

The USAID
Microenterprise
Initiative
in Sri Lanka

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GEMINI

GROWTH and EQUITY through MICROENTERPRISE INVESTMENTS and INSTITUTIONS
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The USAID Microenterprise Initiative in Sri Lanka

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EXECUTIVE SUMMARY

The Mission of the U.S. Agency for International Development in Sri Lanka contracted with the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project to prepare and report on a microenterprise development survey in Sri Lanka. Part of this assignment was to recommend approaches to developing and expanding a specific microenterprise strategy. The field work for this report was carried out in Sri Lanka by a joint GEMINI/USAID team in January and February 1995.

The GEMINI team made a series of recommendations based on insights gained from interviews with numerous microenterprise practitioners. The recommendations cover a wide range of options and strategies for consideration by USAID.

STATUS OF MICROENTERPRISE DEVELOPMENT IN SRI LANKA

Although USAID/Sri Lanka has not had a separate project for microenterprises, many of its projects contribute to the development of the microenterprise sector. These include the PVO (private voluntary organization) Co-financing Project, the Mahaweli Enterprise Development Project, the Agro-Enterprise Project (AgEnt), the Mahaweli Agriculture and Rural Development (MARD) Project, and the Technology Initiative for the Private Sector Project. USAID/Sri Lanka has a track record in microenterprise support, a field presence, and a policy of support for nongovernmental organizations (NGOs). This is a comparative advantage that the Mission can build on.

The range of sophistication of microenterprises within the USAID definition is very wide. At the low end are occasional or periodic income-generating activities by one person based in the household. At the other end are enterprises that employ nonfamily labor, are growth-oriented, and are partially integrated into the economic mainstream. In Sri Lanka the vast majority of microenterprises are concentrated at the low end.

The Government of Sri Lanka does not have an official single definition of a microenterprise. Many agencies consider a microenterprise as one employing up to five people, whereas a small enterprise employs up to 25 people. Information and data on microenterprise and its significance to the Sri Lankan economy are fragmentary. It is hypothesized that 15 to 20 percent of total employment in Sri Lanka comes from the microenterprise sector. There are a minimum of 520,000 microenterprises in the country.

Savings in rural areas are about three times the volume of lending in the same poor areas. Women have a better loan repayment record than men, although traditionally women do not have the same access as men to financial services. An estimated 30 percent of households are considered in the poverty range with a monthly income of less than Rs 1,500 per month in 1992 rupees. More than 80 percent of these households are in rural areas.

Supplier credit is a significant source of financing for many microenterprises. A somewhat unusual aspect of the formal financial sector in Sri Lanka is the prominence of pawn departments in banks. The Regional Rural Development Banks have almost 70 percent of the total loan portfolio in pawning loans. This is an advantage for women since gold jewelry is the most common collateral used for pawn loans.

Women make up 39 percent of the total labor force. An estimated 21 percent of all households are headed by women. Of the female-headed households, 52 percent are dependent on income from children, 25 percent depend on self-employment, and 30 percent depend on food stamps under the government's antipoverty Janasaviya Program. Women are disproportionately represented in the smallest microbusiness sector. A vast majority of home-based businesses are run by women; women play a significant management role in family-run businesses.

The Government of Sri Lanka provides assistance through programs aimed at poverty alleviation, or assisting microenterprise. Among others these include the Janasaviya Program, the Janasaviya Trust Fund, the National Youth Services Cooperative, the Small Scale Enterprise Development Division of the Ministry of Youth Affairs, Sports and Rural Development, and the Samurdhi Program.

In addition to USAID, bilateral and multilateral donors have assisted programs administered through the Government of Sri Lanka and NGOs. The World Bank, NORAD (Norway), SIDA (Sweden), CIDA (Canada), the Netherlands, IFAD, GTZ (Germany), FINNIDA (Finland), ODA (Britain), JICA (Japan), and the Asian Development Bank contribute significant sums for microenterprise development. Representatives of other donor organizations confirmed that microenterprise would continue to be a priority area in future funding decisions.

SOME FINDINGS

General Lessons Learned

Cost-effectiveness of enterprise-creating services can be enhanced through the use of subsector studies to identify high-growth-potential industries, identify the types of interventions to be used, and encourage linkages within a commercial framework.¹

Program and project initiatives must identify the differentiating characteristics of the smallest microenterprises in contrast to the growth-oriented microenterprises because strategies to serve these distinct types will vary widely.

Less than 3 percent of entrepreneurs in microenterprises have received bank loans. The formal financial system are underdeveloped and unable to extend credit to significant numbers of these entrepreneurs.

An inconsistent and sometimes contradictory policy environment has more of an impact on the microenterprise sector than on larger businesses, in many cases. Among the policy factors that appear to negatively impact microbusiness are exchange rate policy, forgiveness of government-sponsored loans during election years, import licensing restrictions, rebate procedures on the business turnover tax, and competition from the government in business development.

¹For a description of subsector analysis, see "A Subsector Approach to Small Enterprise Promotion and Research," by James J. Boomgard, Stephen P. Davies, Steven J. Haggblade, and Donald C. Mead, GEMINI Working Paper No. 10, January 1991.

Some legal and regulatory issues provide advantages and incentive for microbusinesses to remain unregistered. These include exemption from Termination of Employment Act, the Employee Provident Fund, and the Employee Trust Fund.

Literacy is not a major barrier to microbusiness development because the literacy rate is more than 90 percent for both men and women in the under-45 age category.

Lessons Learned by USAID

USAID has learned many valuable lessons in the implementation of its microenterprise-related programming. Among the lessons are the following.

Credit

- Responsible disbursements of credit require building of institutional capacity to administer the program. Subsidized credit encourages recipients to be passive rather than active economic players, resulting in low loan recovery rates, crippling of participating financial institutions, and preventing development of self-sustaining financial services for microenterprise.
- Loan guarantee schemes are subsidizing unsustainable participation of banks in the provision of a scale of financial services for which they are not suited.
- Recovery rates for credit are higher when emphasis is placed on meaningful savings mobilization prior to lending.
- The Mahaweli Enterprise Development Project savings and credit societies are providing credit access to a specific target group and are not providing financial services at the community level.

NGOs

- Rather than working directly in entrepreneurship, it is more cost-effective to use intermediaries such as NGOs and community organizers to encourage group participants to identify and develop their own business ideas for start-up.
- A donor's agenda for credit volume and disbursement often exceeds the capacity of institutions such as NGOs.
- NGOs frequently have insufficient information on their loan portfolio such as number of active borrowers, volume of loans outstanding, and the quality of the loans.

What Not to Do

- Involvement of business advisors in assisting entrepreneurs to apply for loans is very costly because banks are not prepared to lend without their own appraisal.

- Social empowerment and job creation, often through the formation of groups, are quite slow and must be initiated through the efforts of the participants with minimal outside guidance.

What to Do

- Microenterprise entrepreneurs copy the activities of others and oversupply a limited market. Linking entrepreneurs to markets through larger commercial firms helps overcome this problem.
- Direct business assistance programs should be confined to enterprises with substantial growth potential.
- Using contractual arrangements to link microenterprises with larger commercial firms is more effective at building sustainable businesses than working through government or Provincial Councils.
- Subsector surveys are helpful to identify business opportunities, possible commercial linkages, and policy issues. Surveys usually precede the identification and involvement of enterprises making it difficult to recover their cost.
- Entrepreneurship training has a higher success rate in terms of business start-ups when it is focussed on specific job skills. Initial training and business start-up need continued follow-on support.

RECOMMENDATIONS

Sufficient Funding Option

Options to be considered by USAID for any microenterprise initiative depend on the level of funding available. If sufficient funds are available to finance a separate microenterprise project, the following options should be considered. Although listed as discrete alternatives, these options can be combined in several ways.

- Establish and operate a microenterprise project to support practical investigations and advocacy concerning policy, legal, regulatory, and administrative constraints to microenterprise development; sponsor market research; and coordinate and disseminate information for NGOs working in microenterprise development.
- Assist the SANASA Movement to form a bank to extend additional financial services to those not adequately served by the existing formal banking sector.
- Assist the Janashakthi Movement to achieve a larger and more effective outreach program to rural women.
- Provide assistance to banks willing to develop supervisory and advisory linkages with NGOs involved in the provision of small-scale financial services.

- Support the revitalization of the Regional Rural Development Banks so they can focus on making loans in the Rs 30,000 to Rs 300,000 range — a range that is not presently serviced by either the NGOs or the commercial banks.

Insufficient Funding Option

If incremental funding is all that is available, the strategy should be to add microenterprise components to existing projects, or to strengthen existing microenterprise outreach components. Existing or planned projects that would be appropriate for an expanded microenterprise focus include the Mahaweli Enterprise Development Project, the AgEnt project, the TIPS project, and the forthcoming CIPART project.

General Guidelines

Whichever options are chosen by USAID, they should be implemented according to the following general guidelines:

Administrative

- USAID/Sri Lanka should adopt the same definition of microenterprise that is contained in USAID Policy Determination 17 (PD-17), of October 10, 1988. Because PD-17 is under revision, any revisions in the USAID/Sri Lanka definition should reflect this change as well.
- USAID should seek to play a coordinating role with other donors active in microenterprise development.

Government Policy

- USAID should encourage the government to stop granting broad loan forgiveness and refinancing loan schemes with subsidized interest rates. USAID of course should also abstain from committing the same errors.

Appropriate Focus for Activities

- Microenterprise interventions should focus on growth sectors within the economy, not the declining sectors.
- Extension services for microenterprise should not be a large component in any program initiatives because entrepreneurs are excellent emulators. The program should concentrate on identifying feasible markets and technologies, and encourage intermediary organizations to disseminate information.

- USAID should focus on encouraging institutional development of intermediary organizations that, in turn, strengthen natural business relationships. Such organizations include financial institutions, business associations, and selected NGOs.
- A microenterprise initiative should examine ways in which the Rs 24 billion per year (almost double the combined total of loans and grants from official sources) of worker remittances can be used to assist the growth of a strong microenterprise sector.
- USAID should investigate how successful microenterprise entrepreneurs developed the skills necessary to run their existing business, and determine whether these methods can be strengthened. To be included in this investigation are apprenticeships, on-the-job training, and working in a family business.
- The financial sector needs to strengthen retail lending techniques to lower transactions costs in dealing with entrepreneurs in microbusiness.
- A recommended strategy for USAID is to provide assistance in identifying markets that microenterprises can penetrate, similar to the work now being done in Agent.
- The USAID/Sri Lanka microenterprise strategy should pay particular attention to the constraints that prevent women from gaining equal access to development resources, and design project components that remedy the identified constraints. Any program initiative should pay attention to educating women concerning rights and the law, and women's programs should include men so that cultural attitudes of males do not undermine women's participation.

SECTION ONE

BACKGROUND TO MICROENTERPRISE INITIATIVE

SRI LANKA SURVEY

The Mission of the U.S. Agency for International Development in Sri Lanka contracted with the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project to do a microenterprise development survey in Sri Lanka.¹ The survey team was to review and analyze the microenterprise sector in Sri Lanka and prepare a report outlining possible microenterprise programming options.² The team talked with a wide variety of development practitioners. The goal of this team was to identify options that can incorporate the themes outlined in the USAID Microenterprise Initiative while supporting the strategic objectives of the Mission (see Annex B).

The survey team studied those programs that include activities targeting microenterprises or that affect the policy environment for microenterprise development. The team identified programming areas where USAID/Colombo has comparative advantage, and potential platforms upon which to build or expand programs supporting the Microenterprise Initiative. The consultants were mindful that USAID/Colombo is constrained by limited financial and staff resources. Options identified for future programming must include ways to use existing resources for maximum efficiency and impact.

DEFINITION AND SIGNIFICANCE OF MICROENTERPRISES WORLDWIDE

Defining Microenterprise

Microenterprises are very small, informally organized, nonagricultural businesses. Many microenterprises employ just one person, the owner-operator. Some microenterprises include unpaid family workers, and others may have one or several hired employees. Although no single characteristic distinguishes microenterprises from small enterprises, USAID has adopted a threshold of 10 employees, including the owner-operator and any family workers, as the upper bound for an enterprise to be considered "micro."

USAID's Policy Determination also identifies the Microenterprise Initiative as aimed at businesses run by, and employing, the poor.³ Beneficiaries are expected to be within the poorest 50 percent of the population, businesses owned by women, and businesses owned and operated by the poorest 20 percent of the population. The USAID Policy Document states that ideally programs should be designed to seek out the very smallest enterprises. The USAID Administrator has pledged that one-half of all financial

¹GEMINI was inaugurated in 1988 and has experience in more than 40 countries. The program is administered by Development Alternatives, Inc.

²The team comprised David Luccock, Wesley Weidemann, and Charitha Ratwatte of Development Alternatives, Inc., and Mahinda Gunasekera of USAID/Sri Lanka.

³PD-17, dated October 10, 1988, on Microenterprise Development is currently being revised.

support to microenterprises will go through poverty-lending programs or through poverty portions of mixed programs. USAID has traditionally used a loan size of \$300 as a reference point in defining poverty lending. Among microenterprises, those with the greatest potential for expansion should be considered.

There are distinct types of microenterprises along a continuum of economic sophistication. At the lowest level are economic activities that are done on an occasional basis that generate some income, but where it is debatable whether this should be considered an "enterprise." A woman who fabricates occasional brooms for her own household use from gathered raw materials might sell some extra brooms to neighbors. She may, or may not, be considered an entrepreneur. In the same neighborhood, another woman may regularly make brooms for sale as an income-generating activity. This woman clearly fits the profile of an entrepreneur with a microenterprise. At a slightly more sophisticated level the making of brooms may be a home-based family enterprise. In Sri Lanka the vast majority of microenterprises appear to fit the profile of the self-employed or family subsistence businesses. Most of these are home-based businesses.

Included at the low end of the microenterprise sector are individuals who are the disguised unemployed. This includes individuals who are attempting to supplement meager family incomes with home-based income-generating activities. Women as owner-operators and employees comprise the majority of these enterprises. Also included are those who are actively seeking wage employment, but are self-employed until something better comes along. Survival, not business expansion, is the focus. These businesses exhibit little or zero economic growth. As a result of these factors there is a high turnover of businesses at the low end.

At the upper end of the microenterprise continuum are the growth-oriented businesses. The major shift in orientation appears to be when a business expands beyond the level of using only family labor. A very small minority of microenterprises are expansion-oriented. The growth-oriented enterprises expand quickly with annual growth of 40-80 percent not uncommon. The expanding enterprises are often characterized by the proprietor having had previous experience in a related business, family support, engineering or technical skills, a productive work force, and not being risk-averse.

Subsistence-oriented and growth-oriented microenterprise entrepreneurs each require a different strategy and a different set of interventions. However, the need for credit is common to both, and both have difficulty finding a supplier of financial services. Banks are usually not structured to be able to provide satisfactory financial services to small survival-oriented entrepreneurs and their households. Financial institutions able to cost-effectively deliver services to small communities are needed. When such institutions are not available, intermediaries such as nongovernmental organizations (NGOs) are often used. Business development training is appropriate for expanding businesses but not appropriate for survival-oriented businesses.

Importance of Microenterprises

It is estimated that up to 80 percent of the third world population is underserved by social and economic services. Poverty alleviation and microenterprise development programs reach 4-20 percent of the targeted population at the most. Governmental and donor programs have been unsuccessful in reaching intended beneficiaries. This has led to a more market-oriented approach to aid with more attention paid to the environment surrounding microenterprises and to the strengthening of intermediaries able to develop and provide sustainable post-project services. A major need of microenterprise

entrepreneurs is financial services. As a result, project assistance focussing on this need has been able to reach large numbers of beneficiaries at relatively low cost.

The provision of savings services able to reach the poor and the communities in which they live is of critical importance. Frequently the number of beneficiaries under savings programs is five times that of borrowing beneficiaries: many entrepreneurs are debt-averse due to their small equity base and the economic uncertainties of their lives. A savings program allows such people to accumulate liquid assets available for use during emergencies and offering positive rates of returns. Universally, data show that even very poor families are able to save 20-50 cents per week — significant amounts when measured against initial loan sizes of \$25 to \$50. Also of importance, is the positive relationship between the recovery rate of loans and the collection of savings from within the same community. The volume of community savings, furthermore, usually exceeds the demand for lending when satisfactory savings services are provided.

Commonly, microenterprises are responsible for around 30 percent of employment in an economy. The majority of microenterprises, however, grow very little: about 70 percent show no growth and these employ half of the microenterprise work force.⁴ New starts are responsible for 80 percent of employment growth and more than 80 percent of new starts are one-person enterprises.

Gender plays a part in this story of microenterprises. The use of enterprise profits for household needs, as frequently occurs with female proprietors, conflicts with the capital needs of a rapidly growing business. Access to capital is the most frequently stated constraint to microenterprise development. For most microenterprises, the next largest problem relates to markets. The fastest-growing enterprises, however, see raw material inputs as being an important economic constraint.

Information from microenterprise development projects in Bangladesh, the Philippines, and Indonesia indicates that project benefits can be high and can exceed the costs of providing services. Although employment can be generated at a relatively low investment cost, the income, or labor surplus, tends to be little different from the manual wage rate. Daily income surpluses are usually \$1.50-\$2.50. Because of the low opportunity cost of labor associated with underemployment or unemployment, however, this increase in income can lead to a substantial improvement in family incomes.

Because banks are neither structured nor located to provide small-scale financial services outside urban areas, it has been necessary to provide these services through small financial institutions (SFIs) and NGOs.⁵ Although the provision of financial services can have large outreach and be sustainable, their development requires a substantial investment in time. The Grameen Bank needed 10 years to prove its viability; BancoSol in Bolivia needed almost twice its anticipated time for start-up and commencement of operations; the BRI Units and the BKKs in Indonesia benefitted from project assistance received over 10 years. This amount of time is necessary to ensure that all regulatory, commercial, and social linkages are fully tested and viable in a nondistortionary manner.

The cost of self-help group development, to enable members to be eligible to receive services, is unlikely to be less than \$4 per group member. Job training programs usually exceed \$200 per trainee

⁴Much of this information is from GEMINI baseline surveys in Africa and work in Bolivia, the Philippines, Bangladesh, and Indonesia.

⁵Some banks are developing innovative ways to provide banking services; see the section below on Regional Rural Development Banks and their competition.

and, with failures in start-ups and the inevitable death of many enterprises within three years, will be more than double this amount per surviving entrepreneur. Additional business investment cost per job created will commonly be \$130-\$1,000. If training is not focussed on specific job needs, its cost, plus business investment costs, will mean that resultant businesses are not feasible financially.

Cost-effectiveness of enterprise-creating services can be enhanced through the use of subsector studies to identify high-growth-potential industries, identify the types of interventions to be used, and encourage their linkages within a commercial framework.⁶ Needed services can then be identified and correctly costed so that, as far as possible, they are recoverable from the consumers. The high rates of return feasible from microenterprise activities make cost recovery a realistic goal if the services are of a satisfactory standard.

Measuring the impact of microenterprise development activities is difficult. Many households are involved in more than one economic activity and often have multiple sources and uses of funds generated and used in both business and personal activities. This makes it very difficult to separate out the costs and benefits of each activity. The lack or paucity of appropriate records further complicates this problem. The occurrence of spillover benefits of projects on unintended beneficiaries, particularly at the village level, further contaminates the statistical integrity of a control group against which project benefits can be measured and compared.

The effect of projects on the intermediaries delivering services to microenterprises needs to be measured carefully; there are many instances of intermediaries being socially or financially destroyed through project participation.

Intervention Focus

Experience in microenterprise programs indicates that they should expand opportunities by:

- Increasing access by the poor, especially women, to credit and savings services provided by a variety of sustainable financial service institutions;
- Providing innovative nonfinancial assistance in a cost-effective manner for technical and management training, and marketing and technology development;
- Strengthening the capacity of local organizations, such as NGOs and associations, to have a voice in the policy process affecting microenterprise development at the national and local level; and
- Fostering an enabling environment for microenterprise through institutional and economic policy change.

Interventions need to embody the themes of achieving greater outreach and significant scale, financial viability of financial services, cost-effectiveness of nonfinancial services, local institutional development and long-term viability, and inclusion of women and the very poor. These themes were

⁶For a description of subsector analysis, see "A Subsector Approach to Small Enterprise Promotion and Research," by James J. Boomgard, Stephen P. Davies, Steven J. Haggblade, and Donald C. Mead, GEMINI Working Paper No. 10, January 1991.

used as guidelines by the survey team in identifying and recommending microenterprise interventions by the Mission.

SECTION TWO

MICROENTERPRISE IN SRI LANKA

DESCRIPTION OF MICROENTERPRISES

Definition of Microenterprise

The Government of Sri Lanka does not have an official single definition of a microenterprise. Many agencies consider a microenterprise as one employing up to 5 people whereas a small enterprise employs up to 25 people. For microenterprise, this definition is too restrictive; many of the growth-oriented microenterprises would be excluded and it is these that are some of the best clients for assistance. Furthermore, USAID is revising its system of monitoring microenterprise activities, and the team recommends that the Mission follow USAID's revised definition to provide a better measure of the Mission's support of microenterprise in Sri Lanka.

Employment Trends in Sri Lanka, 1990-1993

A survey in 1986 indicated that 67 percent of total employment was in the unorganized private sector, 9 percent in the organized private sector, and 24 percent in government and Statutory Boards.⁷ By the fourth quarter of 1993, the public sector was employing 16 percent of the employed work force compared with 22 percent in 1990 (see Table 1).

The private sector was entirely responsible for the growth in employment from 1990 to 1993.⁸ The bulk of this growth was in the increase in employers (up 92 percent) and the increase in employees (up 38 percent). The average number of employees in private businesses has declined from 23 in 1990 to 16 in 1993. This means the new employers averaged 9 employees. With the inclusion of 1.5 million self-employed, which includes farmers, the majority of businesses are in the micro and small categories.

Number of Microenterprises

Except for data on industries no official statistics are available concerning the number of microenterprises, their impact on employment, and their contribution to GDP.

⁷"Finance and Socio-Economic Survey 1986/87," Department of Census and Statistics.

⁸"Labor Force Survey," Third Quarters, 1990 and 1993, Department of Census and Statistics.

Table 1

Employment in Sri Lanka: 1990 to 1993

Form of Employment	Labor Force 1990			Change in labor force 1990-1993			Labor Force 1993		
	Total	Female	Male	Total	Female	Male	Total	Female	Male
Employee: Public	1,071,480	408,349	663,131	-209,880	-82,862	-127,018	861,600	325,487	536,113
Private	1,687,411	480,848	1,206,563	632,828	294,299	338,529	2,320,239	775,147	1,545,092
Employer	75,015	3,196	71,819	68,958	22,449	46,509	143,973	25,645	118,328
Own account	1,475,254	267,052	1,208,202	21,371	5,243	16,128	1,496,625	272,295	1,224,330
Unpaid family	642,166	409,054	233,112	-238,091	-183,629	-54,462	404,075	225,425	178,650
Total employed	4,951,326	1,568,499	3,382,827	275,186	55,500	219,686	5,226,512	1,623,999	3,602,513
Unemployed	964,331	481,826	482,505	-124,837	-51,241	-73,596	839,494	430,585	408,909
Total economic active	5,915,657	2,050,325	3,865,332	150,349	4,259	146,090	6,066,006	2,054,584	4,011,422
Total population	14,138,930	7,108,119	7,030,811	644,280	369,617	274,608	14,783,210	7,477,736	7,305,474
Employees as % total	46.6%	43.4%	48.4%				52.5%	53.6%	51.9%
Change in Employers				91.9%	702.4%	64.8%			
Change in own account				1.4%	2.0%	1.3%			
Unemployment	16.3%	23.5%	12.5%				13.8%	21.0%	10.2%
Public sector employment	21.6%	26.0%	19.6%				16.5%	20.0%	14.9%
Population growth				4.6%	5.2%	3.9%			
Econ. active growth				2.5%	0.2%	3.8%			

Within the industrial sector, firms employing nine or less workers provide 4 percent of total employment and 1.4 percent of value added.⁹ The addition of firms employing up to 24 workers brings the respective totals to 8 percent and 3.5 percent. Compared with the industry average of Rs 100,613, the value added per worker averages Rs 33,948 for the 9-person category and Rs 29,080 for the 10-to-24-worker category. These figures, however, exclude household/cottage industries and the service sector.

A survey in the Kurunegala District indicated that 37 percent of sample firms employed up to 4 employees while a further 46 percent of firms employed 5-24 workers.¹⁰ This suggests that microenterprises provide about 15 to 20 percent of total employment in Sri Lanka.

A survey of household activities in 1984/85 showed that there were 341,069 nonagricultural own-account entrepreneurs.¹¹ These employed 165,502 unpaid family workers to average 1.5 workers (full-to part-time) per enterprise. There has undoubtedly been a growth in these numbers since 1985 because of the activities of NGOs and the SANASA Movement (a credit union federation), especially since 1991. Within the SANASA Movement alone, 78,200 nonagricultural microenterprises (18 percent of the loan portfolio) are active borrowers. Given that 15 percent of all households are Thrift and Credit Cooperative Societies (TCCS) members, it is hypothesized that there are at least 520,000 microenterprises in Sri Lanka

Relationship to Poverty Alleviation

The majority of NGO programs involved in microenterprise development are in this field because of their concern for the very poor. These are usually those with household incomes not exceeding Rs 1,500 per month in 1992 rupees. It is estimated that up to 30 percent of households are in this category. This classification, however, includes only the poorest. A survey in 1986 showed that 51 percent of households had incomes of less than Rs 1,000 (Rs 2,100 in 1992 rupees) per month.¹² This grouping comprised the poor and near-poor. At a household size of five persons this corresponded to Rs 200 per capita per month, which was almost equal to the Rs 202.5 expenditure then required for a minimum level of food intake.¹³

The Food Stamp Program (FSP) begun in 1979 targeted 1.55 million poor households able to fund 60 percent or less of their needed caloric food intake. The monthly income ceiling of Rs 300 per household (equivalent to Rs 700 in 1986 and Rs 1,500 in 1992) covered 50 percent of all households.

⁹"Survey of Industrial Production: 1990," Department of Census and Statistics.

¹⁰W.D. Lakshman et al., "Small and Medium Industry in an Intermediate City - A Case Study of Kurunegala in Sri Lanka," University of Colombo, 1994.

¹¹"Survey of Household Economic Activities 1984/85," Department of Statistics and Census.

¹²"Survey of Demographic and Social Aspects," Department of Census and Statistics, 1986/87. The proportion of poor households coincides with the suggested target of the poorest 50 percent as contained in the conference report accompanying PD-17.

¹³As calculated by Dr. A.G.W. Nanayakkara, Director, Department of Census and Statistics, Premaratne.

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The Household Income and Expenditure Survey in 1990/91 showed that, although average household monthly income was Rs 3,549, the lowest 50 percent of households had less than Rs 2,954 in income. This level was a 21.1 percent share of total income. The share for the lowest 40 percent is only 9 percent. The survey also showed that about 25 percent of households had incomes, in 1986 values, of Rs 1,000 or less.

These figures indicate that the percentage of the population classified as very poor has declined from 50 percent of households in 1979 to less than 30 percent of households in 1991. Although there has been such a decline, the income share of the lowest 50 percent of households has changed very little: from 20.7 percent of total income in 1985/86 to 21.2 percent in 1990/91. The target population of poor and near-poor for this study is the 50 percent of poorer households. In 1995, this is estimated at 1.7 million households out of the 3.4 million households in Sri Lanka.

Of the total of 1.6 million poor and near-poor households in 1986, 1.3 million (82 percent) were found in rural areas. There were 0.2 million poor households in urban areas and a further 0.07 million in estates. Comparable data for 1990/91 are not available.

There are districts where the share of total income by the lowest 40 percent of households is significantly below the national average of 9 percent. These are Matara (7.88 percent), Hambantota (6.05 percent), Anuradhapura (8.24 percent), Monaragala (8.17 percent), and Kegalle (7.11 percent).

CONSTRAINTS FACED BY MICROENTERPRISES

Financial Constraints

Credit

The majority of microenterprise entrepreneurs have not been able to access the banking system as borrowers, and attempts to provide credits to targeted producers have not been successful. A TCCS survey showed that only 20 percent of TCCS borrowers had ever taken loans from commercial banks, 10 percent had been refused loans, and 70 percent had never applied. This latter percentage increased to 84 percent for those with monthly household incomes of less than Rs 3,000. The Central Bank's New Comprehensive Rural Credit Scheme reached less than 3 percent of farmers. Because nonagricultural activities have received less of the financing from banks than has the agricultural sector, then less than 3 percent of microenterprise entrepreneurs have received bank loans. The number of small loans funded through the TCCS (annually 434,000) and Janashakthi Banku Sangam (total 34,000) are indicative of the demand for loans.

Loan recovery rates of targeted credits have frequently been less than 70 percent and this coupled with high administrative costs and fixed rates on loans has resulted in losses and damage to participating financial institutions.

One of the most common methods for a microenterprise to receive credit is through supplier credit. Suppliers have long established business and personal relationships with some of the microenterprises that they are working with. Suppliers know market conditions, are familiar with the competitive environment, and know the character of the entrepreneur they are dealing with. These suppliers often provide raw materials for use as inputs or final products to be offered for sale to selected

microenterprise customers on consignment, or with delayed payment. The team found metal workers, shoemakers, jewelers, ayurvedic medicine manufacturers, and others who were both receiving and extending supplier credit.

However, in Sri Lanka, microenterprises apparently have not established as close a working relationship to larger businesses as is common in other countries. Larger businesses have established lending relationships to formal financial institutions and may be able to expand their business by extending their credit lines. Part of this business expansion could be to extend terms to the microenterprises they are working with, either as suppliers or as distributors. However it appears that most of the direct suppliers to microenterprise entrepreneurs are very small themselves, and have limited access to additional lines of credit through formal financial institutions. Therefore the potential to increase the effective credit to microenterprise entrepreneurs by encouraging the development of existing supplier business linkages via formal financial institutions is limited.

In certain circumstances a postdated check is used as collateral, even though a postdated check is not legally recognized. The survey team found that in some circumstances, postdated checks are used by banks as informal collateral. If a business owner with a strong banking relationship brings a postdated check, the bank will sometimes advance as much as 70 percent of the face value of the check to the business owner.

Savings Mobilization

There is a very strong demand for savings facilities in rural areas and among the poor. Rural savings are about three times the volume of lending (see Table 2). At the macro level there is no need to provide an external supply of funds for rural lending. Savings, however, tend to be seen as a source of funds rather than as a service to be developed for the poor and microenterprise entrepreneurs.

Within the Janashakthi Movement, total savings of the poor is two times the volume of credit. Savings within the TCCS are close to or exceed the total of loans disbursed. Unfortunately, many poor households do not have access to conveniently located savings services. Although they may have a savings account with a bank, it is a token deposit only and largely inactive. Most of their assets are in commodities or money stored in the house. These people are deprived of the advantage of holding inflation-proof liquid assets and, because of illiquidity, are often forced to borrow for emergencies.

Linkages between savings and credit are weak. The institutions with the largest amount of rural savings, the banks and the Cooperative Rural Banks (CRBs), are not so active in rural lending. This means that the positive effects of savings on improved loan recovery are being underutilized.

Financial Institutions

The formal financial system is relatively remote from the microenterprise sector in Sri Lanka. In many countries, microenterprise entrepreneurs maintain savings accounts and checking accounts in formal financial institutions, although it is unusual to have a lending relationship. In Sri Lanka there is

Table 2

Deposits and Advances – Rural Sector 1988–1993

Year	Rs. millions									
	CRBs		BoC:ASCs		RRDBs		TCCs		Total	
	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits
1988	138.3	1,908.4	11.1	180.4	112.8	103.5	413.3	388.0	675.5	2,580.3
1989	238.7	2,211.9	22.5	203.9	135.0	159.6	416.0	418.0	812.2	2,993.4
1990	434.7	2,497.3	24.6	196.5	429.8	313.9	449.0	491.2	1,338.1	3,498.9
1991	583.7	3,448.5	208.8	220.1	595.4	437.5	637.0	622.1	2,024.9	4,728.2
1992	559.6	4,333.1	134.2	287.3	703.2	666.6	715.1	696.8	2,112.1	5,983.7
1993	538.9	5,196.7	233.3	366.6	966.4	1,099.4	1,086.0	1,415.5	2,824.6	8,078.2
Shares: 1988	20%	74%	2%	7%	17%	4%	61%	15%	100%	100%
Shares: 1993	19%	64%	8%	5%	34%	14%	38%	18%		

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some debate about the number of microenterprise entrepreneurs who maintain savings accounts in a formal financial institution. However there is no disagreement that it is very unusual for such an entrepreneur to have a checking account. The increase in sophistication for an entrepreneur from a simple savings relationship to a checking relationship is large. The step from a checking relationship to a lending relationship is even larger. In Sri Lanka the gap from the average microenterprise to a lending relationship with a formal financial institution appears to be larger than for most other countries in a similar income category.

The problem in the supply of small-scale financial services is customer access rather than the availability of funds. A substantial amount of the World Bank funding of \$30 million for the Janasaviya Trust Fund (JTF) credit line is unused. The problem of access lies in the relatively high transaction costs incurred by small savers and borrowers and in the relatively high administrative costs of formal financial institutions being coerced into the supply of such services. The banking hours, 09:30 am to 2:30 pm, also do not suit many microenterprise entrepreneurs.

At least 140 NGOs, including SANASA and Janashakthi, have moved into supplying the smaller scale of financial services at a level where banks almost never operate. The banks, on the other hand, have been coerced, through special credit and loan guarantee schemes, to move down-scale in the supply of services. The ability of the NGOs to move upscale is constrained by a general lack of professional competence and by financial regulatory issues. The banks, which were constrained by targeted low interest rates are still constrained by a general public perception that rates should not rise substantially. Consequently there is very little small-scale lending done by the banks and what exists is really for public relations purposes. Banks need more flexibility in their pricing of services to allow them to develop and compete in their own niche markets.

There are signs of more flexibility in pricing and of the banks moving toward finding and developing their market niches through a more innovative supply of financial services. This needs encouragement. The government can support this by not refinancing loan schemes with cheap interest rates and by not forgiving loans.

The poor supply of services in the past was caused by trying to use, with a degree of force, institutions and organizations that were inappropriate for the sustainable supply of small-scale financial services and not allowing these institutions to price their services to ensure balanced and sustainable growth. As a result the rural financial market is operating well below its potential.¹⁴

Nonfinancial Constraints

The team found a wide variety of constraints to the development of microenterprise. Following is a brief discussion of some of those mentioned by respondents, or the constraints were discussed in previous reports or studies on microenterprises in Sri Lanka. The list is far from comprehensive, and the emphasis is on areas where USAID might be expected to have a comparative advantage because of program history and USAID strategies.

¹⁴Economic and social activity and income per capita in rural areas are similar in Indonesia, where the volume of financial services per capita is more than twice that of rural Sri Lanka.

Foreign Exchange Policy

Foreign exchange policy appears to support overvaluation of the rupee. Private economists argue that the rupee is overvalued by about 40 percent against the dollar, and about 90 percent against the Indian rupee.¹⁵ The impact of an artificially high exchange rate makes imports cheaper and exports more expensive. This combination discourages domestic economic activity. Microenterprises are subjected to competition from artificially cheap imports on items that could easily and cheaply be produced in Sri Lanka. A survey of microenterprises found that 9 percent of respondents listed competition from imports as one of the most severe difficulties faced by the enterprise.¹⁶

Subsidies and price controls cover selected agricultural commodities and food items. Wherever this happens price relationships are distorted and enterprise behavior is influenced. Distortion of price relationships may render business enterprise unprofitable in these commodity groups. Such enterprise areas include fertilizer distribution, bread baking, and rice marketing. These are all areas where microenterprise might otherwise be expected to play a significant role.

Loan Forgiveness

Forgiveness of unpaid loans from government-controlled banks undermines the financial discipline of the borrowers. This in turn undermines the viability of financial institutions, and financial institutions are hindered in any attempt to develop products and coverage to service the types of borrowers who have just had their loans forgiven. Although individual microenterprise entrepreneurs might initially benefit from not being required to repay an outstanding loan, microenterprise entrepreneurs as a whole would suffer. This is because these entrepreneurs are usually marginal borrowers, and the vast majority have never had access to bank credit. Thus, by the government action of forgiveness, the financial discipline is reduced and financial institutions are less likely to extend services at the margins. This directly impacts the access of microenterprise entrepreneurs to future credit.

Import Regulations

Import regulations sometimes inadvertently give preference to foreign imports at the expense of local production. An example is provided by importation of subsidized skim milk powder from New Zealand and the European Union. Present import duties on milk powder are 20 percent. Dairy industry sources indicate the effective subsidy rate on New Zealand imports is 50 percent and the subsidy on European Union (EU) imports is 35 percent. In addition it is estimated that the Sri Lankan rupee is overvalued by as much as 40 percent, thus providing additional incentives to import rather than produce dairy products locally.

Because of the combination of these circumstances, the prices of dairy products are probably below world market prices. Although Sri Lanka cannot be expected to develop an export-oriented dairy

¹⁵A January 1995 study of exchange rates by Econsult, Sri Lanka, concluded that since 1989 the Sri Lankan rupee has become significantly overvalued in relation to the currencies of competitor and trading partner countries. This overvaluation has become particularly acute since the beginning of 1995 when the exchange rate was employed as an anti-inflation tool before the elections.

¹⁶W.D. Lakshman, *Self Employment Within a Framework of Structural Adjustment: A Study in the Light of Social Mobilization Programme Experiences in the Marara District, Sri Lanka*, SLAE-SIDA Research Project, 1994.

industry, a significant domestic industry is being damaged by subsidized imports. This is a microenterprise and gender issue because the domestic dairy industry is dominated by microenterprises, and livestock are usually a female-run enterprise. Offsetting import duties would raise market prices to a point where the domestic industry could survive.

Other Government Policies

Government policies change rather quickly to suit the political climate when elections are near. This creates uncertainty, thus inhibiting private sector activity and investment. All private enterprise is subject to this uncertainty, not just microenterprise.

Business Turnover Tax (BTT) is charged in the formal sector on total sales of firms with a turnover exceeding Rs 100,000 per year. Rebates are given for taxes paid on purchase of raw materials and intermediate products. However microenterprises often do not have the accounting and financial skills to file for the rebate. In addition, businesses must be formally registered to receive a rebate. The large majority of microenterprises are unregistered and not eligible to receive rebates. As a result some microenterprise entrepreneurs pay an unnecessarily high price for inputs.

Foreign investors are sometimes given duty free import privileges to invest in Sri Lanka. In the past, a Singapore-based company entered the animal feed market, and for a while was able to import rough grains, protein concentrate, and pharmaceuticals duty free whereas Sri Lankan firms in the same business had to pay import duties. This regulation has now been changed, but while it was in effect it discouraged the entry of indigenous businesses into feed milling, mixing, and distribution. Typically the feed industry is made up of a large number of small family-run businesses with village hammer mills for grinding and mixing feeds. In addition the distributors for the larger feed companies are typically small village outlets. Thus, even though the feed industry may be dominated by a few large producers, the vast majority of businesses involved in mixing and retailing feed are microenterprises. In this case, giving preference to investment by a foreign company hindered the development of indigenous microbusiness.

Import and licensing restrictions are discriminatory against microenterprise. Only larger businesses have the financial and political resources to obtain import licenses for raw materials and intermediate products. Small businesses are forced to buy from the importer who extracts economic rent in the pricing of the materials and products for sale to small businesses. If the importer instead decides to enter the business, he is able to undercut the small-scale entrepreneur. For example, to import grains for poultry feed an entrepreneur must obtain a license. A small business does not have access to letters of credit, and cannot afford to purchase in container-load quantities. Thus, the small business owner must buy from the importer who charges high prices to absorb most of the profit that would otherwise accrue to the poultry farmer.

Many government-mandated programs do not apply to the smallest microenterprise. The Termination of Employment Act and the Employee Provident Fund & Employee Trust Fund are examples. The Termination of Employment Act applies only to larger firms and directs that an employer must get permission from the Labour Commissioner to release an employee. This discourages hiring and encourages the use of outsourcing or subcontracting. Realistically this Act is often dealt with by bribing a worker in the government to misplace the file. There are a series of legal and regulatory barriers such as those just cited that come into force as soon as a microenterprise officially registers or attains a predetermined size. This discourages growth-oriented firms from registering, and also then disqualifies the unregistered firms from receiving certain types of assistance, or receiving bank loans.

Government often competes with the private sector. For example, the government operates an Ayurvedic Department, and has a parastatal that imports ayurvedic herbs and medicines from India. One of the areas where microenterprise clearly is dominant is in the gathering, production, processing, and distribution of ayurvedic herbs and medicine.

Underdeveloped Infrastructure

Underdeveloped infrastructure discriminates against microenterprise. Larger businesses are able to buy their way out of infrastructure constraints by getting their own trucks to remedy transportation problems, buying cellular phones to remedy communications problems, or using political influence to persuade government to provide needed infrastructure that would benefit the large firm. These are normally not options open to the microenterprise. Thus, underinvestment in infrastructure results in discrimination against the small business sector. Infrastructure investment as a share of GDP (3.6 percent) in Sri Lanka is below the average range for other low income countries.¹⁷ Inadequate telecommunications and poor road capacity were mentioned as part of the six most significant constraints by firms interviewed under the private sector assessment of the World Bank.

Other

In addition to those constraints mentioned above, a myriad of constraints are being addressed in some measure by a number of NGOs, projects, and other donors. Included are inadequate market identification, unavailability of raw materials at crucial times, rudimentary technical skills, lack of quality awareness in production, undeveloped markets, lack of grades and standards, undeveloped management and bookkeeping skills, and many more. Some of these constraints are dealt with elsewhere in the text, and some are left for future investigation.

FINANCIAL INSTITUTIONS

State and Commercial Banks

Banks and their branches are located at the city and District levels. There are some mobile units that reach the Divisional and, infrequently, village levels. Their location leads to two major problems. First, by not being located in smaller communities, it is difficult and costly for banks to obtain adequate information about their customers. Their intended customers, meanwhile, see the banks as outsiders rather than as a part of their community. This makes it difficult to build up a mutual and lasting relationship.

Second, by virtue of their distance from the community coupled with high infrastructure costs, banks have administrative costs that prohibit an involvement in small financial transactions (see Table 3). At the same time, their customers incur high transactions costs in travelling to a bank for loan repayments

¹⁷"Private Sector Assessment," World Bank, p. 42, as referenced in *Sri Lanka: Employment Promotion and the Development of Micro and Small Enterprises*, International Labour Organization, South Asian Multidisciplinary Advisory Team, October 1994.

Table 3

Estimated Lending Costs:**A. Business Center/Bank Lending:**

Basics:			
RS:\$US	50		<u>Rs</u>
Loan size	\$721		36,035
Loan administration 1/.	\$85		
Reserve ratio	15.0%		
Loans as % total assets	90.0%		
Term deposit rate	14.0%		
Lending charges			
Cost of funds			18.30%
Administration			11.84%
Loan loss			4.00%
			<u>34.14%</u>
Interest recovery rate			<u>95.0%</u>
Required charge out on lending:			35.94%

1/. Loan administration expenses:

			<u>Rs</u>
Center salary: Loan preparation	2.0 days @	1,074	2,148
Bank salary: loan approval	1.5 days @	939	1,409
Application review travel	20 km @	7.50	150
Materials	\$4.00		200
Sundry	1.00% of loan		<u>360</u>
			4,267

N.B. Center salary rate is Rs19,000 per month, 13 months per year, 230 work days

Bank salary rate is Rs12,000 per month, 15 months per year, 230 work days, & 20% overhead

B. Sanasa Unit Lending

Basics:			
RS:\$US	50		<u>Rs</u>
Loan size	\$250		12,500
Loan administration 2/.	\$16		
Reserve ratio	0.0%		
Loans as % total assets	90.0%		
Term deposit rate	14.0%		
Lending charges			
Cost of funds			15.56%
Administration			6.55%
Loan loss			2.00%
			<u>24.11%</u>
Interest recovery rate			<u>97.0%</u>
Required charge out on lending:			24.86%

2/. Loan administration expenses (with full cost recovery):

			<u>Rs</u>
Unit salary	1.75 days @	200	349
Review travel	1 km @	7.50	8
Materials	\$3.00		150
Sundry (including District supervision)	2.50% of loan		<u>313</u>
			819

N.B. Salary rate is Rs2,500 per month, 12 months per year, 230 work days

and savings deposits. Although banks have participated in small credit schemes, this has been a token gesture for public relations purposes rather than a serious attempt at fulfilling market needs.

In 1985, 48 percent of lending was through banks and cooperatives whereas 52 percent was through moneylenders and other informal suppliers. For agricultural purposes, the respective figures were 41 percent and 59 percent.

Regional Rural Development Banks

Regional Rural Development Banks were established to extend the reach of the formal financial system. There are now 17 Regional Rural Development Banks with 169 branches. Structurally, the Regional Rural Development Banks operate at the District and Divisional levels — one level lower than the commercial banks. The Regional Rural Development Banks, which disbursed 34 percent of rural advances in 1993, are now encumbered with poor loan recovery rates on their portfolio of government-sponsored credits. Latest data for 1994 show a loan portfolio of only 54 percent of total assets. The loan portfolio of Rs 1,389 million and 228,930 borrowers included Rs 966 million and 156,760 borrowers with pawning loans. These figures indicate the Banks are not achieving their original purpose.

Market opportunities for the Regional Rural Development Banks exist but there is growing competition for the market. In the formal financial market there are the recent innovations by Hatton National Bank (HNB) with its mobile units and the People's Bank with its Village Groups program. The less formal market is increasingly being supplied by the TCCS movement and the entry of many NGOs. The problem for the Regional Rural Development Banks is to determine and develop their own market niche within a changing environment.

The reach of the Regional Rural Development Banks to the Divisional level would seem to enable linkages with village-level services supplied by the Banks or in conjunction with a community-oriented SFI such as SANASA Janashakthi. However, the ideological gap between the Regional Rural Development Banks and the NGOs (which consists of differences of opinion over lending criteria) and the Banks' regulations effectively prevent the development of this type of relationship.

The average size of loan outstanding at the end of 1993 was Rs 6,682. Even by charging interest rates on loans of up to 26 percent (as mandated), it is doubtful that the Regional Rural Development Banks could fully recover their operational costs. Small loans are probably better disbursed by cooperatives, societies, and NGOs.

Cooperative Rural Banks

CRBs are operated by multipurpose cooperative societies (MPCSs). Banking supervisory services have been provided by the People's Bank. The financial and nonfinancial activities and the management of the MPCSs and CRBs are frequently co-mingled. This makes accountability very difficult and affects the proficiency of management. Funds management and loan performance of the CRBs is poor. The recovery rate on loans is about 70 percent. Since 1991, loan disbursements have declined 15 percent in real terms. Savings deposits rose 38 percent over the same period. Given the poor management of its loan portfolio and use of funds, however, the safety of these deposits should be of concern to regulatory authorities.

Thrift and Credit Cooperative Societies

In 1995, there are an estimated 8,500 TCCSs with a total of 800,000 members. Allowing for about half of TCCS households having two members, this means that more than 500,000 households, or 15 percent of all households in Sri Lanka, are within the TCCS movement. Women comprise 50 percent of total membership. Data for 1993 show Rs 1,086 million disbursed in loans to 434,000 borrowers at an average loan size of Rs 2,500. Savings and deposits were Rs 1,415 million in the same year. These lending and savings figures are, respectively, 38 percent and 18 percent of the formally serviced rural market

Survey results from a sample of TCCSs indicated that half of member households were at a Central Bank designated poverty level with a monthly income level of Rs 2,100 or less.¹⁸ Overall average monthly household income was Rs 3,582. Household income rose an average 15.8 percent in real terms following the borrowing of an average of Rs 5,094 (\$115 in 1992). Only 18 percent of borrowers reported negative or unchanged asset levels. Housing was the dominant use of the increase in wealth. Outside of increased employment within households, there was very little change in labor employment.

In 1992, housing took up 35 percent of lending followed by agriculture at 33 percent, small industry and self-employment at 18 percent, and other uses at 15 percent. Interest rates on lending are commonly around 24 percent per annum; on savings, interest rates are 12-15 percent per annum. Interest rates on consumption loans are higher than on productive-use loans. Administrative costs are in the range of 2-8 percent. Loan recovery rates are frequently better than 95 percent.

The major strength of the TCCSs is that they are usually an integral part of the community in which they are located. Social linkages are further strengthened by the use of community savings as the major source of loan funds. The costs of financial intermediation are minimized by using simple procedures, partly voluntary labor, and minimal investment in fixed assets. This, in turn, enables the Societies to be very competitive in their interest rates on savings as well as in their lending rates.

Some of the weaknesses are related to the apparent strengths. The community spirit surrounding the TCCSs can mean that units are dragged into nonbanking activities. The use of voluntary labor often results in the poor management of operations and the autonomy of each TCCS can make it difficult to correct both personnel and managerial deficiencies. This problem is compounded by a general inadequacy in financial and managerial reporting. The costs of providing necessary supervisory and advisory services are not costed into the operations of individual Societies and are presently being covered through external donor funding.

The TCCS movement has attracted many donors. There is no need to provide credit lines to increase the outreach of the movement. There is further scope for increased savings mobilization and this, coupled with pricing to enable the better retention of profits, should be sufficient for steady growth. The provision of a long-term credit line, however, would improve the financial stability of the TCCSs. This could be supplied through the JTF, care would be needed to ensure that the amount provided does not act as a disincentive in the mobilization of community savings.

¹⁸"A Study of the Federation of Thrift and Credit Cooperation in Sri Lanka (SANASA)," David Hulme and Richard Montgomery with Debapriya Bhattacharya, Working Paper No. 11, 1994, Manchester University.

Assistance is needed in financial recording and reporting and an improved supervisory system. The TCCSs need to price their services to allow them to pay for these costs. Donors need to be careful that in trying to improve the TCCS system they do not destroy the elements that make up its strengths.

Nongovernmental Organizations

Particularly over the last four years, NGOs have become more active in savings and credit activities. At first, NGO intervention was financed by grant funds from donors and loan recovery was not satisfactory. Recently the perception that sustainability is important has gained force and NGOs are charging rates closer to the market. Donors also are frequently charging interest, although at low rates, on their funding and relating their support to the ability of NGOs to mobilize savings. Despite this, however, the supervision and training costs are largely subsidized by donor grants and the costs of these are not recovered from the end-users. This then gives the NGOs an unfair advantage over commercially oriented institutions and leaves an unserved market when the NGOs eventually close down or move to another location.

The NGOs are generally weak in their management of funds and in the management of their loan portfolios. Although they are experienced in borrower selection and loan disbursement, they have deficiencies in their management and recording systems for subsequent loan recovery. This places savings depositors at risk.

The Presidential Commission on Finance and Banking had several recommendations for expanding credit to the poor.¹⁹ We have included these in Annex A along with the team's comments.

GENDER ISSUES

With population growth of 1.2 percent, life expectancy of 71.2 years, adult literacy of 89 percent, and recent GDP growth close to 7 percent per annum, Sri Lanka ranks fairly high on the United Nations development index. This lends credence to the general belief that there is very little overt socioeconomic gender discrimination. There are, however, some differences as described below.

In 1994 according to a study by the Department of Census and Statistics, women made up 39 percent of total labor force. The proportion of women in the labor force is projected to increase to 46 percent of the total labor force by 2006.²⁰

Literacy rates for both men and women in the productive work years is more than 90 percent. Literacy rates for females drop off dramatically in the 45-50 age category.²¹ However this is not significant for program considerations for the microenterprise sector because any program targeted at this sector should be focussed on the younger and productive workers.

¹⁹"Final Report of The Presidential Commission on Finance and Banking," December 31 1992.

²⁰"Population and Labor Force: Projections for Sri Lanka," Department of Census and Statistics.

²¹"Household Income and Expenditure Survey 1990/91."

It is estimated that 21 percent of Sri Lankan households are female-headed.²² Of the female-headed households, 52 percent are dependent on income from children, 25 percent depend on self-employment, and 30 percent depend on food stamps under the government's antipoverty Janasaviya Program. Thus, 11-12 percent of all Sri Lanka households are female-headed with the woman as the major income earner, or dependent on the Janasaviya Program.

Among female-headed households, 10 percent are single-member households and 34 percent are made up of 5 or more members. The latter figure is of some concern because it implies a high dependency ratio among selected female-headed households.

The proportion of female-headed households increases with age. Because of the life cycle, as the average age of women increases they are more likely to be widowed, divorced, or separated. Therefore the probability that a household will be headed by a female increases to 35.9 percent of all households when the head is over age 65. Seventy-one percent of female-headed households are headed by widows, 14 percent are currently married, 11 percent are separated or divorced, and 4 percent are unmarried.

Access to Financial Services

Getting a loan from a formal financial institution is difficult for any entrepreneur. Microenterprise entrepreneurs find the process is even more difficult, and women face particularly large obstacles. Women also have difficulty getting equity capital or working capital for starting a business, even from family sources. Only 17 percent of the New comprehensive Rural Credit Scheme borrowers were women.

Social customs sometimes stand in the way of women receiving credit. Formal credit and financial matters, outside the household, are a male preserve. In addition is the fact that land and other forms of collateral needed for bank loans are commonly registered in the names of male household members. Women often receive bank loans only with the concurrence of male relatives. The husband or father is often required by bank officers to countersign a loan, even though this is not officially required by bank policy. Bankers told the team that, in practice, if a woman were to apply for a business loan, the bank would ask for the husband's signature also. However, if a man were to apply for a loan, the same banker said he would not necessarily require the wife to sign. Usually two guarantors are required for every loan. Husbands were reported to be sometimes reluctant to countersign for their wives' loans, even though women are widely reported as being better credit risks than men.

Women are generally viewed by bankers as being more conservative about incurring debt and take out smaller loans. When male members of a household are negligent in making loan repayments, it is the women members of households who face most of the social and institutional pressures and stigma associated with loan default.

An unusual feature of the banking system in Sri Lanka is that formal sector banks have pawn departments that accept gold jewelry as collateral. Almost 70 percent of the outstanding loan portfolio of the Regional Rural Development Banks system is in pawned loans. In addition there are pawn shops

²²"National Household Survey," 1993, Department of Census and Statistics, Ministry of Finance, Planning, Ethnic Affairs, and National Integration. The head of household is usually the principal breadwinner. However, the head of household was the member designated as such by the other members of the household. In cases where the husband is absent because of desertion or work, the woman was counted as the head of household.

located throughout the country. Pawning is a fast and nonbureaucratic way for microenterprise entrepreneurs to get needed cash for business purposes. Women are more likely than men to have gold jewelry for its value or for ornamentation. Therefore the presence of widespread pawning in the country is an advantage for female entrepreneurs.

The promotion of SFIs such as the TCCS and services through NGOs, which provide noncollateralized lending, is necessary to provide better services for women. Similarly, any improvement in savings services will be very beneficial for women.

General Business Activities

Because of child care and household responsibilities, rural women entrepreneurs are more likely to focus on home-based business activities. It was reported that participation in product supply and distribution and selling and marketing activities in rural areas is regarded as somewhat socially improper for women. However, that observation was hotly disputed by other observers in Colombo. In urban areas it is not uncommon to find women entrepreneurs working away from their house.

Women are disproportionately represented in the microenterprise sector, and they are particularly likely to be in the lowest income category of microenterprise. A Mahaweli survey of 10,000 microenterprises in 1992 showed that 75 percent of employees of microenterprises were women. Most microenterprises are family-run businesses and women play a critical and active economic role in these businesses. In addition some businesses are completely run by women.

The vast majority of home-based enterprises or income-generating activities are run by women. The business is initially started as a home-based business and expands from there. Because of competing time demands of child care and other household responsibilities, women are less likely than men to expand their business beyond the level of the home. Female-run businesses are less likely to employ nonfamily labor. Aspects of the business that require absence from the home or going into the market place are likely to be carried out by other family members such as children, or the husband.

From observation, it appears that, like other areas of the world, women in Sri Lanka are more likely to maintain a number of small income-generating activities instead of expanding an existing enterprise outside of the home.

Employment

A comparison of data over the period 1990 to 1993 (see Table 1 above) shows a small decline in the number of women unemployed.²³ The percentage unemployed is twice that of the male work force. The increase in employment has been entirely due to the private sector where the number of female employees grew at a faster rate than for male employees, and the number of women employers, as a percentage of employers, rose from 4 percent in 1990 to 18 percent in 1993. Because the number of economically active females changed very little (0.2 percent), the supply of labor for the private sector has come from unpaid family labor and unemployed groups. The layoffs in the public sector during this period were not gender-specific. These figures suggest that the government's policy of privatization and the innovations of SFIs and NGOs are having a positive impact on female employment.

²³"Labor Force Survey," Department of Census and Statistics, 1990 and 1993 Fourth Quarters.

MISSION EXPERIENCE IN MICROENTERPRISE DEVELOPMENT

Recent Microenterprise Experience

Although the Mission has not had a separate project for microenterprise, many of its projects have directly or indirectly contributed to the development of the microenterprise sector. The PVO Co-financing Project and Mahaweli Enterprise Development (MED) Project have had substantial involvement in microenterprises; the Agro-Enterprise Sector Development (AgEnt), Technology Initiative for the Private Sector (TIPS), and Mahaweli Agriculture and Rural Development (MARD) Projects have had some involvement with the sector.

Because the Mission's microenterprise experience has been contained within a number of projects that were not designed expressly as microenterprise in nature, the viewpoint of microenterprise has been fragmented. The last microenterprise monitoring system (MEMS) data collection, May 1993, included six projects. The data showed that 17,322 microenterprise entrepreneurs (95 percent under SANASA) had received loans under projects receiving USAID assistance and 14,950 microenterprise entrepreneurs had received technical assistance.

Mahaweli Enterprise Development Project²⁴

The MED project was started in 1990 with USAID support to provide assistance to the Employment, Investment & Enterprise Development (EIED) Division of the Mahaweli Authority in promoting and facilitating inward investment and in developing entrepreneurship and microenterprises. The initial emphasis of MED was more on inward investment, particularly in the agribusiness sector, than on microenterprise development, although both approaches were supported.

There has been a shift of EIED/MED emphasis to extension services for local entrepreneurship and microenterprise development. In 1991-1992, rural business centers were opened in each Mahaweli system, and, by 1993, 12 centers had been set up. Although continuing to pursue all three aspects of its mission (inward investment, industrial estates, and local entrepreneur development), the opening of the centers marked a shifting of the primary emphasis of EIED to entrepreneurship and microenterprise development. In most cases the opening of the centers was in fact the renaming of the existing EIED office; however, in doing so, it marked a reconceptualization of the function of the field office and a clear recognition that the most important role of the field staff was extension, rather than enforcement. With the emphasis on the small-scale sector and extension, the Business Centers, with their daily interface with entrepreneurs in the field, became the key organizational units of EIED.

Purpose of Business Centers

In terms of results, a center's main purpose is to assist entrepreneurs to start and improve their businesses to generate employment. In doing this, the centers also foster the development of participatory associations of entrepreneurs. A secondary, complementary purpose is to provide assistance to nucleus farm-outgrower schemes. With the economies of the areas of the centers dominated by settler farmer

²⁴Abstracted from a report on "Rural Business Centers" by James Finucane, September 1994.

agricultural production and with most entrepreneurs members of farm families, this combining of microenterprise and outgrower scheme development activities occurs quite naturally.

During the period that EIED maintained a strong emphasis on the promotion of inward investment, the centers tended to be the field service and support offices for the unit in Colombo, which was responsible for the mobilization of investors. As the emphasis has shifted to the development of local entrepreneurship in the areas, the main role of the head office unit in Colombo has shifted (or rather is shifting — this is a process) to one of supporting the operations of the centers.

Clients

The Business Center clients are mainly home and family-based self-employed individuals and microenterprises. In the Mahaweli areas, 75 percent of the nonfarm enterprises are self-employment units, and 22 percent are microenterprises employing no more than five people, including the entrepreneur. Most of the individuals engaged in these enterprises are family members and most of the enterprises (including those in the commercial areas) are located at or adjacent to their homes.

Staffing and Technical Assistance

A typical center is staffed by an EIED officer (Deputy or Assistant Manager), a MED Business Consultant, a secretary, and a messenger/general assistant. The EIED field officers normally have a professional background in investment promotion, training, entrepreneurship, and community development or agriculture and considerable experience in the public sector, including the Ministry of Agriculture itself. The Business Consultants (all Sri Lankans) have professional backgrounds in finance, accounting, or a technical field, and work experience in banks, accounting firms, private enterprises, or the Industrial Development Board.

Staff time and Activities

The professional staff are expected to spend roughly 50 percent of their time in the field making enterprise visits, meeting with bank officials, and in meetings of Savings and Credit Societies, entrepreneur associations, and other groups.

Services

Professional services: The menu of services of the centers has gradually become more limited. This increases efficiencies by concentrating on services that appear effective. The center staff currently provide the following professional services:

- Business identification, planning and problem solving;
- Credit facilitation (forming Savings and Credit Societies under the Societies Ordinance, forming other group credit ties under the Agrarian Services Act, assisting in direct access to banks, serving as field staff for MVCC);
- Market development;

- Technology identification and adoption;
- Training (technical, financial, management);
- Entrepreneur association development;
- Outgrower program facilitation; and
- Compliance with and understanding of official requirements (for example, for land).

Support Services: The centers provide photocopy, fax, secretarial, courier, typing, telephone, and translation services to clients.

AgEnt and TIPS

AgEnt works with a range of private agro-businesses in developing new markets and technologies. Most of the clients of AgEnt are small to medium-sized. The TIPS project works in the industrial and manufacturing sectors. Both TIPS and AgEnt work with some microenterprises that employ less than 10 employees. In addition, AgEnt and TIPS clients have backward linkages with contract suppliers or outgrowers and raw material suppliers, the majority of whom are in the broad category of microenterprises.

PVO Co-financing Project

Phase I of this project started in 1979 with the objective of improving local development efforts to benefit the poor majority with subprojects to be implemented by U.S. and indigenous private voluntary organizations (PVOs). The project is a mechanism to target assistance directly to the poor majority at the local level who are prepared to join in collaborative efforts to help themselves. Phase II of the project started in 1987 and the focus expanded to support private sector and enterprise development and the strengthening of NGO management. This project, which is due to terminate in 1996, specifically targets income generation, microenterprise, minority groups, and women.

As of December 1994 the PVO Co-financing Project has committed more than \$18 million and disbursed more than \$12 million in 55 grants and subprojects. Among the PVOs that have received assistance under the project are CARE and the AgroMart Outreach Foundation. Although a final evaluation of this project is slated for later in 1995, some of the activities funded under the PVO Co-financing Project may be taken over by the CIPART project.

AgroMart

Agromart Outreach Foundation was created as an NGO by the Women's Chamber of Commerce and Industry. It has focussed its efforts on developing supplementary income, and developing entrepreneurship for the poorest families in agroenterprise. The focus has been primarily, but not exclusively, aimed at women. Over a four-year period 8,000 individuals (75 percent of whom are female) have received entrepreneurship training. More than 70 percent of those receiving training went on to start their own business. Accompanying the entrepreneurship training is eligibility to participate in a small loan program sponsored by the foundation with assistance from the Swedes. The maximum

size of loan that can be extended through this fund is Rs 15,000 (\$800). Agromart has been attempting, without success, to mainstream women into lending relationships with formal financial institutions. AgroMart officers said: "In Sri Lanka it is hard for anyone to get credit from a bank, and it is almost impossible for a woman to get credit."

CARE

CARE implemented the Credit and Training for Economic Development in Sri Lanka Project (CATER) starting in 1987 and ending in 1994. USAID provided funding for this initiative under the PVO Co-Financing Project. The goal of the project was to increase incomes of poverty-level members of multipurpose cooperative societies by establishing or expanding commercially viable income generating activities. Guaranteed credit was extended through the Cooperative Rural Bank branches of the multipurpose cooperative societies. Loans averaged Rs 7,500 with a maximum loan of Rs 10,000. More than 70 percent of the beneficiaries of this project were women.

The CATER project provided valuable experience in a type of experimental lending for income-generating activities to the rural poor with no collateral. Repayment rates were high, but weaknesses were evident in the capabilities of the Cooperative Rural Banks to appraise loans and determine appropriate payback periods. Development professionals at CARE concluded that decentralized social development organizations have excellent client relations among the poor, but that the financial management capabilities of these organizations are weak.

GOVERNMENTAL AND OTHER DONOR ACTIVITIES

In the late 1980s, with government policy shifting toward targeted poverty alleviation, special programs aimed at the poor were implemented. The government poverty alleviation program, the Janasaviya Program, administered by the Department for Janasaviya, assisted the poor to start up microenterprises. Large numbers of poor families accessed group savings and funding from the state banks to support microenterprise activity.

The government received assistance from the IDA (World Bank), KFW (Germany), and the United Nations Development Programme (UNDP) to operate the Janasaviya Trust Fund, a poverty alleviation project. It is an apex organization providing credit and other services to the poor through NGO Partner Organizations to assist in their general development and the start-up of microenterprises.

Another noteworthy organization is the Janashakthi Banku Sangam of the Hambantota Women's Development Federation. This organization is an example of a successful Partner Organization. Located in the southern region, this organization is made up of a head office and 52 Janashakthi banking units. The movement targets women in poor households. By the end of 1994, the Janashakthi Banks had 24,000 members within 3,718 groups. A total of 38,316 loans totaling Rs 76.1 million had been disbursed. Average loan size was Rs 2,000. Of total assets of Rs 68 million, loans outstanding comprise Rs 45 million, cash and bank deposits Rs 13 million, and fixed and other assets Rs 10 million. The major sources of funds are a JTF loan of Rs 43.6 million, savings deposits of Rs 9.5 million, and member shares, plus a contingency fund totalling Rs 14.9 million.

Other government and semigovernment agencies, such as the National Youth Services Co-operative, MED, the Small Scale Enterprise Development Division of the Ministry of Youth Affairs,

Sports and Rural Development, the Industrial Development Board, and the Sri Lanka Business Development Center, are also active in microenterprise development and promotion activity.

Although some of these programs are run solely with government funds, others receive donor support. Extensive donor support has gone into the Integrated Rural Development Programs of the Regional Development Division of the Ministry of Finance, Planning, Ethnic Affairs and National Integration. NORAD (Norway), SIDA (Sweden), the Netherlands, IFAD, GTZ (Germany), FINNIDA (Finland), ODA (Britain), JICA (Japan), and the Asian Development Bank (ADB) contribute significant sums for microenterprise development.

Sarvodaya programs have received support from government and nongovernment sources. Donors also funded the nongovernment sector directly for microenterprise development programs. The SANASA Federation of TCCS has been assisted by CIDA (Canada) and the World Council of Credit Unions (WOCCU), among others. Sarvodaya sponsored the Sarvodaya Economic Enterprise Development Service (SEEDS) and Regional Enterprise Development Services (REDS) programs. Many other smaller NGOs have also received funding for similar activities. USAID supported efforts of the Hatton National Bank to assist the Gamu Pubuduwa microenterprise promotion project.

The government recently announced a new Samurdhi (prosperity) poverty alleviation program, which has a savings and credit component targeting the poorest 20-25 percent of the population. Beneficiaries will be provided with a supplementary income, part of which will be for compulsory savings. Potential entrepreneurs among them will be identified by a group of mobilizers who will provide assistance to generate credit from their own savings; thereafter these entrepreneurs will be encouraged to link up with other existing credit programs. The savings of the beneficiary groups will be mobilized to operationalize the proposed Samurdhi Bank at each Grama Niladhari Division.

The Government of Sri Lanka has voiced ongoing support for microenterprise development. A recent policy statement by the President of Sri Lanka stated that small and medium-scale industry will be developed with 20,000 new ventures planned for the next five years creating an estimated 250,000 new jobs.²⁵ Details of the method have not been spelled out at the time of this writing.

Donor interest in the sector will remain high as reflected by the number of players presently participating in the sector. An informal sounding of donor representatives confirmed that microenterprise would continue to be a priority area in the future. The World Bank has recently completed a poverty assessment and a study on microenterprise and self-employment to identify areas for possible lending for this sector in the future.

It is clear that the political environment among donors and the government of Sri Lanka will continue to support microenterprise initiatives. However, conversations with donor representatives and review of present and planned microenterprise activities show many organizations with different objectives, approaches, and levels of resources working in the area. This points up the need for a coordination of activities to prevent duplication of efforts, overloading of intermediary organizations, and identify gaps in the efforts. USAID is in a position to play such a coordinating role with other donors.

²⁵*Daily News*, January 7, 1995.

LESSONS FROM THE PAST

Lessons in this section relating solely to microenterprise development in Sri Lanka are derived from recent and current projects implemented by the Mission and by other donors. The relevant project/program is noted in parentheses.

Financial Supports

- Responsible disbursements of credit require building of institutional capacity to administer the program. The JTF showed that one year is not an unreasonable time period.
- Targeted and cheap credits encourage recipients to be passive rather than active economic players, result in bad loan recovery rates, cripple participating institutions, and prevent the development of a full range of financial services available to everyone. Subsidized credit is often viewed by the borrower as a grant, with the expectation of loan forgiveness.
- Donors usually have their own agenda for the volume of credit and the timetable for its disbursement that exceeds the capacity of participatory institutions such as NGOs. (JTF)
- Credit delivery has better recovery rates when emphasis is placed on meaningful savings mobilization (at least half of the eventual loan volume) prior to lending activities. (JTF, including Janashakthi)
- Although NGOs usually know their number of borrowers and amount of loan disbursement, they frequently have insufficient information concerning the number of active borrowers, the volume of loans outstanding, and the quality of the loan portfolio. (Many NGOs including Janashakthi).
- Rather than try to encourage banks to take up nontraditional business, it is better to provide supports to institutions that are more appropriate to the market. Loan guarantee schemes are subsidizing unsustainable participation of banks in the provision of a scale of financial services for which they are not suited. External payments to encourage unsustainable participation restricts the entry of more appropriate institutions. (Microenterprise and Small Business Loan Portfolio Guarantee Program).
- The MED savings and credit societies are providing credit access to a specific target group and are not providing financial services at the community level. All financial transactions take place at a distant bank. The societies are focussed on leveraging savings to allow a small part of the community to receive loans. It is debatable whether they are cost-effective or sustainable. (MED)
- The involvement of business advisors in assisting entrepreneurs to apply for loans is very costly, because banks are not prepared to lend without their own appraisal. This doubles the administrative cost of lending. This type of service needs to be limited to larger loans and a fee levied on the entrepreneur. (MED)

Creation of New Enterprises

- The process of social empowerment and job creation, often through the formation of groups, is slow and must be accomplished through the efforts of the participants with minimal outside guidance. (NGOs/JTF)
- At the elementary level of enterprise creation, most new businesses will be in traditional low investment-low income activities. It is wasteful to involve Business Centers in organizing this level of activity. It is much more cost-effective to use NGOs and community organizers to encourage group participants to identify and develop their own business ideas for start-up. If Business Centers are to be involved in microenterprise development, they need to coordinate and link their efforts more closely with other developers such as NGOs. (NGOs/JTF, MED)
- Lack of market information on products is a constraint. As a result of this lack of information, microenterprise entrepreneurs merely copy the activities of others and oversupply a limited market. Linking entrepreneurs to larger commercial firms overcomes this problem (TIPS)

Business Expansion

- Business centers should concentrate their advisory activities on enterprises with substantial growth potential. (MED)
- The MED, TIPS, and AgEnt projects all show the feasibility of using contractual arrangements to link microenterprises in a sustainable manner with commercial firms. Working through government or Provincial Councils is less effective.
- Surveys can identify business opportunities worthy of development and have yielded positive results. Until now, however, surveys have tended to be commodity-linked. Broader subsector surveys are needed to identify business opportunities, possible commercial linkages, and policy issues. (AgEnt)
- Because surveys usually precede the identification and involvement of enterprises, it is difficult to recover their cost. (AgEnt)
- Training of entrepreneurs has a higher success rate in terms of business start-ups when it is focussed on specific job skills. (Swisscontact, MED, AgroMart)
- Initial training and business start-up need to be followed by hand-holding. (AgroMart)

SECTION THREE

INTERVENTION OPTIONS

GENERAL GUIDELINES

Focus on Growth Sectors

Microenterprise interventions should focus on growth sectors within the economy, not the declining sectors. Investment in occupational categories and sectors of the economy that are static or are dying out will not have the same multiplier effects as would investment in growth areas. Following are some of the opinions that were offered concerning the growth potential of various areas of the Sri Lankan economy for the microenterprise sector. This list should not be viewed as definitive, but merely as a basis for further exploration.

- Tourism
- Computer training
- Computer repair
- Horticultural production
- Clothing assembly for export
- Metal working and finishing
- Soft toys
- Translators
- Poultry
- Vanilla
- Jams & Cordials
- Dairy specialty items
- Finished rubber goods
- Prawns for export
- Data entry
- Business services (desktop publishing, secretarial services)
- Cashew production and export
- Services, temporary worker
- Export-oriented businesses
- Leather working
- Packing of spices for export
- Automobile repair²⁶

A recommended strategy for USAID is to provide assistance in identifying markets that microenterprise entrepreneurs can penetrate. This concept is very similar to that now being used in the AgEnt project. Although quality enhancement alone will allow microenterprise entrepreneurs to tap otherwise unavailable markets, the long-term potential for growth lies in identifying a market and producing the quality and quantity of product that is necessary for that market.

²⁶Slow-growth sectors include traditional handicrafts; food preparation; retail trade; blacksmithing; fishing; carpentry; sewing (traditional); traditional dairy; broom production, door mats; rice hulling; small ruminants; brick making; bicycle repair; furniture making; tailoring; and trading.

Other Guidelines

Deemphasize extension. Microenterprise entrepreneurs are excellent emulators. The rice hulling machines spreading rapidly throughout the country are an example of this. Therefore, extension services for microenterprise should not be a large component in any program initiatives because entrepreneurs learn from each other very well. Rather, the program should concentrate on identifying markets and technologies, and encourage intermediary organizations to disseminate appropriate information.

Avoid development of new organizations. Identify existing business linkages and strengthen these linkages rather than developing and imposing new organizations and institutions into the commercial sector. Commercial consulting services are needed on an affordable basis for microenterprise entrepreneurs. NGOs and the Chambers of Commerce and Industry are now providing some of these services on a limited basis and could be assisted to do a better job.

Use emigrant workers and their remittances. Private worker remittances from abroad (Rs 23.8 billion in 1992) far exceed combined loans and grants from official sources (Rs 13.1 billion in 1992).²⁷ This should be examined for potential channeling of skills and financial resources into the productive sector. Preliminary indications show that emigrant workers are investing in real estate, housing, and consumption items. The potential to channel a portion of these remittances into productive business ventures is tremendous. Emigrants have already demonstrated they have two of the essential characteristics necessary for successful entrepreneurship — willingness to take risks and equity capital. Many of these workers have also acquired skills or worked in businesses that may be transferable to Sri Lanka. In addition the emigrant workers include a high proportion of women, a special interest group targeted in USAID's microenterprise initiative. Unofficial estimates indicate that 500,000 women have emigrated to work overseas. Fifty-two percent of all emigrant workers are female. Seventy percent of the unskilled emigrant workers are female.

Learn from success. USAID should investigate the way that successful microenterprise entrepreneurs learned the business they are in, and investigate how these methods might be strengthened. Many entrepreneurs learned through on-the-job training in family businesses. There is a clear growth path for many microenterprises. In many cases the growth path is intergenerational. The box below illustrates this finding.

The following examples of intergenerational learning were described to the team. A blacksmith's son becomes a welder under a tree, and the welder's son buys a machine shop. A bicycle repairman's son becomes a motorcycle repairman, the motorcycle repairman's son becomes an auto repairman, and the auto repairman's son owns a garage. An appliance repairman's son becomes a radio repairman. Radio repair leads to television and stereo repair, which leads to computer repair. The team also found a typical pattern in which employees of larger businesses, or even employees of microenterprise entrepreneurs, learned the business by working for someone else, and then left to start their own business.

²⁷Source: Central Bank of Sri Lanka.

Identify credit problems characteristic of Sri Lanka. The gap between formal commercial financial institutions and microenterprise seems to be particularly wide in Sri Lanka. In other comparable low income countries it appears that a much higher proportion of microenterprises have direct deposit and checking accounts in formal sector banks. In Sri Lanka, microenterprise owners may have savings accounts; however, very few maintain a checking account. The financial sector needs to strengthen retail lending techniques to lower transactions costs in dealing with microenterprise entrepreneurs

Microenterprises in Sri Lanka generally do not get supplies from suppliers that have established checking and lending relationships with formal sector banks because the suppliers are often only marginally larger than the microenterprise itself. Therefore, supplier credit (providing raw materials, intermediate products, or finished products with delayed payment terms) is less prevalent than in an economy with a more developed and extensive formal banking sector. Thus, a strategy of mainstreaming, or strengthening existing business linkages and credit relationships, is more difficult because of the wider gap between the formal banking sector and the microenterprise. Because there are a large number of NGOs working with income generating activities, there is some possibility that these groups can serve as intermediary institutions to help strengthen existing business linkages.

Coordinate with other donors. Coordination is essential to avoid duplication of programs or overwhelming and destroying some of the intermediary organizations. Microenterprise programs are under way or planned by the World Bank, the Swiss government, the Swiss Foundation for Research on Alternative Finance for Development, the German FES, and the Asia Foundation. Others may be in the planning stage.

Remember women. The USAID microenterprise strategy should pay particular attention to the constraints that prevent women from gaining equal access to development resources. The extent to which women participate in project activities will heavily influence the success of any contemplated microenterprise project or initiative. The participation of women in decision-making and leadership roles will help assure that policies, resources, and services directed to them are relevant and necessary to their needs. Inadequate access to resources is closely linked to poverty and women have less than equal access to training, credit, and other resources that would contribute to success in enterprise. In design of a microenterprise initiative, explicit attention needs to be paid to the cultural roles of women, the household division of labor, time constraints, and educational attainment. Any program or project should determine the particular barriers faced by women and build in components reduce to these barriers.

Women have household and child rearing responsibilities that limit their ability to work outside of the home. This implies that any program for microenterprise development should focus on working with home-based businesses. Women need simple, non-capital-intensive technologies that can be run from the home.

There were reports in the Hambantota area that social custom discourages women from participating in commercial activities outside of the home. There was no reported prejudice against women participating in home-based income generating activities. However this observation of social inhibitions on outside commercial activity was strongly contested by some women in Colombo. Any program initiative should investigate this area to determine whether this is a significant problem.

Although many women are involved in family enterprise in significant positions, cultural norms often direct that official duties (registrations, licensing, or signing for loans, for example) are often done by the husband on behalf of the wife, even if the business is her own. The implication is that any program initiative should pay attention to educating women concerning rights and the law, and women's programs should include men so that cultural attitudes of males do not undermine women's participation.

Women tend to be concentrated in selected sectors of the economy. Judiciously selecting program initiatives where women are particularly active would have the effect of targeting women as beneficiaries. One such area where women play a significant role is in the dairy industry. Sri Lanka is a net importer of milk powder. Any initiatives aimed at strengthening the dairy industry would almost automatically have significant impacts on the economic position of women. However, as discussed earlier in this paper, it is not clear whether an import replacement project would be economically justified in light of off-setting subsidies, import tariffs, and exchange rate distortions.

Women are more likely to form groups and these groups can be used as intermediary organizations to provide services to women in business. Women traditionally form social groups and savings groups called *Seettu*. It is an easy extension to form larger groups of women for credit and savings. However, according to the experience of the Grameen Bank, the lender should not be instrumental in forming the groups.

OPTIONS FOR NEW INTERVENTIONS

Establish and Operate an Institution for Microenterprise Policy and Development (MDT)

Rationale

Catalyst. The survey team heard frequently that there was a need for a national institution to act as a catalyst for microenterprise development. The functions that such an organization could fulfil are extensive, and the terms of reference and funding levels would have to be carefully examined during any further development of this option. At present there is no organization filling the roles described below. It was widely recommended that this institution be outside government.

Data collection. Apart from industry sector data for firms employing up to nine workers, there are no data concerning the number of microenterprises and their activities. There are no detailed industrial data on firms employing 5-9 workers. These data gaps extend to the financial sector where there is almost no information concerning the use of financial services by nonagricultural producers. As a result it is very difficult to formulate policy concerning microenterprise development and impossible to measure the impact of policies and regulations.

Advocacy. Cheap loans and forgiveness of loans prevent development of institutions and development of financial services. The cessation by the government of providing targeted and cheap credit will encourage the innovativeness of financial institutions as they seek market share in a freely competitive market.

MICROENTERPRISE DEVELOPMENT OPTIONS: NEW PROJECTS

Table 4

Target Group	Purpose	Project Vehicle & estimated cost	Outputs	Activities	Inputs
Poor and near-poor microentrepreneurs (1,700,000 households)	Improve availability & use of information concerning poor and near-poor microentrepreneurs	1. Microenterprise Development Trust (MDT)	1. Improved collection and use of data within Government 2. Dialogue with Government, other donors and NGOs on microenterprise issues	1 Assist Government in survey design, data collection and analysis. 2 Identify & discuss policy & regulatory issues 3 Exchange information with other USAID & donor programs	1. TA 6 PMs 2 MDT expenses as below
The poorest & survival-oriented microenterprises (1,200,000 households)	Increase skills and productivity to enhance economic growth among microenterprises	(MDT) (\$10 m)	1 NGOs trained and using subsector surveys to develop 50,000 new enterprises 2 NGOs exchanging and receiving information via MDT	1 Exchange and disseminate information 2 Train & assist NGOs in subsector surveys 3 Encourage inter-firm linkages 4 Assist training & advise expansion-oriented microenterprises 5 Advise and assist migrant workers on funds management and business start-ups	1 TA 54 PMs 2 Set-up costs \$70,000 3 Operating cost (50%) of \$0.9 million incl TA
Growth-oriented microenterprises (500,000 households)		(MDT)	3. Advise 10,000 microentrepreneurs on business investment and expansion 4. NGOs using subsector surveys to expand 5,000 microenterprises 5. Identify & assist > 50 larger firms into microenterprise linkages	1 Train & assist NGOs in subsector surveys 2 Provide business advisory services 3 Explore & develop linkages with larger firms 4 Liaise with chambers of commerce & other intermediaries in accessing skills & training	
Poor and near-poor microentrepreneurs (1,700,000 households)	More accessible and efficient financial markets	2 SANASA (\$4.4 m) JAN 3 Janashakti (\$0.3 m)	1. Savings services for > 1.7 million households 2. Loan services for > 500,000 households not reached by formal banking sector 1. Savings services for > 0.7 million households > \$0.000 2. Loan services for < \$1 million households	1 Design & planning for bank establishment 2 Assist in design and implementation of bank procedures and products 3 Design and assist in implementation of training and supervision systems 1 Design and install improved financial and managerial reporting systems 2 Design and assist in implementation of improved supervisory system 3 Provide advice on costing and pricing of financial products	1 TA 42 PMs foreign & 48 PMs local \$1.16 m 2 Equipment \$1.86 m 3 Training \$0.56 m 4 Seed capital \$0.4 m 5 Contingencies \$0.4 m 1 TA 9 PMs foreign & 3 PMs local \$213,000 2 Equipment \$62,500 3 Training \$10,000 4 Contingencies \$28,500

Savings services reach many people and play a role in poverty alleviation. To be of use to rural customers, however, savings services must be offered in the community and not in a distant township. There is legislation before Cabinet to allow NGOs to broaden the scope of their collection of savings. Although this has the potential to benefit many, NGOs' weakness in funds management poses high risks for depositors and confidence in the rural financial market.

Safeguards to protect NGO creditors and to provide improved financial and management systems and associated training for NGO officers are needed.

Coordination. NGOs need to be networked more effectively. There is a large number of NGOs with estimates ranging to as many as 30,000. This indicates they play an important role in society. Legislation is pending that will require all NGOs to be registered. It is also necessary that information be collected on NGOs and their activities. NGOs carry out a broad range of activities, and a sorting needs to be done to determine which are capable of working with microenterprise, and in what capacity.

Activities of MDT

A Microenterprise Development Trust would be set up to:

- Encourage and support practical research, dissemination of information, and open dialogue with government, on relevant policy, legal, regulatory, and public administration issues, and their impacts on the microenterprise sector;
- Exchange program information with the 160 NGOs known to be involved in microenterprise development and search for, disseminate, and promote the best ideas of NGOs and others;
- Sponsor research and development efforts by individuals and organizations on markets, enterprises, and products appropriate for microenterprises;
- Carry out subsector, commodity, market, investment, and consumer surveys to identify business opportunities, firms with which viable linkages could be developed, and regulatory and market access issues that constrain microenterprise activities;
- Coordinate with donors on programs and projects supporting the growth and development of microenterprise;
- Provide technical assistance to intermediaries to strengthen their ability to work with microenterprise;
- Work with businesses to develop linkages with small subcontractors, suppliers, and distributors;
- As part of a limited research and development effort, identify, train, and assist growth-oriented microenterprises to develop business plans, or investment packages to demonstrate viability of enterprises for the smallest entrepreneurs;
- Facilitate the financing of investments for individuals directly or via bodies such as AgroMart;

- Assist microenterprise entrepreneurs in gaining access to skills training and new technologies; and
- Advise and assist Sri Lankan workers, who have worked overseas, on the management of their savings and the use of their funds in microenterprise investment opportunities in and around their villages.

The MDT would incorporate elements of the TIPS, AgEnt, and MED projects, which have been very successful, such as the use of market surveys, the development of linkages with commercial firms, and the provision of business advice to expanding enterprises. Although these activities can be very beneficial and necessary for development, they frequently require investments that are only partially recoverable.

The MDT would have a sunset clause to close operations after five years to avoid the organizational tendency to self-perpetuating behavior. If the MDT is doing an effective job, it will receive further support from some donor. It would be nonoperational and would work through other organizations and enterprises in support of microenterprise. This would encourage the MDT to avoid self-serving activities. Self-sustainability of such desirable services may not be achievable, but such organizational characteristics would ensure more cost-effective delivery of services.

At the field level, the MDT would work through a few District offices that would expand in number according to the demand for services. The selection of participating Districts could be determined by the incidence of poverty and the existence of good NGOs through which the MDT could work. An example is the Hambantota District, in which the Janashakthi movement already operates. The MDT would develop working relationships with larger businesses, NGOs, and financial institutions at head office and District levels.

The MDT would have a Board of 20 people, which would be made up of representatives of large Sri Lankan and American businesses, government nominees, NGOs, and USAID. The MDT investment and operational costs would be funded by large businesses in Sri Lanka (charitable grants) and by USAID funding. The USAID funds would be used primarily for the costs of foreign expertise and for an annually declining share of the operating budget.

The MDT would be staffed at head office by a director and one professional officer supported by administrative staff. All permanent staff would be Sri Lankans. Foreign expertise would be recruited in accord with a schedule for predetermined needs and also on an as-needed basis. Maximum use would be made of International Executive Service Corps experts with commercial expertise.

The provisions of the Trusts Ordinance CAP.96 Legislative Enactments of Sri Lanka provide for Charitable Trusts, which can receive tax exempt donations. The proposed MDT would not be owned by USAID, but be seen by corporate organizations as an appropriate vehicle to help assure the growth and survival of an open economy. The trust builds on a similar legal concept to such organizations as the Janasaviya Trust Fund. The difference is that the MDT would be much more limited in scope and would be under the control of the private sector.

Cost and Type of Assistance

The estimated cost of this intervention over five years is \$1.93 million. It is suggested that USAID fund 50-75 percent of this: \$1.0 to 1.5 million. Summarized cost details are shown in Table

5. To avoid the need for a ministry location for MDT, this funding could flow through an intermediary institution.

MDT would provide government-oriented technical assistance of 6 person-months to assist in developing appropriate policy, legal, regulatory, and public administration approaches to encouraging the expansion of a vital microenterprise sector. Under this option, 54 person-months of foreign technical assistance would also be provided, over five years, in microenterprise skills and technologies. Wherever possible, retired executives (with good commercial experience) would be used. There may be scope to substitute some local consultants for foreign.

Staff to manage the MDT over five years will be needed. It is estimated that one director/general manager plus 7 professional officers and 5 secretaries would be needed. Each field office would be staffed by 2 professional officers plus 1 secretary. It is recommended that USAID be responsible for the selection and salary payment for the MDT director.

Assist Janashakthi to Achieve Greater and More Effective Outreach

Rationale

The Janashakthi movement is directed at poverty alleviation and encouraging women and their families to start up and operate microenterprise activities through the use of their savings and loans from the movement. In its four years of existence it has reached 35,000 women. The provision of services is done on a cost-recovery basis. The movement covers five divisions within the Hambantota District. Expansion to cover the remaining six divisions will require the establishment of a subregional office and the employment of additional supervisors.

With expansion into new divisions, the number of households reached might increase from 24,000 to 50,000. Most of the growth in services within the existing divisions will need to be in larger loan size and increased mobilization of savings. It will be necessary to set up a subhead office branch to reach the other six divisions.

Currently loan size averages Rs 2,000 (\$40). This can be compared with the Grameen Bank, which has a similar lending philosophy, of \$70. Loan size, therefore, can be expected to grow. An increase in loan size to the Grameen Bank level would mean an increase in the loan portfolio, for the existing divisions, of about Rs 34 million.

Microenterprise Development Trust

I. Investment		<u>Rs</u>	<u>Rs</u>	<u>\$US</u>		
Head office plus 3 district offices						
Computer sets	5 sets	268,000	1,340,000	26,800		
Photocopier	4 unit	500,000	2,000,000	40,000		
Fax machine	4 unit	50,000	200,000	4,000		
Vehicle	2 unit	1,250,000	2,500,000	50,000		
Motor bikes	3 unit	125,000	375,000	7,500		
Desks and chairs	5 unit	12,500	62,500	1,250		
Filing cabinets etc	6 unit	12,500	75,000	1,500		
Legal fees			50,000	1,000		
Contingencies	2.5%		<u>163,813</u>	<u>3,276</u>		
		Total:	6,766,313	\$135,326		
II. Operations						
a. Head Office:						
Salaries		<u>Rs</u>	<u>Rs</u>	<u>\$US</u>		
Director	1 person	80,000 /month	1,040,000	20,800		
Field officer	1 person	20,000 /month	260,000	5,200		
Secretaries	2 person	15,000 /month	292,500	5,850		
Travel	36,000 km	15 /km	540,000	10,800		
Office rental	12 months	45,000 /month	540,000	10,800		
Electricity	12 months	5,000 /month	60,000	1,200		
Telephone	12 months	8,000 /month	96,000	1,920		
Materials	12 months	10,000	120,000	2,400		
Sundry	10.0%		294,850	5,897		
Visiting consultants 1/.	12 PMs	\$15,000 /month	9,000,000	180,000		
Repairs & Maintenance	7.5%		481,125	9,623		
Depreciation	25.0%		1,603,750	32,075		
b. Field offices:	3 offices	1,200,000 /year	<u>3,600,000</u>	<u>72,000</u>		
		Total:	17,928,225	\$358,565		
1/. One third are retired executives						
III. Operating contributions						
USAID		<u>Rs.</u>	<u>Rs.</u>	<u>\$US</u>		
Consultants			9,000,000	180,000	50%	
Businesses						
Sri Lankan						
	40 firms	50,000 each	2,000,000	40,000	11%	
	150 firms	5,000 each	750,000	15,000	4%	
USA						
	20 firms	75,000 each	1,500,000	30,000	8%	
Fees						
Microentrepreneurs		500 units	2,000 each	1,000,000	20,000	6%
NGO fees		20 NGOs	5,000 each	100,000	2,000	1%
Other Sources (unknown)			<u>3,578,225</u>	<u>71,565</u>	20%	
			17,928,225	\$358,565	100%	

If the remaining six divisions were brought into the sphere of operations, the total loan portfolio could reach Rs 155 to Rs 160 million. This would represent an increase in loan portfolio of at least Rs 110 million over a period of five to seven years. A loan portfolio of this size would need an increase in net worth of about Rs 30 million. Savings as a proportion of loans outstanding should rise from a level of 20 percent now to reach 40 percent. This would provide Rs 50 million in funding. The balance needed, of Rs 30 million, could come from the JTF program.

Any growth will require several supports and safeguards. These should be:

- **Diversification of the loan portfolio.** The course of this should follow subsector surveys carried out by the movement with minimal outside advisory assistance. This could be provided by the proposed MDT.
- **Improved funds management.** The increase in the size of the loan portfolio will require better management of liabilities to ensure an adequate and stable source of funding. The large increase needed in savings will require a promotional effort supported by appropriate safeguards and liquidity. A core of longer-term debt is needed to provide financial stability. Adequate provision for bad loans and a sufficient equity balance are needed to cover financial risk. This will require that the movement generate and retain a reasonable level of profit each year. Diversification of assets, besides the loan portfolio itself, will be necessary to reduce risk.
- **Improved financial reporting and analysis.** The system needs to separate financial from nonfinancial activities, to calculate the costs and benefits of growth into new divisions for financial as well as nonfinancial services. The increased volume of savings will require improvements in the recording of deposit, withdrawal, and interest calculation transactions. Costs of each type of savings instruments will need calculation. Early warning signals, specific to each Janashakthi Banku Sangam (or Janashakthi System Bank), will need to be calculated and assessed on a monthly basis to ensure their more effective supervision.

Cost and Type of Assistance

Technical assistance is needed to help Janashakthi in planning future expansion and consolidating the gains it has made. A larger organization will also need some improvements to its reporting systems to ensure that current performance and outreach do not deteriorate.

Technical assistance could be provided to:

- **Provide and install improved MIS and accounting systems.** (3 person-months foreign and 3 person-months local)

This is to improve the accounting and management of funds and allow for the recording of a large number of small-scale financial transactions.

- **Provide and install an improved supervisory system** between individual units and the head office. (1.5 person-months foreign)

This is to strengthen their prudential management and protect creditors.

- **Provide advice on the costing of services** to allow for the retention of adequate reserves and improvements in personnel performance, the cost recovery of advisory and supervisory services, and the design and use of savings instruments to increase the reach of savings services. (1.5 person-months foreign)

In the longer term, assistance could be provided to the Janashakthi movements in its efforts to form itself into a bank. The size of its financial operations, however, may be too small to set up an autonomous bank. Alternatives such as becoming a shareholder of the SANASA bank could be explored.

It is estimated that the total cost of assistance would be about \$314,000 as outlined in Table 6. This is made up of \$213,000 for technical assistance, \$10,000 for training, \$62,500 for vehicles and equipment, and \$28,500 for contingencies.

Recommendation: Focus on The Economic Growth of Microenterprises:

MDT combined with Janashakthi assistance: \$2.25 million

Cost \$10 per family beneficiary

Advantages: Policy, microenterprise expansion and economic growth, women and the poor (Janashakthi), innovative approach set within the private sector.

Assist the SANASA Movement to Become a Bank

Rationale

Although the SANASA Movement has been successful in reaching more than half a million households, its performance has not been consistently satisfactory over all of its areas. Many communities lack financial services despite the existence of a SANASA primary society. Staff of SANASA need to become more professional and competent in their activities, and improvements are needed in the financial intermediation and performance of the SANASA units at all levels. These improvements are needed to enable SANASA units to provide a broader range of financial services to those not adequately served at present by the formal banking sector.

Improvements to SANASA will enable it to achieve greater outreach and be more responsive to the needs of the whole community. This will mean better savings services with a wider range of savings instruments and a wider range of loan sizes and maturities. In particular, the poor and women will benefit from improved savings services and the provision of small-scale loans up to \$300. The improved competence of SANASA staff will also enable the units to make loans of up to \$2,500 — a level at which banks begin to operate efficiently.

Table 6

Cost of Assistance to Janashakthi Sangum Bank

			<u>Total Costs</u>
1. Technical assistance			
Foreign			
Systems	3 PMs	\$22,000 /PM	66,000
Supervision/pricing	6 PMs	\$22,000 /PM	132,000
Local			
Systems	3 PMs	\$5,000 /PM	<u>15,000</u>
		Subtotal:	\$213,000
2. Training			
Managers	40 staff	\$60 /staff	2,400
Supervisors	11 staff	\$200 /staff	2,200
Computer operators	15 staff	\$300 /staff	4,500
Senior staff	3 staff	\$300 /staff	<u>900</u>
		Subtotal:	\$10,000
3. Vehicles & Equipment 1/.			
Motor bikes	1 units	\$2,500 /unit	2,500
Computers	4 units	\$6,000 /unit	24,000
Computers	11 units	\$2,800 /unit	30,800
Filing cabinets	15 units	\$100 /unit	1,500
Desks & chairs	15 units	\$250 /unit	<u>3,750</u>
		Subtotal:	\$62,550
4. Price & physical contingencies		10.0%	\$28,555
		<u>Total estimated cost:</u>	<u>\$314,105</u>

1/. These are shown at full local prices including tariffs and taxes

Issues to be Resolved

There is a vast difference between overseeing a collection of credit and saving societies and operating a fully chartered bank. Discussions with SANASA officials indicate they are yet to understand all the implications and requirements surrounding bank formation. A number of very important issues are yet to be resolved. Examples of these are:

- **Planning:** An exhaustive review of all the activities needed for setting up and operating the bank is urgently needed. This review should show the time, effort, and cost needed for each activity and set out the constraints to speedy implementation.
- **Legal:** Details on ownership, ways to involve grassroots primary societies — both on entry and exit, allocation of shares and their pertaining rights and obligations, scope of operations — geographically and financially, accompanied by full legal incorporation.
- **Organization:** More detail is needed concerning management and supporting structures and their duties and responsibilities, on internal controls and supervisory and reporting procedures, on job descriptions and responsibilities of staff, on the training and evaluation of staff performance, on the delineation of cost and profit centers.
- **Systems:** All financial and managerial reporting will require new systems to record transactions as they occur, prepare financial statements for customers and for each cost center, and prepare reports for Central Bank as well as for the different management and control levels within the bank. The design and installation of new systems is time-consuming. Once all systems have been designed and tested, manuals and the reporting formats will need to be prepared, printed, and distributed. Computer and office equipment will also need to be selected, purchased, and distributed.
- **Operating procedures:** All financial products and services (such as supervision of the primary societies) will need pricing to ensure full cost recovery and provide a margin needed to maintain a satisfactory net worth position in accordance with prudential banking requirements.

Products will need to be priced in accordance with their associated size, term, and risk to encourage the development of a full range of financial services reaching all levels of society.

- **Staff selection and training:** Staff for key banking positions, such as general manager and financial controller, will need to be selected from outside the SANASA organization. Following the design of systems and preparation of all procedural manuals, SANASA staff will need to be trained. Some staff may not be suitable for training and will require replacement. This needs careful planning. The training of just the 7,000 primary society managers for a minimum of three days at Rs 1,000 per day would cost Rs 21 million (\$420,000).

Cost and Type of Assistance

The cost of external assistance is estimated at between \$1.85 million to \$4.375 million as outlined in Table 7. The lower figure covers technical assistance, training only at the Divisional level up, and seed capital.

Table 7

Cost of Assistance to SANASA Bank

			<u>Total Costs</u>
1. Technical assistance			
Foreign			
Initial	3 PMs	\$22,000 /PM	66,000
Implementation	39 PMs	\$22,000 /PM	858,000
Local			
Implementation	48 PMs	\$5,000 /PM	<u>240,000</u>
		Subtotal:	\$1,164,000
2. Training			
Managers	7,000 staff	\$60 /staff	420,000
Supervisors	500 staff	\$200 /staff	100,000
Computer operator	100 staff	\$300 /staff	30,000
Senior staff	30 staff	\$300 /staff	<u>9,000</u>
		Subtotal:	\$559,000
3. Vehicles & Equipment 1/.			
Motor bikes	500 units	\$2,500 /unit	1,250,000
Computers	25 units	\$6,000 /unit	150,000
Computers	100 units	\$2,800 /unit	280,000
Filing cabinets	500 units	\$100 /unit	50,000
Desks & chairs	500 units	\$250 /unit	<u>125,000</u>
		Subtotal:	\$1,855,000
4. Seed capital	10.0% of total paid-up capital		\$400,000
5. Price & physical contingencies	10.0%		\$397,800
		<u>Total estimated cost:</u>	<u>\$4,375,800</u>

1/. These are shown at full local prices including tariffs and taxes

Technical assistance for an initial study and costing of bank incorporation (3 person-months). As outlined above, there are a number of ownership, organizational, procedural, and cost issues that need to be discussed and included in the design of the bank. A clear and orderly plan for implementation of the steps toward bank establishment is then needed.

Technical assistance for implementation of necessary steps toward bank establishment (39 person-months foreign, 48 person-months local). This assistance, continuing over a two-year period, would follow needs outlined above:

- **Reporting systems design and implementation.** (9 person-months foreign, 18 person-months local)

Design of accounting system, all financial and managerial reports for managers and supervisors at all operating levels. Design and test software needed. Prepare procedural manuals. Train key staff.

- **Personnel management.** (6 person-months foreign 12 person-months local)

Set out procedures for staff selection, job descriptions for all positions, design system for evaluation of staff performance and incentives, design a training curricula, prepare training material, train trainers, design and implement a cost-effective training system for new and advancing staff.

- **Establishment of cost centers and services and product pricing.** (6 person-months foreign over 18 months)

Conduct a market survey to determine the range of, and opportunities for, financial products best suited to SANASA and its target customers. Review operational costs at all levels to ensure satisfactory pricing of products, services, and interunit financial flows. Advise on incentives to encourage better staff performance.

Design and assist in the implementation of the supervisory system needed to monitor and advise District, Divisional, and primary societies. Provide training and oversight of supervisors and their managers.

Study tours. In addition to technical assistance, it is recommended that funding be provided to enable senior management to travel to Bangladesh to review the Grameen Bank and BRAC models and to Indonesia to review the BRI units and the LDKP/BPR systems. For five staff this would cost about \$17,000.

Vehicles and equipment. The banking capital requirement of Rs 200 million will be the resource for financing most of the vehicles and equipment. It is recommended that external support be provided for the improved supervision of the primary societies. For 7,000 primary societies this may require about 500 supervisors. Equipment supports could be in the order of 500 motorbikes, 25 core and 100 other computer sets, 500 desks and chairs, and 500 filing cabinets. The cost of these is about \$1.8 million.

Training. As outlined above, the training of 7,000 primary society managers could cost Rs 21 million. Additionally the training of 500 supervisors, 100 or more computer operators, and senior staff could cost a further Rs 7 million. The total cost of initial training could therefore be Rs 28 million (\$560,000).

Seed capital. To operate as a bank, a total of Rs 200 million (\$4 million) paid-up capital is required. It is recommended that USAID provide \$400,000 in seed capital. This is 10 percent of the total requirement. The existing SANASA Movement including the primary societies should finance the balance of the capital needed.

It is quite likely that the bank will also need a stable core of long-term borrowing. This will require calculation depending on expected market services and growth strategies. Once formed as a bank, it will be critical that SANASA be able to retain sufficient profits to maintain satisfactory capital ratios.

Recommendation: Focus on Maximal Outreach, Sustainability and Cost-effectiveness

Formation of a SANASA bank. \$4.375 million

Cost \$5 per family beneficiary

Large outreach, women comprise half of beneficiaries, community oriented including the poor, financial services for both survival and growth-oriented small and microenterprises.

Provide Assistance to Banks to Work with NGOs

Under this option, assistance would be provided banks willing to develop supervisory and advisory linkages with NGOs involved in the provision of small-scale financial services.

- The target banks would be Hatton National Bank, selected Regional Rural Development Banks, and, possibly, the People's Bank and Bank of Ceylon.
- Financial assistance would be provided to the banks to enable them to make the necessary investments required, primarily, for the supervision of the NGOs/SFIs. This could also include the funding of a part of their operational costs during a start-up period of two years. At the end of the two-year period, the banks and their NGOs/SFIs would reach a mutual cost-sharing arrangement based on the flows of business. This would strengthen linkages within the financial sector.

Revitalize the Regional Rural Development Banks

The Regional Rural Development Banks are not functioning as intended. The environment in which they are operating is changing and they are lumbered with poorly performing loan portfolios. The Banks need to become a part of the community they serve rather than an arm of government. This would require a change in their corporate image, a change of their ownership (away from government), the provision of incentives for staff to improve staff productivity, a much greater focus on mobilization of community-level savings, and full autonomy and greater flexibility in lending policies and management.

The Regional Rural Development Banks need to focus on making loans in the range of Rs 30,000 to Rs 300,000 — an intermediate area not well serviced by either NGOs or commercial banks.

Assistance would aim at:

- The development of a corporate image, corporate goals, and associated strategies consistent with an identified and achievable market segment;
- Recommending ways to improve the delivery of services at the community level. This will be concerned with establishment and servicing of delivery points, staff training, and introduction of staff incentives to improve staff productivity;
- Assisting in the design and costing of services to ensure market growth in a self-sustainable manner. Essentially this will be concerned with the design and costing of a range of savings instruments, transfer pricing in the movement of surplus or needed funds between the network of Regional Rural Development Banks, and setting the right loan interest rates and repayment incentives; and
- Designing and installing supportive managerial and financial reporting systems.

Assistance to the Regional Rural Development Banks might be better if accompanied by a specific loan program carrying with it substantial technical assistance for the Regional Rural Development Bank system. This type of program and assistance might be more consistent with Asian Development Bank and World Bank-type projects.

OPTIONS FOR MODIFICATION OF EXISTING USAID PROJECTS

The discussion in this section concerns possible modifications to existing projects to strengthen USAID's microenterprise program.

Mahaweli Enterprise Development

Activities that could be considered include setting out and charging a schedule of fees to be levied on microenterprises for assistance received from the business development centers. MED could also participate with NGOs, such as AgroMart, in surveys to identify and promote enterprise development opportunities, and advise these NGOs on the development of these opportunities.

MED could work more closely with regional chambers of commerce and trade associations in developing initiatives aimed at microenterprises. It could survey and list all types of support services suitable for microenterprises, and print a directory of these services in national languages and distribute it to NGOs, trade associations, chambers of commerce, and consulting organizations. The directory, for example, would list training courses, business associations, market advice, and business-oriented services.

Business advisory services should be confined to enterprises with expansion prospects. This would exclude the provision of general training courses and one-on-one advice for subsistence-level activities.

The monitoring system should be modified to record microenterprise-impacting services, by gender, delivered by the project and measure their effectiveness.

AgEnt

AgEnt could be encouraged to devote part of its market identification and development activities in opportunities for microenterprise and women participation. It should adopt a definition for microenterprise which is consistent with that used by the Mission. AgEnt could also be encouraged to extend its activities so as not to exclude the Mahaweli and its entrepreneurial development.

The monitoring system should be modified to record microenterprise impacting services, by gender, delivered by the project and measure their effectiveness. AgEnt should continue to employ women in the development and supply of its services.

The program should consider the indirect effects of AgEnt market development services on microenterprises. Larger businesses working with AgEnt may have outsourcing, marketing, or financial linkages to microenterprises.

TIPS

Its monitoring system should be modified to record microenterprise impacting services, by gender, delivered by the project and measure their effectiveness. TIPS should improve the liaison with other Mission projects involved in business and market development to disseminate information concerning the identification and development of business linkages between microenterprises and larger firms.

PVO Co-financing (and CIPART)

The Mission should not fund credit operations being carried out by NGOs. The focus should be on the sustainability of NGO operations and assistance should focus on institutional strengthening. However commendable their objectives, the use of subsidized NGOs in providing rural credit will eventually inhibit the development of sustainable financial services. The focus needs to shift to strengthening self-sustainable institutions. The Mission should improve the measurement of project effectiveness in terms of outreach, cost-effectiveness, and sustainability.

- The World Council of Credit Unions has been providing technical assistance to the SANASA Movement. It is understood that WOCCU will submit a new proposal, under CIPART, for continued technical support. The formation of a SANASA bank, however, may lessen or change the need for some of the proposed technical assistance. Some of the assistance could conflict with later banking requirements. At the least, further USAID assistance will need to be compatible with the movement's evolution toward becoming a banking rather than a credit union operation.
- The Mission would provide technical assistance to the Janashakthi Movement to improve its financial and managerial reporting system. Consider assistance for expansion to the remaining six divisions.

- AgroMart should develop closer links with the MED, TIPS, and AgEnt projects to identify and develop products which contain more value-added. If there is a move to the southern province, then AgroMart should link up with the Janashakthi Movement.

SECTION FOUR

SUMMARY OF RECOMMENDATIONS

SUFFICIENT FUNDING OPTION

Options to be considered by USAID for any microenterprise initiative depend on the level of funding available. If sufficient funds are available to finance a separate microenterprise project, the following options should be considered. Although listed as discrete alternatives, these options can be combined in a number of possible configurations:

- Establish and operate a microenterprise project to support practical investigations and advocacy concerning policy, legal, and regulatory and administrative constraints to microenterprise development; sponsor market research; and coordinate and disseminate information for NGOs working in microenterprise development.
- Assist the SANASA Movement to form a bank to extend additional financial services to those not adequately served by the existing formal banking sector.
- Assist the Janashakthi Movement to achieve a larger and more effective outreach program to rural women.
- Provide assistance to banks willing to develop supervisory and advisory linkages with NGOs involved in the provision of small-scale financial services.
- Support the revitalization of the Regional Rural Development Banks so they can focus on making loans in the Rs. 30,000 to Rs. 300,000 range that is not serviced by either the NGOs or the commercial banks.

INSUFFICIENT FUNDING OPTION

If incremental funding is all that is available, the strategy should be to add microenterprise components to existing projects, or to strengthen existing microenterprise outreach components. Existing or planned projects that would be appropriate for an expanded microenterprise focus include the Mahaweli Enterprise Development Project, the AgEnt project, the TIPS project, and the forthcoming CIPART project.

GUIDELINES IN IMPLEMENTING EITHER OPTION

Administrative

- USAID/Sri Lanka should adopt the same definition of microenterprise that is contained in USAID Policy Determination 17 (PD-17), of October 10, 1988. Because PD-17 is under revision, any revisions in the USAID/Sri Lanka definition should reflect this change as well.
- USAID should seek to play a coordinating role with other donors active in microenterprise development.

Government Policy

- USAID should encourage the government to stop granting broad loan forgiveness and refinancing loan schemes with subsidized interest rates. USAID of course should also abstain from committing the same errors.

Appropriate Focus and Activities

- Microenterprise interventions should focus on growth sectors within the economy, not the declining sectors.
- Extension services for microenterprise should not be a large component in any program initiatives because entrepreneurs are excellent emulators. The program should concentrate on identifying feasible markets and technologies, and encourage intermediary organizations to disseminate information.
- USAID should focus on encouraging institutional development of intermediary organizations that, in turn, strengthen natural business relationships. Such organizations include financial institutions, business associations, and selected NGOs.
- A microenterprise initiative should examine ways in which the Rs 24 billion per year (almost double the combined total of loans and grants from official sources) of worker remittances can be used to assist the growth of a strong microenterprise sector.
- USAID should investigate how successful microenterprise entrepreneurs developed the skills necessary to run their existing business, and determine whether these methods can be strengthened. To be included in this investigation are apprenticeships, on-the-job training, and working in a family business.
- The financial sector needs to strengthen retail lending techniques to lower transactions costs in dealing with entrepreneurs in microbusiness.
- A recommended strategy for USAID is to provide assistance in identifying markets that microenterprises can penetrate, similar to the work now being done in AgEnt.

- The USAID/Sri Lanka microenterprise strategy should pay particular attention to the constraints that prevent women from gaining equal access to development resources, and design project components that remedy the identified constraints. Any program initiative should pay attention to educating women concerning rights and the law, and women's programs should include men so that cultural attitudes of males do not undermine women's participation.

ANNEX A
RECOMMENDATIONS OF THE PRESIDENTIAL COMMISSION ON
FINANCE AND BANKING

The Commission had a number of recommendations for expanding credit to the poor. These are summarized as follows:

The Regional Rural Development Banks should:

- Be established in all remaining districts;
- Have their issued capital increased from Rs 20 million to Rs 30 million and allow commercial banks and cooperative societies to participate in their equity;
- Recruit more staff and provide productivity-related staff bonuses; and
- Establish a Microenterprises Support Fund, with funding through the Central Bank.

Comment: The survey team sees that the focus still seems to be on channeling credit to the poor; almost nothing is mentioned about the provision of savings services. The Commission discusses the market niche of the Regional Rural Development Banks in terms of supplying the agriculture sector and the poor. Ways of doing this cost-effectively are not addressed. The importance of nonagricultural activities is not discussed. It is important that the Regional Rural Development Banks find their place in the market. It is possible, however, that if all banks participate in the equity of the Regional Rural Development Banks, as recommended, the Banks may be constricted to activities that do not compete with its owners.

The Cooperative Rural Banks (CRBs) should:

- Be delinked from the Multi-Purpose Cooperatives (MPCs);
- Receive prudential supervision by the Central Bank;
- Be given the status of banking institutions within the meaning of the Monetary Law Act; and
- Strengthen audit procedures.

Comment: The survey team believes that adequate supervision of the CRBs by the Central Bank would need a substantial increase in supervisory staff, special training of inspectors, and the use of procedures geared to SFIs rather than using the normal commercial bank supervision procedures. The team supports:

- Activating a credit programming exercise by the Central Bank;
- Widening access to credit at market-related rates of interest; and
- Establishing a credit coordinating and monitoring committee to improve coordination between financial institutions and to monitor the progress of credit to the poor.

ANNEX B
USAID'S MICROENTERPRISE INITIATIVE



USAID's Microenterprise Initiative

The economic growth strategy of the U.S. Agency for International Development (USAID) emphasizes poor peoples' economic empowerment. Microenterprise development is an important means to this end.

ARTICULATING GOALS

Administrator Brian Atwood has issued a charter outlining the goals of the initiative and directing agency staff to pursue them. The goals are: 1) to assist poor people to increase their income and assets, thereby gaining the basis to improve their welfare, nutrition, health, housing and education; 2) to increase the skill and productivity base of the economy, so that economic growth is enhanced; and 3) to develop sustainable institutions through which disadvantaged groups gain greater access to resources, fostering a social fabric that more effectively weaves poorer people into their societies as participating members.

In pursuing these goals, USAID will be committed to:

- *Focus on women and the very poor.* USAID has pledged to devote half of its support for microenterprise programs to poverty lending programs (and the poverty lending portion of mixed programs) by fiscal year 1996. Poverty lending programs are defined as those that serve the very poor, with reference to loan amounts below \$300 in 1994 dollars.
- *Assist implementing organizations in reaching greater numbers of people.* Because the scale of need is great, involving tens of millions of entrepreneurs around the world, the agency's approach is designed to reach as many people as possible.
- *Sustainability and financial self-sufficiency.* Through sustainable institutions, more people can be reached and services can continue over time, becoming permanent parts of local economies.
- *Partnerships with local organizations.* USAID will seek improved partnerships with governmental and non-governmental organizations, associations, credit unions and other institutions.

IMPLEMENTING THE INITIATIVE

Creating Change at USAID

The heart of USAID's program lies in its field missions, and microenterprise development programs are best designed and managed in the field. USAID is restructuring incentives for missions to strengthen their commitment to microenterprise development.

- Mission strategies increasingly include microenterprise as an area of concern.
- Despite budget reductions in other areas, USAID plans to increase total funding for microenterprise during the next few years, to \$130 million in fiscal year 1994 and \$140 million in fiscal year 1995. Bureaus will be asked to ensure that their programs reach these targets.

- The administrator has asked Dick McCall, the agency's chief of staff, to ensure that all parts of USAID work together to move the initiative forward.

USAID will develop expanded central mechanisms to support the initiative both financially and technically. Central support is crucial to ensure that new programs receive the benefits of cross-fertilization, high standards of performance and cutting-edge innovation.

- The administrator has bolstered the Microenterprise Development Office with a significantly larger staff to act as the hub of the initiative. For 1995 implementation, that office will design a Microenterprise Innovation Program, with the following elements:
 - Financial resources to leverage mission programming in microenterprise, particularly where such leverage can spark important innovation.
 - Financial resources to support selected organizations directly, such as U.S. private voluntary organizations (PVOs), non-governmental organizations (NGOs) and credit unions, for innovative, cutting-edge programming.
 - Expanded capacity to provide technical assistance to missions and other organizations. The office also will perform essential research, training, monitoring and evaluation duties.
 - Development of better tools for monitoring the performance of USAID-supported programs and assessing their impact on entrepreneurs
- The existing PVO Matching Grant Program and Micro and Small Enterprise Loan Guarantee Programs will expand the portion of their funding that supports microenterprise, under the guidance of the coordinator of the initiative

FISCAL YEAR 1994 STATE-OF-THE-UNION

To begin the initiative quickly, USAID has expanded three existing microenterprise programs in 1994. Despite severe budgetary constraints, central funding for microenterprise activities for fiscal year 1994 will be between \$20 million and \$23 million.

- A facility for leveraging mission programming will be available for 1994, based on a revision of the existing Anti-Poverty Lending Project (APPLE) authorization.
- The Bureau for Humanitarian Response's Office of Private and Voluntary Cooperation PVO Matching Grant Program will give increased support to microenterprise. This year the program expects to allocate approximately \$3 million to microenterprise development compared to \$4.2 million in fiscal year 1993.
- The Micro and Small Enterprise Development Program will increase support to microenterprise this year. With its \$1 million in subsidy appropriation, it can leverage approximately \$25 million in lending to the micro and small business sectors in 1994. Programs with substantial funding for microenterprise this year include the West Bank, Sri Lanka, Indonesia, Bangladesh, South Africa and a regional program in Latin America.



USAID Microenterprise Initiative

Summary - June 1994

To support poor entrepreneurs around the world, the Microenterprise Initiative raises microenterprise development to a level of priority within the program of the U.S. Agency for International Development (USAID).

POVERTY LENDING PROGRAMS

The Microenterprise Charter makes microenterprise development a prominent part of USAID's economic growth strategy for reaching the poor. USAID has set a goal of devoting half of all its support for microenterprise programs to poverty lending programs or the poverty lending portion of mixed programs by the end of fiscal year 1996. Poverty lending programs are defined as those that serve the very poor, with reference to loan sizes below \$300 in 1994 dollars.

KEY PROGRAMS

- Increases in overall support for microenterprise from an estimated \$80 million in fiscal year 1993 to targets of \$130 million and \$140 million in fiscal years 1994 and 1995, respectively
- A commitment that 35 percent of dollar funding for microenterprise (about \$38 million) will go through USAID/Washington in 1995 and 1996, while the majority of the program continues to be funded by USAID field missions. Central funding for microenterprise in 1994 has already grown to \$23 million.
- A Microenterprise Innovation Program of \$30 million for 1995 and again in 1996, with a new grant program to support microenterprise programs of non-governmental organizations (NGOs), private voluntary organizations (PVOs) and other institutions; matching funds to increase mission support for microenterprise; and expanded technical assistance in design, monitoring and evaluation.
- Increases in the existing PVO matching grant program (to \$8 million in microenterprise funding) and the Micro and Small Enterprise Loan Guarantee Program.


IMPLEMENTATION

- Designation of USAID's chief of staff as coordinator of the initiative; a strengthened Office of Microenterprise Development in the Bureau for Global Programs, Field Support and Research.
- Revised monitoring systems, including establishing performance indicators that are practical to measure and accurate reflections of results achieved. Review of central mechanisms of the initiative in 1996.

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Charter of the
USAID Microenterprise Initiative

The Microenterprise Initiative

 captures no aspect of development is more important than economically empowering the individual. Economic vitality is a crucial linchpin in improving living standards and generating the increased incomes that allow for better education, health care, family planning, environmental protection and community involvement. Microenterprise is one of the most important means by which vast numbers of people throughout the world seek to improve their well-being. In many countries, particularly lower income countries, a third or more of the labor force is often engaged in microenterprise. This is particularly true in instances where other formal sector employment is limited. In launching its microenterprise initiative, the United States Agency for International Development (USAID) affirms that support for microenterprise will be a central component of an approach to economic growth that stresses increasing the economic participation of the poor. In particular, USAID is strengthening its capacity to support poverty-reducing programs.

The microenterprise initiative entails an enduring commitment to microenterprise by the agency. USAID has long been active in the microenterprise field and has made a number of important contributions to its progress, but microenterprise has not always been a consistent agency priority. Through the microenterprise initiative, USAID raises its

microenterprise activities to a level that is more closely in keeping with its mandate to empower the poor and establishes microenterprise as a viable and integral part of the agency's sustainable development strategy.

The microenterprise initiative encompasses a number of activities. First and foremost involves support for microenterprise development programs carried out by local organizations that offer credit, savings, advocacy, training or similar services. A wide variety of organizations can effectively nurture microenterprise, including governmental organizations, private voluntary organizations (PVOs), non-governmental organizations (NGOs), associations, cooperatives, credit unions and financial institutions. The microenterprise initiative seeks to use each of these types of organizations wisely and complementarily.

In addition, the microenterprise initiative seeks to foster greater awareness throughout the agency of the importance of microenterprise and the need to more fully integrate its consideration into the broadest range of USAID programs and policies, such as in agricultural development, economic growth, urban development and health. For example, macro-economic policy-making should be concerned about restraining policies and regulations at the national and local levels that constrain small and microenterprises.

The Goals of the Initiative

There are three primary development goals for the microenterprise initiative:

To assist the efforts of the poor to increase their income and assets. Microenterprises have been shown to be an effective means of increasing the income and assets of the poor in developing countries. This economic empowerment will, in turn, allow the traditionally disadvantaged to gain access to better standards of health, housing, nutrition and education. In the poorest countries, microenterprise can outperform more formal enterprises in this dimension.

To increase skills and productivity to enhance economic growth. Microenterprises develop entrepreneurial and managerial abilities among their proprietors. In some countries they are important sources of technical skills training for young people, and they have the capacity to spread innovation quickly. Also, growing microenterprises can serve as a primary source of new demand for labor.

To facilitate the development of "economic democracy." Through microenterprise programs a wide range of local institutions is created. Some of these are highly participatory community-based organizations, such as village banks or credit unions, which groups of villagers manage pools of savings and loans. Others are more formal, such as partnerships between non-governmental organizations and commercial banks. Some are concerned with financial services, while others are focused on advocacy. In some instances, the aim is to develop sustainable structures through which disadvantaged groups gain greater access to resources and establish the poor as more effective participants in their societies. These organizations are an important aspect of civil society. However, the crux of all microenterprise activities still remains basic financial services, i.e., the institutional capacity to provide financial and other services without external subsidy.

A Focus on Results

Realizing the goal of better opportunity for microentrepreneurs requires direct action by institutions that serve or affect microenterprise, and this is the area where USAID will direct its efforts. USAID's operational approach will focus on:

- Increasing access to the provision of credit and savings services provided by a variety of sustainable financial service institutions. The initiative seeks to catalyze and/or changes in the effectiveness, efficiency, and scale of services provided.
- Providing innovative non-financial assistance (e.g., technical and managerial training, marketing and technology development) to microenterprise entrepreneurs in a cost-effective manner.

- Strengthening the capacity of local organizations, such as NGOs and associations, to have a voice in the policy process affecting microenterprise development at both national and local levels.
- Fostering an enabling environment for microenterprise development through policy change (e.g., improving the legal and regulatory environment, reducing barriers to credit and information) and access to both microfinance and other services.

USAID will provide support through its local operational presence for training, research and policy dialogue.

Program Principles for Microenterprise Development

The past decade of experience in the microenterprise development field has shown that certain principles are critical to the success of microenterprise programs. The following principles are integrated throughout USAID's initiative:

- **Commitment to significant outreach.** Microenterprises are a global phenomenon and yet only a small fraction of microentrepreneurs have access to the financial and other services that microenterprise programs sponsor. USAID's microenterprise programming will strive to achieve significantly greater outreach.
- **Continued focus on women and the very poor.** The microenterprise initiative will maintain a particular concern for very poor entrepreneurs, especially women, who may be more difficult to reach, but who depend for survival on microenterprises. USAID is committed to allocating half of all funding for microenterprise activities to support poverty lending programs by the close of fiscal year 1996. In this context, poverty lending programs are those that meet the needs of the very poor members of society, particularly women, and that provide loans smaller than a reference point of \$300.
- **Sustainability and financial self-sufficiency.** Fostering sustainability is essential, particularly in an era of shrinking foreign assistance flows. The USAID microenterprise initiative will assist financial services programs to develop financially self-sufficient operations and to tap more permanent sources of funds, including local savings, borrowing from local banks and increasing U.S. private sector funds.

- **Partnership with governmental organizations, PVOs, NGOs, associations, credit unions and other local institutions.** USAID will seek improved local partnerships, working through a variety of mechanisms, including strengthening programs funded in Washington as well as those funded by USAID missions.
- **Partnership with other multilateral and bilateral donors and other U.S. organizations, especially Peace Corps.** USAID will strengthen linkages with other donors and U.S. government agencies to promote the expansion of microenterprise activities.
- **Performance standards.** The most experienced microenterprise institutions should be encouraged to push forward the frontiers of achievement, while the newer entrants should be urged to meet performance standards that move them up the ladder of sustainability.
- **Improved information about the effectiveness of microenterprise programs and policy changes.** Among concerns are the cost-effectiveness of services, the impact on enterprises (increased sales and employment) and the effect on the quality of life of microentrepreneurs and their families.

The microenterprise initiative will continue to support the high degree of innovation that has characterized the microenterprise development field and has contributed to its rapidly expanding levels of achievement.

Management Challenges

The microenterprise initiative will incorporate microenterprise development into agency programming at a level that is in keeping with its high priority in USAID's new development strategy. The initiative aims to increase USAID's technical and staff capacity in microenterprise development. The microenterprise initiative must also increase the knowledge of microenterprise development among key staff and deploy available technical resources efficiently.

USAID will develop mechanisms for greater cross fertilization among its worldwide programs to ensure that its projects are based on the best models in the field. The microenterprise initiative also will strengthen funding mechanisms in Washington to channel resources more efficiently through NGO networks.

Improved monitoring of program performance and results is essential. At present, performance information is inaccessible and non-comparable across programs. Improvement in this area would lead to better programs, better allocation decisions about scarce aid resources and greater ability to demonstrate what aid accomplishes. Similarly, improved donor policy coordination in microenterprise, particularly in the areas of support for program sustainability and of advocacy for policy change, will result in a more effective program.

USAID also will seek to improve public education of development efforts by demonstrating that what the agency is learning in developing countries provides valuable lessons for microenterprise development at home.

Conclusion

The microenterprise initiative will be guided by the framework set forth in this charter, signed June 22, 1994, and serve as an agenda for economic empowerment through microenterprise.

J. Brian Stovall Director U.S. Agency for International Development	Jim Gronlund Chairman Subcommittee on Economic Policy, Trade and Environment House Foreign Affairs Committee		



From USAID's Office of Microenterprise Development:

What Are Microenterprises and What Activities Does the USAID Microenterprise Initiative Support?

This statement is intended to answer some of the questions frequently asked about USAID's Microenterprise Initiative.¹

Microenterprise Characteristics

Microenterprises are very small, informally organized, non-agricultural businesses that often employ a third or more of the labor force in lower-income countries. Many microenterprises employ just one person, the owner-operator or "microentrepreneur". Some microenterprises include unpaid family workers, and others may have one or several hired employees. Although no single characteristic distinguishes microenterprises from small enterprises, USAID has adopted a threshold of ten employees, including the owner-operator and any family workers, as the upper bound for an enterprise to be considered "micro".

Another important characteristic of a microenterprise is the level of assets or income—both of the business and those working in it. USAID has targeted its Microenterprise Initiative at the businesses run by and employing the *poor*. While definitions of poverty differ from one country context to another, Missions should ensure that any microenterprise programs they support benefit the most disadvantaged members of the sector. When screening potential clients, instead of means testing, successful microenterprise programs tailor their services to be attractive to the poor. Poverty lending programs, for example, use very small loans to reach the poorest clients and are an important part of the Initiative. The USAID Administrator has pledged that one half of all financial support to microenterprises will go through poverty-lending programs or through the poverty-level portions of mixed programs. USAID has traditionally used a loan size of \$300 as a reference point in defining poverty lending.

Goals and Principles

As primary goals, the Microenterprise Initiative seeks to help the poor increase their income and assets, raise their skills and productivity, and form organizations that facilitate their more effective participation in society. In so doing, programs receiving USAID funding incorporate the following principles: a commitment to significant outreach of services, a continued focus on women and the very poor, a striving for sustainability and financial self-sufficiency, an adherence to rigorous performance standards, a sharing of information on best practices, and a fostering of innovation in both programs and supportive policy change. Programs supported by Missions should be committed to financial viability and have a credible plan for attaining it. Before receiving funding, existing programs should also demonstrate their ability to maintain low levels of delinquency and default while charging cost-recovery interest rates on loans.

¹The notice is for information only and does not replace USAID's Policy Determination #17 (PD-17) on Microenterprise Development. PD-17 is currently being revised.

Ways to Implement Programs

In promoting microenterprise development, Missions are encouraged to form partnerships with non-governmental organizations, associations, credit unions, banks, cooperatives, or other local institutions. A number of institutional paths are possible. Similarly, programs may use a variety of mechanisms including village banking, peer group "solidarity" lending, innovative individual savings and credit programs, and experimental, cost-effective techniques in non-financial assistance. Non-financial assistance might involve technical and management training, advocacy, or the release of market and infrastructural constraints identified in subsector analyses. Interventions may also encompass support of an enabling environment for microenterprises through institutional and economic policy change such as improvements in the legal and regulatory framework or reforms in the financial sector.

Microenterprise programs may range from an exclusive focus on non-financial assistance to programs concentrating solely on micro-credit delivery. Non-financial programs, particularly those that involve training, tend to be expensive and in most cases will be unable to cover costs through fees for services. Missions should exercise caution in funding these kinds of activities. Such programs may need to experiment with new techniques to increase their efficiency in service delivery.

Missions may want to wean successful micro-credit programs from continued dependence on donors' funds by helping the institutions transform into licensed financial intermediaries able to borrow from commercial banks and mobilize deposits from the public. Once licensed, the newly created intermediaries have the potential to leverage donor investments by several times or more.

Activities Not Included

In designing new programs, Missions should be aware of what does not constitute microenterprise development. Enterprises owned and operated by middle- or high-income persons, such as professional partnerships or small consulting firms, are not eligible for support under the Microenterprise Initiative, regardless of their size. Congressional interest in microenterprise development has always centered on reaching the poorest entrepreneurs. Missions should, therefore, not label as microenterprise development any programs that do not specifically address the sector in ways described above. For example, general policy reforms or agricultural-crop lending may, in fact, indirectly benefit microenterprises, but should not be classified as microenterprise development programs. Some microenterprise programs may also provide support to small businesses, but should clearly distinguish the different enterprise categories when reporting to USAID/Washington and the Congress.

Questions?

If Missions have any questions concerning this statement or whether particular activities fit under the Initiative, please contact Elisabeth Rhyne, Director of the Office of Microenterprise Development (G/EG/MD).

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THE ADMINISTRATOR

A.I.D.POLICY DETERMINATIONMICROENTERPRISE DEVELOPMENT PROGRAM GUIDELINESA. Statement of Objectives

Microenterprise assistance is an important element of A.I.D.'s private enterprise development strategy. It is particularly important in advancing the goal of broad-based economic growth and, specifically, increasing incomes of the poor, providing opportunities for advancement of micro-entrepreneurs, and encouraging indigenous investment. The microenterprise subsector includes the whole spectrum of productive activities ranging from rural-based agribusinesses and handicraft production to urban-based trading, service, and manufacturing enterprises, many of which are labor-intensive.

The policy guidelines described below were developed to ensure that the resources provided under A.I.D.'s microenterprise development program benefit the many and diverse business efforts of the poor.* The program's objective is to help people with limited or no access to

* Many A.I.D. policy guidance documents identify important issues that need to be addressed in designing A.I.D.'s assistance to lower-income groups in both the formal and informal sectors in developing countries. The policy guidelines contained herein should be applied by Missions in concert with those in the A.I.D. policy papers on Financial Markets Development (August 1983), Cooperative Development (April 1985), Private Enterprise Development (revised March 1985), Women in Development (October 1982), and Private and Voluntary Organizations (September 1982); the Guidelines on Terms of Aid; and the guidance contained in cables 1986 STATE 259310 and 259314 on the private enterprise local currency lending program contained in sections 106 and 103 of the Food Security Act of 1985. Some of these policies are summarized in the annex to this guidance.

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capital achieve a level and quality of business activity that will permit increased access to formal financing and technical services and expand productive employment and incomes. Development Assistance funds, Economic Support Funds, and local currencies support programs that develop institutions that serve microenterprises and that provide microenterprises with credit, training, and technical assistance.

B. General Program Guidelines

1. Program Earmark and Funding Information. A.I.D.'s FY 1988 appropriations legislation required that A.I.D. make available not less than \$50 million of the Agency's FY 1988 DA and ESF appropriations to implement a microenterprise development program. A.I.D.'s FY 1989 appropriations legislation increased the earmark to \$75 million. Missions will be informed annually by AID/W of changes in the earmark level. Local currencies that result from nonproject assistance (such as cash transfers, CIPs, and PL 480 sales) may be used in lieu of dollars to achieve the objectives of the legislation. This earmark may be met through the funding of credit, technical assistance, training, or related activities directed at microenterprises. Missions should be creative in seeking funding and project approaches to implement this program.

2. Program Beneficiaries. There is no precise definition of a microenterprise. As a working definition, subject to the following exceptions, a microenterprise should have no more than approximately 10 employees and should have characteristics (assets, revenue, etc.) that fit well within the framework of objectives set forth below. Special emphasis should be placed on small-sized and individually-owned productive activities. An attempt to define or limit the size of a microenterprise too severely would exclude from the program some enterprises that Congress desired to receive the benefits of the program, i.e., enterprises made up of poor people, such as a rural, community-based firm owned and operated by 20 women or certain cooperatives. Furthermore, the objective of gradually advancing an enterprise to access formal sources of financing could be undermined with too severe a limit based upon the firm's employees.

Missions may well have to use a locally appropriate definition of microenterprise. This definition should be delineated in project or program documentation. Missions should focus on assisting new as well as existing

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enterprises. Programs should be designed ideally to (a) seek out the very smallest enterprises and, among them, those with the greatest potential for expansion; (b) help firms access formal systems of financing and technical services; and (c) make at least 50 percent of their resources (credit, technical, and training) available to women-owned and -operated enterprises.

Missions should note that the conference report accompanying the appropriations legislation suggested some levels or classifications of program beneficiaries: (a) individuals in the poorest 50 percent of the population, (b) businesses owned by women, and (c) businesses owned and operated by the poorest 20 percent of the population.

3. Policy Dialogue. Microenterprises often face a macroeconomic policy and administrative environment that contains serious market access and entry barriers. Although A.I.D. may be able to address some of these problems through microenterprise assistance activities, Missions should seek to address these problems in their other policy dialogue efforts as well. Conversely, where successful policy reform efforts create private business opportunities in a given area, Missions should consider special emphasis in existing programs or new microenterprise activities to reinforce the policy change and exploit the opportunity presented in favor of microenterprises.

Some policies that have a particularly negative effect on microenterprises and inhibit their graduation to the formal sector are:

- o Interest rate ceilings that encourage financial institutions to ration credit towards favored large clients, discriminate against riskier microenterprises, and discourage savings mobilization;
- o Trade and investment policies that promote large-scale industry and are biased against agriculture (such as foreign exchange rationing and tariff systems);
- o Tax laws that often offer low tax rates to larger enterprises and encourage the use of capital-intensive activities; and
- o Restrictive regulatory and legal systems that create considerable obstacles for small firms, thereby encouraging informality and discouraging access to benefits afforded to legally constituted firms.

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4. Access to Program Resources. In general, the provision of credit and technical assistance under this program is aimed at enterprises or entrepreneurs that cannot access formal sources of credit. Although special microenterprise programs may be developed with banking and other intermediate financial institutions (IFIs), an important objective of A.I.D.'s efforts is to introduce microenterprises into the formal financial system. Therefore, A.I.D.-financed technical assistance may be used to assist microenterprises to access the banking system even in the absence of a special microenterprise "window". In such instances, the microenterprises benefit even though they are not specifically targetted by a particular credit program.

5. Microenterprise Credit Activities. A frequent approach to assisting microenterprises is the provision of credit.

a. Loan Size. The average loan size should not exceed \$300 unless there are indications that larger-sized loans are needed to achieve the objectives of this program. For programs where prevailing country conditions make the \$300 limit unreasonable in terms of meeting program objectives, Missions should set forth the reasons for the higher loan size in project or program documentation.

Although the \$300 loan size was originally proposed by Congress as a mechanism for directing A.I.D.'s assistance towards new enterprises, such a limitation may (1) deny program resources to viable microenterprise program candidates, (2) be difficult for Mission programs to meet due to such factors as differing country conditions, and (3) bias policy against microenterprise growth to a viable size in some economic sectors. The loan size should be small enough to reach the target beneficiaries but sufficient to achieve the objectives of the program.

b. Interest Rates and Associated Costs :o
Microenterprises. The setting of interest rates is an important element in a program designed to promote viable microenterprises and financially viable and sustainable IFIs. Where practicable, the interest rates and associated fees charged to a microenterprise by an IFI should reflect the full cost of the credit provided. Such an approach will reduce the likelihood of decapitalization and increase savings mobilization. If interest rates, collateral requirements, or repayment periods are administratively imposed by the government, the terms agreed to in A.I.D.-supported activities will be part of a planned effort to

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encourage governments to move progressively toward market terms.

The interest rate to be charged on loans to microenterprises (1) shall, at a minimum, be at or near the prevailing interest rate paid on Treasury obligations of similar maturity (to the maximum extent practicable), and (2) should not be less than terms prevailing locally or a rate that approximates the opportunity cost of capital in that country. At a minimum, the interest rate to ultimate private borrowers should be significantly positive in real terms, i.e., when adjusted for inflation.

In many cases, the transaction costs of microenterprise loans are greater than similar costs associated with commercial loans. These costs include the costs of funds mobilized or borrowed; the normal premiums for the higher risks of term loans or devaluation risks for loans denominated in foreign currency; the administrative costs of providing loans to microenterprises; any extraordinary costs of non-bank services furnished the microenterprises or of supervising the sub-loans; and a reasonable profit margin for the IFI. Missions may wish to provide technical assistance to reduce loan transaction costs in the credit delivery system and to encourage greater linkage with the formal financial system.

It is recognized that, in most cases, most of the initial loan activity in this program will be short-term.

c. Terms to IFIs. The interest rate charged to commercial intermediaries that act as IFIs for this program (1) should be at least equal to the cost of local, nonconcessional sources of capital; (2) approximate the cost of lendable resources of comparable maturities from the local private capital market (if such resources exist); and (3) be based on the appropriate rate to the ultimate borrowers. If interest rates within a particular country are held down artificially by government policies, the rate charged to the IFIs should be set within the context of U.S. efforts to encourage adoption of free market interest rates.

IFIs should strive to develop more simplified application processes, where appropriate, as well as to link and accelerate the movement of borrowers into the formal financial system.

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PVOs and cooperatives should be encouraged to work with and through existing IFIs to handle credit components of the program. Where this is not feasible, grants may be made available to PVOs and cooperatives for certain startup costs of becoming IFIs under this program.

6. Technical Assistance and Training. Another common approach to assisting microenterprises is the provision of technical assistance, such as management, marketing, or production support. Many microenterprise projects involve training or extension services to microenterprises, either as a self-contained technical assistance and training project or as a component of a credit project. As past experience has demonstrated the value of charging recipients for technical assistance and training, programs offering these services should strive for increasing cost recovery over the life of the program.

Studies have concluded that training and extension services are a potentially effective vehicle for reaching the poorest or smallest enterprises if:

- o The training is simple and builds on existing knowledge relevant to microenterprise level needs;
- o They advise or serve as a broker in dealing with government regulations and licensing procedures; and
- o The recipients are organized into groups or associations, thus reducing the unit costs of reaching them.

Evaluations of successful technical assistance projects aimed at assisting microenterprises and small scale enterprises indicate a number of common traits:

- o Focus on a "single missing ingredient" rather than addressing multiple constraints;
- o Give priority to addressing the needs of particular industries and problems; and
- o Concentrate support on established enterprises, rather than attempting to create new enterprises.

7. Institutional Intermediaries. A.I.D. should maximize the use of private sector institutions (i.e., commercial banks, credit unions, cooperatives, PVOs/NGOs, village banks, and training organizations) when such institutions operate as intermediaries in this program.

Strong preference should be given to strengthening and working through local privately-owned and controlled

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institutions. When utilizing section 106 and 108 local currencies for microenterprise assistance, Missions should follow the provisions contained in cables 1986 STATE 259310 and 259314 on the private enterprise local currency lending program described in the Food Security Act of 1985. When utilizing funds other than section 106 and 108 local currencies, Missions should follow the guidance contained in the Private Enterprise Development Policy Paper (revised March 1985).

It is especially important that intermediaries work as directly as possible within the community of the beneficiaries of credit and technical assistance. When appropriate, credit could be extended through groups or similar mechanisms that use business or individual reputation in the community as a primary decision criteria in credit allocation. Encouragement of the participation of women in the decision-making and management of intermediaries should also be emphasized.

In selecting IFIs, A.I.D. should give particular attention to the existence of or plans to attain the following desirable institutional characteristics:

- o Financial soundness - demonstrates reasonable prospects for long-term viability;
- o Orientation toward microenterprise lending;
- o Market-based pricing policies - demonstrates a willingness and ability over time to operate in the market without reliance on subsidies;
- o Capital mobilization capability - demonstrates capability to mobilize capital from internal savings programs and/or from access to local capital markets;
- o Portfolio and client diversification - diversification relative to loan purpose and type of borrower or in other ways reduce exposure;
- o Complementary financing capability - demonstrates potential over time for providing other financial services to meet the diversity of borrower needs;
- o Support system - demonstrates potential, over time, for forming part of a network or system capable of providing financial, technical, and managerial assistance.

A.I.D. should strive to obtain life of project funding for more than the three to five year norm and allow for the long-term assistance provided to the IFI to achieve the result necessary for sustained operations beyond project life.

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ANNEX

CURRENT A.I.D. POLICIES
RELATED TO MICROENTERPRISE DEVELOPMENT

The promotion of microenterprise development is consistent with A.I.D.'s emphasis on market-based growth and the involvement of the private sector in development. A.I.D. policy has reflected this orientation for some time. Policy papers on Financial Markets Development, Cooperative Development, Private Enterprise Development, Women in Development, and Private and Voluntary Organizations all play important roles in shaping A.I.D.'s framework for supporting microenterprise development. Some aspects of these policy papers are summarized below.

1. Financial Markets Development (August 1988)

The Financial Markets Development policy paper describes A.I.D.'s policy on financial markets development and provides guidance on the development of A.I.D.'s programs and projects in financial markets. A.I.D. tries to promote a system of financial markets that is integrated and relatively undistorted, one that relies heavily on competitive financial institutions, and on policies to facilitate competition. This system should be capable of effectively mobilizing private savings, allocating that savings to investments yielding maximum returns, and maximizing the participation of the general populace.

Among the subjects discussed are macroeconomic policies, encouraging and mobilizing domestic private savings, credit allocation policies, legal and regulatory constraints, tax policies, institutional development, credit policy, financial training and standards development, and new financial instruments and institutions.

Specific guidance is provided on the informal sector. The policy paper recommends that A.I.D. encourage host governments to adopt specific reforms that increase access to formal sources of credit and that A.I.D. should sponsor studies on the nature and functions of informal financial markets.

A.I.D.'s assistance to the informal sector has historically been in the form of project-based credit and technical assistance. Although many A.I.D. programs directed at microenterprises and informal sector enterprises have

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demonstrated that these enterprises are reliable borrowers and can be reached cost-effectively, studies have shown that providing credit alone to microenterprises only rarely produced self-sustaining gains; increases in income were short-lived.

Informal sector enterprises often face a policy and administrative environment that contains serious market access and entry barriers. Some macroeconomic policies have a negative impact on informal enterprises and serve as entry barriers to the formal sector. These issues should be addressed within the framework of A.I.D.'s assistance to the informal sector.

A.I.D. should also continue to encourage formal financial institutions to serve the same clientele served by the informal financial markets. In the process, the more efficient formal markets gradually displace less effective informal markets. The best examples are those involving the extension of formal financial systems to better serve the growing financial demands of small farmers and small scale entrepreneurs. This approach depends for its success on the truth of an assumption that formal financial markets are more effective than informal institutions under appropriate circumstances. Although this assumption is generally borne out over the long run, it may not be correct in some markets in the short run.

To facilitate graduation to commercial borrowing, A.I.D. should foster the involvement of formal financial institutions in the informal system. For example, it may be useful to have a representative from a local private bank involved in an A.I.D.-sponsored informal sector lending program conducted through a PVO. This might facilitate an informal enterprise's graduation from the A.I.D. program to commercial banks by increasing the bank's familiarity with the borrower (and much of that segment of borrowers) while establishing a credit history in which the bank has confidence.

2. Cooperative Development (April 1985)

The Cooperative Development policy paper discusses the rationale for A.I.D.'s work with cooperatives and its objectives for the cooperative development. A.I.D. supports the development of cooperative organizations because cooperatives embody aspects of the principles of voluntarism, democratic choice and the economic effectiveness of private enterprise that historically have shaped our own nation's development.

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Two important points made are:

- o Cooperatives are able to reach and benefit sectors of the population that would not normally be served by other private sector institutions or direct government programs.
- o Cooperatives offer an attractive alternative to public sector programs. The paternalistic approach of governments and absence of competition provide little incentive to seek efficient methods of product or service delivery. A cooperative, because it is recipient owned, has an automatic incentive to maximize benefits to the members.

3. Private Enterprise Development (revised March 1985)

A.I.D.'s private enterprise initiative is directed at the development of the LDC's private sector. The policy paper states that the goals of A.I.D.'s policy toward private enterprise are:

- o to encourage LDCs to open their economies to a greater reliance on competitive markets and private enterprise in order to meet the basic human needs of their poor majorities through broadly-based self-sustained economic growth, and
- o to foster the growth of productive, self-sustaining income and job producing private enterprises in developing countries.

The Private Enterprise Development policy paper also identifies A.I.D.'s target group for private enterprise development activities. It repeats Sections 101 and 102 of the Foreign Assistance Act of 1961 (FAA), as amended, stating that one of the four principal goals of U.S. foreign economic assistance is ". . . the alleviation of the worst physical manifestations of poverty among the world's poor majority. . . .".

Consistent with this, it further declares ". . . that the principal purpose of United States bilateral development assistance is to help the poor majority of people in developing countries to participate in a process of equitable growth through productive work . . .". The policy paper directs that projects which implement A.I.D.'s private enterprise policy should clearly demonstrate the linkages between the activity that is to occur on the project and progress toward this primary FAA objective.

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Specific policy guidance in the policy paper addresses activities that include policy dialogue, legal and regulatory constraints, assistance to the indigenous private sector, private sector participation in the provision of traditional government services, parastatals and government authorized monopolies, capital saving technology, training, and infrastructure.

With respect to the informal sector, the policy paper stated A.I.D.'s belief that the operation of the heterogeneous, dynamic and largely unregulated informal economy provides a powerful argument in favor of eliminating uneconomic controls on the formal economy. In countries amenable to policy dialogue and related reforms, direct A.I.D. assistance to enhance the importance of the informal economy is a valuable complementary program to policy dialogue with the LDC governments. In countries that are reluctant to discuss policy, assistance to productive activities carried out in the informal private sector may be the only effective way to stimulate broad-based growth and development. A.I.D. has a strong interest in programs which support the informal private sector.

4. Women in Development (October 1982)

Poor women in developing countries bear major economic responsibilities, yet they are generally less well educated than men and have less access than men to modern productive resources. Thus, they often fill jobs which require little skilled work and are among the lowest paying. In the Women in Development policy paper, A.I.D. recognized that the productivity of women is important to personal, family and national well-being, and that women's productivity depends on their improved access to resources, e.g. land, improved farming techniques, information, and employment.

As a matter of policy, A.I.D. will:

- o seek to increase relevant knowledge and skills among women and girls where lack of education and training constrain women's effective access to more productive work;
- o support the development of labor-saving technologies which are acceptable and accessible to women where inefficient technologies reduce women's overall productivity; and
- o support efforts to alleviate the bias, through policy reform and/or experimental programs which

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demonstrate ways in which women can enter nontraditional types of work where systematic bias exists against females in the labor force, or in certain segments of the labor force.

Effective implementation of A.I.D.'s Women in Development Policy depends on the policy being reflected throughout A.I.D.'s portfolio. This is to be done primarily by:

- o introducing gender distinctions in the terminology employed in all of A.I.D.'s program and project documents in order to define more precisely the social context and impact of A.I.D.'s work;
- o disaggregating by sex data collected for A.I.D.'s country strategy formulation, project identification, project design and throughout the life of projects;
- o requiring A.I.D.'s country strategy, project identification and planning documents to explicitly describe strategies to involve women, benefits and impediments to women and benchmarks to measure women's participation; providing substantive analysis of these statements during the process for their review; and
- o evaluating and assessing the impact of A.I.D.'s programs and projects according to gender differentials - both in relative and absolute terms - with regard to improvements in access to and control over resources and predicted benefits and returns.

The policy paper discusses actions to be taken in both the formal sector and informal sector. Although general trends in developing countries show women's participation in the formal labor force to be low, increasing population pressures and the inability of the formal sector to accommodate the expanding labor force has pushed more people, especially women, into seeking employment in the informal sector.

In the formal sector, the policy encourages attempts to break the pattern of women's relegation to low-productivity occupations with no growth potential. A.I.D. can accomplish this by designing into projects the expansion of employment opportunities in sectors where women have not traditionally worked, and in those relatively new sectors of the economy where gender-specific work roles are not yet entrenched. In addition, A.I.D. can support and fund occupational training programs for women.

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In the informal sector, a variety of programs for small entrepreneurs and microenterprises have been successful, and can be adapted for women. A.I.D.'s decision to focus on technical assistance and/or provision of credit through financial intermediaries must depend on the particular situation. However, in many countries there are substantial numbers of self-employed women, particularly in micro and small industries, who will gain from enhanced managerial, administrative, and financial skills, as well as from the formation of cooperative institutions.

Specific policy guidance is also provided in such areas as women in agricultural development, human resources, education, energy and natural resource conservation, and water and health.

5. A.I.D. Partnership in International Development with Private and Voluntary Organizations (September 1982)

The policy paper on Private and Voluntary Organizations presents the rationale for A.I.D.'s work with private and voluntary organizations and the procedures that the Agency will follow in this area. The paper states that PVOs are a heterogeneous universe - diverse in their expertise, size, bases of support, and modes of operation. PVOs bring unique skills to the job of Third World development and can be a means for effectively engaging the rural and urban poor in their nation's development.



Alan Woods

10 October 1988
Date

ANNEX C
PEOPLE AND ORGANIZATIONS VISITED
DURING THE MICROENTERPRISE DEVELOPMENT SURVEY

People and Organizations Visited During The Microenterprise Development Survey

January

9	Monday	Janasaviya Trust Fund	A.A.S.M.Ali, Director of Credit
10	Tuesday	Central Bank Central Bank Sanasa Federation	P.T.Sirisena, Director of Bank Supervision W.A.Wijewardena, Director, Rural Credit L.B.Dasanayake, General Manager P.W Abayawickrama, Financial Consultant
11	Wednesday	Mahaweli Enterprise Development Project Hatton National Bank Agromart Outreach Foundation Central Bank	James R. Finucane, COP Sunil Amarasinghe, Director D.Wijesundera, Assnt General Manager Ms. Beulah W. Moonesinghe, Chairperson. G.I Hewapathirana, Project Director Mrs. M.N R.Cooray, Additional Secretary, Banking Development Dept.
12	Thursday	TIPS AgEnt	Spencer T. King, CEO Richard Hurelbrnk, Managing Director Ralph Chaffee, Financial Advisor Anthony Dalgleish, Marketing/Agro-processing Advisor
13	Friday	Industrial Services Bureau, North Western Province AgroMart Mahaweli Enterprise Development Project (Madatugama Business Center)	Gamini Senanayake, Director Training Center Jayantha Jayewardena, Deputy COP M.W Panditha, Credit Advisor
14	Saturday	SANASA Community Action Foundation (NGO)/JTF	Unit Manager, Walas Wewa Community Organizer, Kurunegala.
17	Tuesday	Ministry of Agriculture	Mr. B Warsakoone, Additional Secretary.
18	Wednesday	UNDP Ministry of Youth Affairs, Sports & Rural Development	T K.Barman Mr. R.M. Ratnayake, Secretary

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19	Thursday	Hatton National Bank People's Bank	R.T.Wijetilleke, Managing Director & Chief Executive Daya Muthukumarana, Deputy General Manager S.S.A.L.Siriwardena, Director of Research Titus Abeysinghe, Assnt. General Manager Carmel Goonetilleke, Deputy Chief Manager
21	Saturday	Janashakthi Sangum Bank Hatton National Bank	W.G. Mithraratne, Government Agent, Hambantota S.H. Chithrani Dammika, WDF Organizer, Hambantota
27	Friday	The Asia Foundation National Planning Department	Edward H. Anderson, Representative. Mrs. Chitra Perera, Director
30	Monday	Swisscontact, Kalutra	Mr. W. van der Veer, Project Manager
1	Wednesday	IRDP, Min. Planning & Implementation	Mr. Amerasekera, Director
2	Thursday	Center for Women's Research Sri Lanka Business Development Center Women's Chamber of Industry and Commerce	Prof. Swama Jayaweera, Joint Director Mrs. Thana Sanmugam, Joint Director Dr. Abhaya Attanayake, Managing Director Suriyakanthi Mellawa, Chairperson Mrs. S P Gunasinghe, 1st Vice-Chairperson Mrs. Wangasekera, 2nd Vice-Chairperson Mrs. Ramola Sivasundaram, Joint Secretary
3	Friday	CARE International, Sri Lanka SANASA	Lora Wuennenberg, Assistant Country Director Swama Kodagoda, Director/Training Robert F. Lestina, Consultant, WOCCU. P.W. Abayawickrama, Financial Consultant
6	Monday	Central Bank Chambers of Commerce	M.G. Senanayake, Dep. Director, Banking Development Dept. Patrick Amerasinghe
7	Tuesday	CIDA Mahawelli Authority of Sri Lanka International Labor Organization Small & Medium Enterprise Developers	Julian Murray, First Secretary, Canadian Embassy S.W.K.J. Samaranyake, Director General S. Kulatunga, Project Co-ordinator H.M. Ranasinghe, Project Manager

GEMINI PUBLICATION SERIES

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1. "Growth and Equity through Microenterprise Investments and Institutions Project (GEMINI): Overview of the Project and Implementation Plan, October 1, 1989-September 30, 1990." GEMINI Working Paper No. 1. December 1989. [not for general circulation]
- *2. "The Dynamics of Small-Scale Industry in Africa and the Role of Policy." Carl Liedholm. GEMINI Working Paper No. 2. January 1990. \$5.50
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