time necessary to identify local constraints imposes a dilemma for A.I.D., which is driven by the need to spend the earmarked budget but can provide only part of the answer at the moment. In this domain, further research on technology transfer, education, and policy is necessary.

The various presentations demonstrated the diverse routes to the desired goal of improving the economic status of the most disadvantaged strata of society. Microenterprise interventions define some of these routes, but other ways include policy and complementary MSE and SSE activities. In concentrating on microenterprise interventions, A.I.D. must take care not to be distracted from the real goal and how it can be attained with limited A.I.D. resources.

This preferred priority, of concentrating on the individual rather than the microenterprise, highlights the need for education as another route, stressed at several points. Low income women forego ME growth to draw off the firm's resources for education of their children and other basic human needs. On the other hand, the role of education and educational policy in determining the choice and utilization of correct technologies on the part of entrepreneurs is crucial.

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**ANNEX A
SEMINAR AGENDA**

Co-chairs:

Norman Nicholson (ANE/DP) & Eric Nelson (DAI/EEPA Project)

- 9:00-9:15 **Opening and welcoming comments**
- **Opening:** Norman Nicholson & Eric Nelson
 - **Legislative mandate:** Michael Farbman, S&T/RD/EED
- 9:15-10:15 **Defining the problem, and an overview of some pertinent findings; productive employment v. job creation; micro enterprise v. the informal sector; and an overview of some research findings.**
- **Microenterprise State of the Art:** James Boomgard, DAI
 - **Asian comparison:** Tyler Biggs, HIID/EEPA Project
- 10:30-12:00 **Is small beautiful? Enterprise efficiency, job creation and productive employment by scale of enterprise: A panel and discussion of the evidence supporting a priority for small enterprises.**
- Carl Liedholm, Michigan State Univ. & EEPA Associate
 - Ian Little, Oxford University
 - William Steel, World Bank, discussant
- 1:00-4:45 **Alternative approaches to broad-based growth and productive employment--the evidence and lessons learned.**
- **Policy--(a) sectoral policies affecting SSEs, directly or indirectly, (b) macro policy:** R. Albert Berry, U. of Toronto
 - **Legal and regulatory climate:** Eric Nelson
 - **Intermediary organizations:** Thomas Timberg
 - **Credit:** Thomas Timberg, R.R.Nathan/ARIES project
 - **Approaches to the peri-urban environment:** John Grayzel, S&T/RD/RRD
 - **Technology:** R. Albert Berry
- 5:00-5:30 **Summary, discussion, and closing comments:**
- David Hagen, ANE/PSD
 - Eric Nelson
 - Michael Farbman
 - Norman Nicholson

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**ANNEX B
LIST OF PARTICIPANTS**

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