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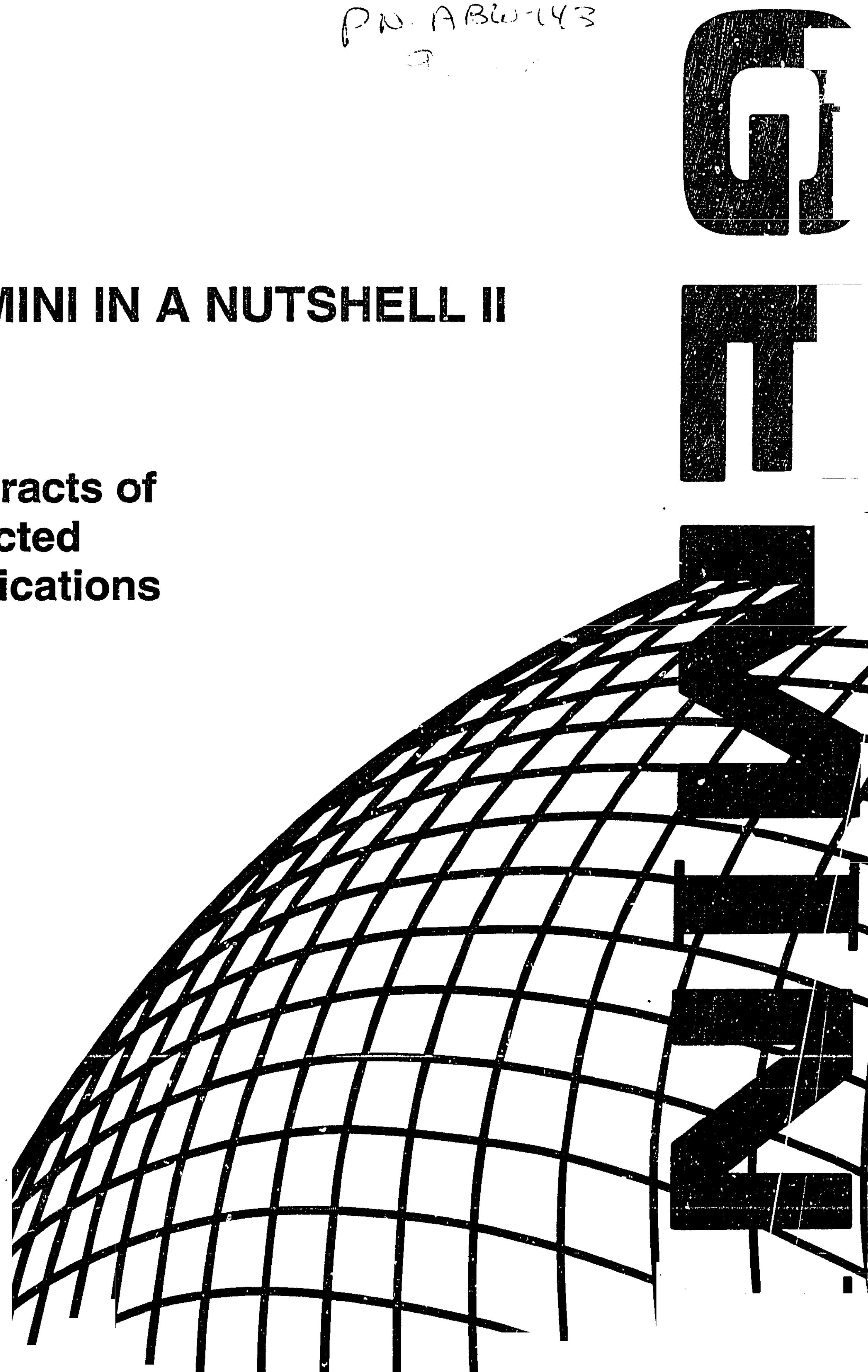
GEMINI IN A NUTSHELL II

Abstracts of Selected Publications



GEMINI in a Nutshell II

Abstracts of Selected Publications

Compiled by

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PREFACE

Welcome to *GEMINI in a Nutshell II*, the second volume of abstracts produced under the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project, funded by the U.S. Agency for International Development. The first volume, *GEMINI in a Nutshell*, was developed to make the extensive GEMINI literature more accessible to readers wishing to keep abreast of project findings. Composed of 21 abstracts, *Nutshell I* examined GEMINI working papers on cross-cutting issues of enterprise development and financial services. As such, *Nutshell I* serves as an overview document of the principal themes and findings of the GEMINI project. However, many valuable documents were not included in *Nutshell I* and new documents appear continuously as the project progresses. As a result, the project has compiled *GEMINI in a Nutshell II*, the collection of 20 abstracts presented here.

In contrast with the first volume, *Nutshell II* largely comprises technical reports that examine specific country cases, although several papers examining more general issues are also included. It includes works that provide the broad picture, such as the examination of business dynamics in Southern Africa, and studies applying core concepts in particular settings, such as an examination of financial services targeting women in Indonesia.

The abstracts are organized into four sections. The first section includes abstracts of seven documents identifying the characteristics and needs of the micro and small enterprise sector. The second section is devoted to financial assistance issues, and includes one general study and five case studies. The third section comprises seven abstracts examining an array of questions regarding nonfinancial assistance, ranging from the identification of needs of small enterprises to the role of business organizations in the legislative process. The final section includes two longer abstracts of papers on the policy environment and sectoral needs in Poland and the New Independent States.

To guide readers through the variety of abstracts, the editors have added a short introduction at the start of each section. In addition, the volume opens with a special introduction on gender issues, pointing the reader to gender findings that appear throughout the volume. Recognizing the centrality of women in the micro and small enterprise sectors and the exciting information emerging from GEMINI work on gender issues, we hope this guide will be helpful to the reader already interested in these issues and will lead other readers to identify gender issues as a recurrent theme.

Special thanks go to Eugenia Carey and Linda S. Rotblatt, who artfully undertook the task of distilling extensive reports into the digestible bites presented here.

Joan C. Parker
GEMINI Deputy Director

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A NOTE ABOUT GENDER

As mandated in the GEMINI contract, gender issues have been a prominent focus of the project's work, as a topic of research and of assistance programming. No one, however, anticipated how central and significant the gender findings would become. Indeed, as noted by a key observer from the U.S. Agency for International Development's Office of Private Enterprise, the gender findings constitute one of the most important contributions GEMINI has made to the literature on the micro and small enterprise (MSE) sector.

Rather than placing the abstracts of gender-oriented papers in a separate section, we have chosen to integrate these abstracts into the broader sections organized by technical interest. In this way, they can be read within the perspective of the larger literature on microenterprise development, and will not be missed by the general reader. This note is designed to highlight the implications of this literature and to help the gender-oriented reader, as well as the reader interested in learning more about gender and microenteprise, locate these important findings.

REPORTS INCLUDED IN THIS VOLUME

Findings related to gender appear in Sections One, Two, and Four. Section One, Profiles of MSE Sectors Worldwide, includes abstracts of three studies that focus on gender, as well as two studies with important gender-specific information.

- Downing and Daniels's (1992) study of female entrepreneurs in Southern Africa (Abstract I-7) provides an empirical examination of the dynamics of women-run enterprises that were suggested by Downing's 1990 paper on gender and microenterprise development.[1] This study is particularly significant because of its relatively large sample size (some 20,000 entrepreneurs in four countries) and because the authors make broad observations about the survival and growth rates of women-owned businesses.

- Weidemann's (1992) study of Egypt (Abstract I-6), and Weidemann and Finnegan's (1994) study of Poland (Abstract I-5) examine the nature and extent of female participation in the MSE sectors in those countries. The Polish study includes information on some constraints limiting the ability of women to establish their own businesses in post-Communist economies.

- Daniel's (1994) second-generation survey of the Zimbabwean MSE sector (Abstract I-4) confirmed many earlier hypotheses about the dynamics of women-owned businesses in the informal sector, including that female participation in the economy is most concentrated in those sectors with the lowest profit margins.

- Fisseha's (1994) study of MSEs in Jamaica (Abstract I-3) also confirms this finding: among MSEs engaged in manufacturing, women are confined to sectors with the most marginal returns. This may well be a factor in the higher closure rates Fisseha finds in women-owned businesses.

[1] Jeanne Downing, "Gender and the Growth and Dynamics of Microenterprises," GEMINI Working Paper No. 5, September 1990. Also abstracted in *GEMINI in a Nutshell I*.

Section Two, Financial Services, includes numerous studies on models of financial service delivery, some of which contain significant gender-oriented data.

- Weidemann's (1992) technical note on financial services for women (Abstract II-5) draws on empirical data from the large body of GEMINI literature and other relevant documents. The technical note suggests strategies for practitioners and donors to tailor programs to reach greater numbers of women.

- Holt's (1991) "Women in the BPD and Unit Desa Programs" (Abstract II-6) compares the results concerning women and financial services from two earlier studies of Indonesian village-level banking systems. By examining the different service delivery methodologies involved in the two programs and their different rates of female participation, the paper presents some preliminary hypotheses about attracting female clients.

Finally, the in-depth study of the small business sector in the New Independent States in Section Four includes a special focus on women, which led to some important gender-related conclusions:

- Despite the presumed gender equality during socialism, women are increasingly facing unequal economic opportunities in the New Independent States.

- A close examination of the changing roles of women during the transition reveals that women lose jobs at a higher rate than men because women tend to be concentrated in declining sectors, such as universities, where heavy government subsidy had previously been the norm.

- The availability of services that allow women to participate fully in the work force (such as child care) is currently limited.

GENDER-RELATED FINDINGS

Overall, the documents reveal several common findings about gender and microenterprise development even in countries with vastly different cultural and economic settings, such as Egypt, Kenya, Indonesia, Southern Africa, and Poland. Regarding the profile of women in the MSE sector, we have learned that:

- In most countries, the majority of businesses with 10 or fewer workers (defined as microenterprises) are owned by women. Few women own businesses with between 11 and 50 workers (defined as small enterprises).

- The failure rate of businesses run by females is similar to those run by men. However, female-run businesses are less likely to grow than male-run businesses.

- The sectors dominated by women entrepreneurs tend to grow less rapidly than sectors where male entrepreneurs are more prominent. Female business owners are concentrated in marginalized sectors with low returns, such as trade and services, although the relative proportion differs by country. When the financial returns in a given sector, such as banking in the New Independent States, increase, men are likely to displace women in that sector.

- Women hire fewer paid workers than do men, but those workers who are hired are likely to be female.

- Women are more likely to operate businesses from their home than are men.

- Women are likely to increase their entrepreneurial activities laterally (that is, they will engage in multiple income-earning activities and spread their risks over a wider base) to stabilize their income stream. They are less likely than men to invest in a single activity.

With respect to the participation of women in financial service programs, we have also learned that:

- Women may be perceived by financial institutions as greater credit risks than men.

- Women will demand smaller loans than men because they tend to own businesses that are smaller and less profitable.

- Women participate as both borrowers and savers in financial services programs.

Finally, because of these lessons, the studies concur that:

- To maximize project impact on female entrepreneurs when designing programs, policy makers and practitioners should consider the specific constraints facing women regarding the development of their businesses and access to financial services.

- Because of specific constraints they face, women are more likely to participate in financial service programs that are decentralized, offer small loans, and offer savings services.

Other GEMINI Publications with Significant Gender-related Results

Most of the literature to emerge from the GEMINI project has included gender-related information. However, the following GEMINI reports contain the most salient gender findings:

Gender and the Growth and Dynamics of Microenterprises, GEMINI Working Paper No. 5, Jeanne Downing, October 1990 [abstracted in *GEMINI in a Nutshell*]

Access to Credit for Poor Women: A Scale-up Study of Projects Carried Out by Freedom from Hunger in Mali and Ghana, GEMINI Technical Report No. 33, Jeffrey Ashe et al., March 1992

Integration of Gender into GEMINI, GEMINI Technical Report No. 66, Catherine R. Neill and Olaf Kula, January 1994

SECTION ONE

PROFILES OF MSE SECTORS WORLDWIDE

NOTES ON PROFILES OF MSE SECTORS WORLDWIDE

GEMINI research teams have contributed a great deal to the literature on the micro and small enterprise sectors of several countries. These studies contain important information on firm-level dynamics, baseline data on the size and characteristics of the sectors, and details on the contribution of these sectors to national employment.

We have organized the abstracts here into three categories: first-time baseline surveys, repeat baseline surveys providing view of sectoral transformation, and special topic surveys. Two ***baseline surveys*** are covered here, presenting results from first-time national investigations of the MSE sector, include "Micro- and Small-Scale Enterprises in Kenya: Results of the 1993 National Baseline Survey," and "The Contribution of Small Enterprises to Employment Growth in Southern Africa." Repeating the baseline survey at a later point in time, the ***second-generation surveys*** reveal important information about growth and change of the sector. We have included "A Dynamic Study of Jamaican Micro- and Small-Scale Enterprises," and "Changes in the Small-Scale Enterprise Sector from 1991 to 1993: Results of a Second Nationwide Survey in Zimbabwe." Finally, the three ***special-topic surveys*** abstracted here focus on women in the MSE sector: "Small Enterprise Development in Poland: Does Gender Matter?," "Egyptian Women and Microenteprise: The Invisible Entrepreneurs," and "The Growth and Dynamics of Women Entrepreneurs in Southern Africa."

- The Kenya survey revealed that the MSE population in Kenya, composed mainly of microenterprises, is much larger than previously estimated. Most of these microenterprise have more than one worker and operate outside the home. The Kenyan findings sharply contrast with findings from the parallel sector in southern Africa, where the majority of microenterprises comprise one worker, and are based in the home and owned by women.

- In "The Contribution of Small Enterprises to Employment Growth in Southern Africa," Don Mead concludes that, over the past decade, MSEs employed about a third of the increase in the population of working age people and more than 40 percent of all new entrants to the labor force. Microenterprises that grow provide a base for small and medium-sized enterprises, further contributing to the role of MSEs as a significant source of jobs in the countries examined.

- The 1992 study of Jamaican MSEs found that the maximum average annual closure rate for MSEs was only 3.5 percent over a 12-year period, a remarkably low rate considering the difficult economic situation in Jamaica in that period and the often-cited high turnover rate of microenterprises. The study also found that the average life of all enterprises was just over 20 years.

- The Zimbabwe second-generation survey examined not only changes that occurred in the MSE sector from 1991 to 1993 but also the combined impact of the economic structural adjustment program and the drought of the 1991/92 agricultural season.

- Although women make up 46 percent of the work force, they make up almost 60 percent of Poland's 2.5 million unemployed. The 1993 study suggests that women in Poland face a "catch-22" situation: women's lack of management experience, assets, and time hinders their ability to become entrepreneurs, yet the lack of jobs available to women leave them few alternatives except self-employment.

- The Egyptian study examined the experiences of male and female entrepreneurs to focus attention on the differences between these two groups. It found that women are more likely to go into business to seek increased income and that they prefer a home base to higher earnings.

- In "The Growth and Dynamics of Women Entrepreneurs in Southern Africa," the authors argue that, although the sectors in which women-owned businesses are concentrated have grown less than those dominated by men, women-owned MSEs should not be overlooked by assistance programs because of the view that MSEs owned by women have little potential for contributing macroeconomic growth. Women own the majority of MSEs in the countries surveyed, and firms owned by women last as long as those owned by men.

For further reading on the characteristics and needs of the MSE sector, please refer to the GEMINI Publication Series list and *GEMINI in a Nutshell*, Section One, which includes abstracts of the following reports:

"The Dynamics of Small-Scale Industry in Africa and the Role of Policy," GEMINI Working Paper No. 2, Carl Liedholm, January 1990

"Gender and the Growth and Dynamics of Microenterprises," GEMINI Working Paper No. 5, Jeanne Downing, September 1990

"Data Collection Strategies for Small-Scale Industry Surveys," GEMINI Working Paper No. 11, Carl Liedholm, January 1991

"Dynamics of Microenterprises: Research Issues and Approaches," GEMINI Working Paper No. 12, Carl Liedholm and Donald Mead, January 1991

"Dynamics of Microenterprises: Research Priorities and Research Plan," GEMINI Working Paper No. 13, Carl Liedholm and Donald Mead, August 1990

"Baseline Surveys of Micro and Small Enterprises: An Overview," GEMINI Working Paper No. 16, Donald Mead, Yacob Fisseha, and Michael McPherson, March 1991

"The Structure and Growth of Microenterprises in Southern and Eastern Africa: Evidence from Recent Surveys," GEMINI Working Paper No. 36, Carl Liedholm and Donald Mead, March 1993

ABSTRACT I-1

MICRO- AND SMALL-SCALE ENTERPRISES IN KENYA: RESULTS OF THE 1993 BASELINE SURVEY

GEMINI Technical Report No. 75

Joan C. Parker with Tanya R. Torres
March 1994

In the context of a worsening employment crisis in Kenya, development practitioners and policy makers are paying increasing attention to the micro and small enterprise sector as a provider of employment and as a means of ensuring stability and growth in the Kenyan economy. The survey results presented in this report provide estimates on the size, composition, and employment of all enterprises with up to 50 workers; identify constraints faced by these businesses; and identify subsectors with a history of growth and expansion. The survey looks at the location and structure of work premises, linkages to other areas of the economy, access to business assistance (financial or otherwise), patterns of change, and constraints to growth.

SURVEY RESULTS

Magnitude and Importance of MSE Sector. Employing nearly 2 million people, the MSE sector comprises 910,000 enterprises, three-fourths of which are located in rural areas. Although rural businesses are more likely to be seasonal, most enterprises nationwide operate year-round. The MSE sector provides employment for 16 percent of the labor force, the bulk of which, again, is in rural areas. Nationwide, one quarter of all households engage in some form of business activity, while the comparable figures are higher for urban areas (35 percent in large urban areas other than Nairobi and Mombasa, and 59 percent in small towns). Roughly one-fourth of entrepreneurial households depend on their businesses for all of household income, while 69 percent depend on their businesses for half or more of their income. Women-owned businesses provide a substantially lower share of household income than businesses owned by men.

Microenterprises — defined as businesses with one to 10 workers — make up most (98.6 percent) of the MSE sector, as compared with enterprises with 11 to 50 workers (1.4 percent) and those with more than 50 workers (less than 1 percent). Of these microenterprises, less than one-fourth have just one worker, one-third are based in the home, and half are run by female entrepreneurs.

Sectoral Distribution. Kenya's MSE sector is dominated by commerce and trade activities, most of which are related to the agricultural sector (61 percent of enterprises and 53 percent of all MSE employment), followed by the manufacturing sector (27 percent of enterprises; 30 percent of employment) and services (13 percent of enterprises; 18 percent of employment). Kenya differs from the countries of Southern Africa in that Kenya has a larger proportion of enterprises in commerce and a smaller proportion in manufacturing.

Labor Force Characteristics. The composition of the MSE work force varies by gender of the proprietor and the size of the enterprise. Women rely primarily on their own labor (66 percent) or on unpaid family workers (24 percent), hiring few paid workers. In contrast, 37 percent of workers hired by male proprietors are paid employees. Women-run businesses provide a greater share of jobs for women in the sector, with 82 percent of all positions held by women compared with 14 percent in enterprises run by men.

Locational Characteristics. Nationwide, nearly half of all enterprises are found in traditional marketplaces. However, as in earlier door-to-door surveys of enterprises, this survey also revealed that one-third of all enterprises are located within households, and it is likely that these enterprises went largely uncounted in previous surveys. The third largest group is located in neighborhood or rural trading centers. Location varies by several factors, including the level of urban development and the gender of the proprietor. Rural enterprises are more likely than their urban counterparts to locate within the home (37 percent versus 16 percent) or be mobile (7 percent versus 3 percent), and women are more likely to operate businesses from their home than are men (43 percent versus 23 percent). Just over half of all MSEs operate in a permanent structure (although this varies between rural and urban areas), but more than two-thirds of enterprises do not have access to water or electricity on their work premises (a proxy for the quality of infrastructure available to the entrepreneur). Some three-fourths of enterprises have some security of tenure to their work place (defined as a title deed to their work space or a written lease), although these figures vary by location, gender of proprietor, and size of business.

Linkages to the Kenyan Economy. Although it appeared to researchers that there were few forward linkages (84 percent of enterprises reported selling their goods directly to individuals), some 13 percent of enterprises do provide goods or services to other businesses. Strong backward linkages were found: fully 84 percent of microenterprises rely on Kenyan-made inputs or stocks.

Access to Business Assistance. Some 85 percent of entrepreneurs reported that they had never received assistance of any kind (formal or informal), 9 percent have used credit at some time, and 5 percent have received some form of non-financial assistance. One-fifth of entrepreneurs who completed a supplementary questionnaire reported that they belong to some kind of business support group, although no attempt was made to categorize these groups.

Amount of Start-up Capital. Looking only at enterprises that were less than two years old at the time of the survey (to minimize error caused by inflation), the researchers collected data on the amount of start-up capital used by enterprises, as a proxy for informality as well as way to judge which types of enterprises have higher capital requirements. Eighty-nine percent of enterprises start with Ksh. 10,000 or less, whereas businesses in the service sector were more likely to require greater amounts. As expected, the larger the enterprise is at the start, the more capital was required to open the business.

Patterns of Change. The researchers used data reflecting the amount of additional employment generated on a yearly basis by existing enterprises as a measure of business growth. In the aggregate, 38 percent of businesses currently in the MSE sector have added workers since they opened. Overall, roughly 70 percent of current jobs were created upon opening and 30 percent through expansion. Enterprises located along roads are more likely to add workers than those operating out of homes (48 percent versus 33 percent), and female-run businesses are less likely to grow than male-run businesses (32 percent of expansion in sector versus 43 percent). It further appears that much of the growth into enterprises in the 3 to 5 worker and 11 to 50 worker categories emerged from the vast population of one-worker enterprises.

Constraints. Eighty percent of surveyed entrepreneurs cited one, two, or three or more major problems, while the rest were unable to point to any specific constraint. By far the most commonly cited major problem was related to market size (93 percent of responses), followed by difficulty accessing nonfinancial inputs (25 percent) and capital shortages (14 percent). Other problems mentioned include transport (7 percent), location (7 percent), economic conditions (7 percent), risky environment (5 percent), and government involvement or harassment (5 percent).

Additional Findings from the Supplementary Questionnaire. A supplementary questionnaire allowed researchers to assess reasons for the choice of business activity and future business plans. Among the most common reasons given for entering a particular type of business are the entrepreneur's specific skills or qualifications (23 percent of entrepreneurs), the perceived profitability of a venture (17 percent), limited start-up capital (15 percent), or family or friends operating in the same business (8 percent). When asked if, given the opportunity, they would expand their businesses, 78 percent said they would expand while another 20 percent said they would shift into a different line. Again, these results vary markedly by sector and by gender of proprietor.

In general, the supplementary questionnaire revealed that people tend to enter businesses with lower barriers to entry (that is, low skill and capital requirements) and thereby find themselves in oversaturated markets. When combined with the finding that market size is the key constraint for enterprise expansion, this suggests that future assistance to the sector must be directed by a knowledge of both market potential and the competitive structure of the marketplace. In addition, technical skill development was mentioned as a key need of those in manufacturing or services as well as a key motivator for entering a specific type of enterprise.

COMPARISON OF PRIMARY RESULTS WITH SAMPLE OF INDUSTRIAL AND COMMERCIAL AREAS

Researchers conducted an additional survey of a purposive sample of commercial and industrial areas in six major urban regions, after it was discovered that the random sample for the original baseline survey uncovered only MSEs and thus provided no statistically valid findings on small- and medium-sized enterprise (SME) population (defined as those with 11 to 50 and 51 to 100 workers, respectively). Despite the focus on the SME sector, the additional survey revealed the surprising result that nearly 90 percent of businesses in the commercial and industrial areas were, in fact, microenterprises (that is, they had 10 or fewer employees). In addition, the supplementary data reveal some characteristics of SMEs in industrial and commercial areas, although the authors are careful to recognize that design problems associated with this portion of the survey limit the viability of these results.

Profile of Small Enterprises. Enterprises with 11 to 50 workers make up 10 percent of the enterprise population found in commercial and industrial areas, and are likely to be involved in manufacturing (30 percent) or services (50 percent). The majority of enterprises are multi-owner establishments, half of which are corporations. Of the 41 percent that are sole proprietorships, 83 percent are owned by men. With women making up only 16 percent of workers, it is clear that there are few women involved in this sector. Most enterprises operate year-round and started in the microenterprise category. There are more forward linkages in this sector than in Kenyan enterprises overall (29 percent service other enterprises), but the majority still sell the bulk of their goods and services to final consumers.

Profile of Medium-sized Enterprises. Although medium-sized enterprises represent only about 1 percent of urban enterprises even within commercial and industrial areas, they are highly visible because of their size and location. They are based in permanent structures, have access to utilities, and mostly operate year-round. The majority of the sample maintained a group ownership structure, and none were owned by women. Half began as microenterprises and 25 percent as small enterprises, and owners and workers both tend to have higher skills than in the population at large. Overall, the medium-sized enterprise sector is dynamic, based in production of goods and services (rather than trade) and exhibiting substantial past growth, longevity, and strong domestic linkages.

TAKING A SUBSECTOR APPROACH

The authors regrouped the data from the baseline survey into seven subsectors, five defined by their inputs (agriculture-based products, forest-based products, textile products, metal products, and leather products) and two that are service product subsectors (construction and transport services). Several interesting conclusions emerge from this analysis, including that agriculture and forest-based activities provide the bulk of MSE employment (45 and 16 percent of the sector's employment, respectively) and are predominantly rural and dominated by women. Conversely, the metal and leather subsectors have small roles in the MSE sector and tend to be urban and dominated by men.

CONCLUSIONS: IMPLICATIONS FOR POLICY MAKERS

The most striking conclusions to emerge from the study are the following:

- The MSE population in Kenya is much larger than previously estimated. One-third of enterprises operate from the home and probably were not counted in previous surveys.

- Microenterprises make up the vast majority of the MSE sector. Of these, most have more than one worker and tend to be operated outside the home. Half are owned by women. By contrast, the majority of businesses in the parallel sector in southern Africa are owned by women, one worker, and based in the home. A higher percentage of Kenyan enterprises have added workers (a proxy for business growth) than enterprises in southern Africa.

- Agriculture-related enterprises are by far the most numerous of any group of activities in the Kenyan MSE sector, making up the bulk of commercial enterprises and one-third of manufacturing businesses.

From the above results, the researchers arrived at recommendations for policy makers concerned with assisting the MSE sector in Kenya:

- Assistance should focus on those enterprises with 1 to 10 workers, the portion of the MSE sector that provides 93 percent of the sector's jobs and is more likely to evolve into tomorrow's small enterprise sector.

- Strategies should be developed specifically to reach rural and home-based enterprises because of their numbers, general invisibility, and involvement of women.

- Policy makers should take into account the particular constraints faced by female entrepreneurs when devising assistance strategies.

- At least in the short run, microenterprise development will be strongly tied to the development of the agricultural sector.

ABSTRACT I-2

THE CONTRIBUTION OF SMALL ENTERPRISES TO EMPLOYMENT GROWTH IN SOUTHERN AFRICA[1]

GEMINI Technical Report No. 72

Donald C. Mead
March 1994

Job creation is one of the most pressing challenges facing policy makers in Sub-Saharan Africa today. Since population growth far exceeds the absorptive capacity of the agricultural sector, a substantial number of new job seekers find work in micro and small enterprises. This paper explores patterns of change in employment in Botswana, Kenya, Malawi, Swaziland, and Zimbabwe. It builds upon an earlier GEMINI study of the overall structure and patterns of MSE growth.[2]

The data cover enterprises with up to 50 workers engaged in manufacturing, trade, and services. The study includes marketing and processing of agricultural products, but excludes agricultural goods and mining activities. It uses broad terms to assess the employment totals in a heterogeneous group of enterprises: micro and small, formal and informal, and survival and developmental. Using a uniform methodology over three years involving stratified random sampling of localities followed by a door-to-door enumeration of all nonfarm enterprises in selected localities, the authors describe the existing structure and patterns of growth of small producers and traders.

OVERALL TRENDS

MSEs represent a significant source of jobs in the countries examined; ***over the past decade, MSEs employed about a third of the increase in the population of working age and more than 40 percent of all new entrants to the labor force.*** Some 75 to 80 percent of the job expansion in MSEs appear to have come from new start-ups; one can hardly argue that overwhelming barriers to entry deter the formation of new MSEs in any country examined. Furthermore, although most MSEs do not grow, about a quarter do grow at least in small amounts and one percent grow substantially. Most new jobs from expansion resulted from small additions to microenterprises with fewer than five employees after expanding, but the process of graduation to more than 10 employees also made a significant contribution to job creation. Moreover, microenterprises that grow provide the base for today's small and medium-sized enterprises; ***more than half of today's medium-sized firms began with fewer than five employees in every country except Malawi.***

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[1]Revised versions of this document using new data on Zimbabwe may be found in an article by Donald Mead in a forthcoming edition of *World Development.* This information is also examined in greater detail in Chapter Six of the soon to be released monograph by Carl Liedholm and Donald Mead: *Growth and Dynamics of Micro and Small Scale Enterprises: Comparative Analysis of Southern and Eastern Africa and Other Countries.*

[2]Liedholm, Carl and Donald Mead. "The Structure and Growth of Microenterprise in Southern and Eastern Africa: Evidence from Recent Surveys." GEMINI Working Paper No. 36. March 1993.

SUMMARY OF PRINCIPAL FINDINGS BY COUNTRY

Looking first at Botswana and Kenya, MSEs have played a relatively small role in labor force absorption in these two countries; less than half of new entrants to the labor force in Botswana and only a quarter of new entrants in Kenya found work in small enterprises (see Table 1). The share of all enterprises that grew was substantially higher in Kenya (34 percent) than in the other countries under study. Of the MSE employment increase that did take place in Kenya and Botswana, a relatively high proportion (approximately 25 percent) came from an expansion of existing enterprises.

More striking in Kenya and Botswana is the importance of graduation. In both countries, 55 percent of firms currently employing 10-19 people started at the micro level with fewer than five employees. Of the medium-sized firms (20-50 employees), 65 percent in Botswana and 94 percent in Kenya started with fewer than five workers.[3] The data suggest that this graduation process not only makes a significant contribution to employment creation, but also is an important source of today's medium-sized firms. It appears that these two countries have established an environment that is relatively favorable to the expansion of existing enterprises, and in which other components of the economy have been growing rapidly enough so that small enterprises play only a supporting role in job creation.

The contrast between these two countries and Malawi is striking. The contribution of MSEs to the absorption of new entrants to the labor force is somewhat higher in Malawi (56 percent) than in Botswana and Kenya, although lower than in Swaziland and Zimbabwe. It is interesting, however, that the process of growth and graduation was much less widespread among small enterprises in Malawi than in the first two countries examined. Enterprise expansion made a smaller contribution to new job creation in Malawi than in the other countries (21 percent), and a relatively small percentage of MSEs grew at all (23 percent) in Malawi. Also, graduation of firms occurred the least in Malawi (0.2 percent) of all the countries studied, and contributed the least to today's medium-sized enterprises. The figures suggest that there are fewer constraints to opening a small business in Malawi, but significant obstacles to firm expansion.

In Swaziland and Zimbabwe, the highest percentage of the new labor force finds work in small enterprises of the five countries studied. Well over 80 percent of all new jobs in these two countries came either from new start-ups or from expansions among existing small enterprises. In terms of most of the other measures presented in Table 1, these two countries are about average for the region; what sets them apart is not the detailed pattern of employment growth among small enterprises as much as the overall magnitude of this growth, which is strikingly high. The expansion of small enterprises appears to be the dominant factor in employment creation in the economies of both countries.

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[3]Although medium-sized enterprises usually are more than 50 workers, this paper defines them as 20-50 workers.

Table 1
Summary of Principal Findings, 1980-1990[4]
(000)

Variable	Botswana	Kenya	Malawi	Swaziland	Zimbabwe	Five Countries Together
Increase in employment in MSEs	55	731	443	56	981	2,266
Change in MSE employment/change in labor force	44%	25%	56%	92%	104%	47%
Employment creation through new MSEs	40 (73%)	554 (76%)	351 (79%)	43 (77%)	766 (78%)	1,754 (77%)
Employment creation through expansion of existing MSEs	15 (27%)	177 (24%)	92 (21%)	13 (23%)	215 (22%)	512 (23%)
% of all MSEs that grew	20%	34%	23%	21%	19%	26%
% of all MSEs that graduated (>10 empl.)	1.3%	1.3%	0.2%	0.8%	0.7%	0.8%
% of small MSEs (10-19 workers) that started very small	55%	55%	42%	53%	66%	57%
% of medium-sized MSEs (20-50 workers) that started very small	65%	94%	6%	49%	15%	54%

POLICY IMPLICATIONS

In the heterogeneous community of MSEs, different target groups have different opportunities and different needs. Start-up enterprises may need an array of technical assistance, enterprises that are expanding in small amounts require small amounts of working capital, and small firms transforming to the medium size may need significant loans and advisory services. Policy makers should take into account these diverse needs in designing assistance programs. For example, a project helping school-leavers or retrenched civil servants to start a business may be a useful response to political pressures, but it generally requires substantial resources per beneficiary, given the lack of experience of this target group. A micro-lending program providing small working capital loans will help existing MSEs, but will be inadequate for start-up enterprises or firms trying to expand to the intermediate level.

[4]Editor's Note: For the most part, these numbers are consistent with the new publications, with the exception of Zimbabwe. Reading down the column, the new Zimbabwe numbers are 809, 86%, 629, 179, 18.1%, 0.7%, 44.5%, and 11.8%. Consequently, the new numbers in the "Five Countries Together" column are 2,094, 43%, 1,618 (77%), 476 (23%), 26%, 0.8%, 50%, and 52.7%. For more information, please see the forthcoming documents mentioned in footnote #1.

The large numbers of people who succeeded in setting up new businesses in each country provide evidence of why governments and donors should support microenterprise initiatives, but program planners face many additional questions. What volume of resources should be allocated to facilitate the process? To whom should resources be allocated? Which of the groups within the MSE sector should governments and donors try to reach? Those designing policy reform programs or project interventions need to be clear about why they seek to intervene in the sector and, on that basis, which category of enterprises is most appropriate to attain their goal. It will then be possible to more precise about the kinds of interventions that are most suit the needs of that particular target group.

FURTHER RESEARCH NEEDS

Many questions remain. We know all too little about the quality of the jobs that emerge through MSE creation and expansion. Research to date has not clarified whether the significant job growth in small enterprises reflects an increase in low-paying subsistence activities or the growth of productive employment in enterprises that generate rising levels of income. The truth appears to lie somewhere in between, but the relative proportions of these two components remain in question.

Nor do we know enough about the pattern of growth over time of these different categories of employment. This time pattern has two dimensions: the age or life cycle of the enterprise itself, and the interaction between the enterprise and what is taking place in the rest of the economy. In addition, many questions remain about firm closures. More research is needed on enterprise closures and on the magnitude and causes of these "deaths." This information would greatly improve our understanding of the relationship between gross and net employment creation.

ABSTRACT I-3

A DYNAMIC STUDY OF JAMAICAN MICRO- AND SMALL-SCALE ENTERPRISES

GEMINI Technical Report No. 70

Yacob Fisseha
March 1994

This report presents the findings of a 1992 dynamic tracer study of 142 Jamaican micro and small enterprises that had been previously surveyed by the author in 1980. The aim of the study was not only to find out what changes have taken place and why, but also to document new insights on the life cycle of MSEs. Rather than attempt to provide information on total births and deaths of MSEs in Jamaica in the study's time span, the report provides insight only on the growth or death of the firms within the sample and observes shared characteristics among successful firms and among firms that closed.

SAMPLING CHARACTERISTICS

The 1992 study followed up on data collected in a 1980 study, which, in turn, had been drawn from a 1978 census of MSEs in Jamaica. The 1978 census defined MSEs as manufacturing, commerce, and service enterprises with 25 or fewer workers, including proprietors and participating family members. The 1978 census identified 38,000 MSEs in Jamaica but excluded vendors — both stationary and mobile. For the 1980 study, investigators limited research to MSEs engaged primarily in manufacturing: woodworking, metalworking, crafts (usually straw work), repairs, shoes or leather working, and garment production. The 1980 study consisted of two parts, the first part being a "flow data" study of 310 manufacturing MSEs randomly drawn from the 1978 census. The flow data study visited the enterprises once or twice a week to collect information on business operations, including flow of expenses, sales, investments, and labor hours. The second part of the 1980 study drew a random sample of 80 MSEs from the flow data sample for an in-depth study of management characteristics and practices.

The 1992 study included all 80 enterprises from the 1980 management study along with an additional 62 enterprises randomly selected from the remaining firms in the flow data study for a total of 142 MSEs. Using addresses, proprietor's nicknames, and information from former neighbors or relatives, researchers successfully located more than 90 percent (130) of the MSEs from the 1980 study.

PROFILE OF FIRMS STUDIED

Firms engaged in garment production made up more than a third of the sample, and woodworking firms almost a quarter. The heavy concentration in these two sectors should not be surprising: the 1978 census found that these two groups account for 80 percent of Jamaican manufacturing MSEs. The focus on manufacturing firms limited the presence of female-owned firms in the study: men owned 77.5 percent of the MSEs studied. Significant numbers of women were found only in the crafts industry (eight out of nine of the crafts firms studied were operated by women) and in the garment industry, where nearly 30 percent were female owned. Men owned 82 to 100 percent of the firms in other sectors. Finally, the 1992 study concentrated on rural MSEs; less than one-third of the firms studied were located in urban areas.

1992 STATUS OF MSES TRACED FROM THE 1980 STUDY

Looking first at the sample as a whole, *it is noteworthy that more than 90 percent of the firms selected from the 1980 study could be traced and that almost three-fifths (57 percent) of the 142 sample enterprises still exist in one form or another after 12 years.* Of the original 142 MSEs, *one-third are still open full-time and operated by the same owner,* another 12 percent are operated on a part-time basis, 8.5 percent have been passed on to heirs, and 6.2 percent had been sold. One-third of the MSEs studied had closed completely, and 8.5 percent could not be found. Even if one assumes these last enterprises have closed, *the maximum average annual closure rate is only 3.5 percent over the 12-year period.* This is a remarkably low closure rate, especially considering the difficult economic situation in Jamaica in that period and the often-cited high turnover rate of microenterprises. In fact, the 1992 study found that the average life of all enterprises — currently operating and closed — was 20.3 years.

- **Variation by Setting.** *Researchers noted that it was easier to find proprietors (past and present) in rural areas; there were three times as many untraceable MSEs in urban centers as in the countryside.* This may be a factor in why it appears that rural MSEs suffered a higher death rate than urban MSEs. If a larger number of the unknown urban enterprises are in fact closed, the difference between the locations may not be as big as it seems. This reasoning is plausible, given that almost the same percentages of MSEs are still open in urban and rural locations on a full-time and on a part-time basis.

- **Variation by Gender.** *The closure percentage for MSEs owned by women is slightly higher (40.6 percent) than the closure rate of male-owned MSEs (32.7 percent).* Part of this difference may result from the higher percentage of closures among craft works (44.4 percent) — a sector dominated by women. The study later finds that women's firms are usually smaller, face more market-related problems, and have lower average returns. Because this is the case, income from women-owned MSEs may be too small for the owner to justify continued operation even on a part-time basis.

- **Variation by Sector.** *On average, all sectors lost about one-third of the enterprises that had existed in 1980,* except for repair work (garages, bike repair, and other mechanical repairs), which lost only 25.7 percent, and craft works, which lost 44.4 percent. One noticeable characteristic of craft work, however, is that it is almost always operated on a part-time basis in rural areas. The garment sector has been adversely affected by cheap imports (33.4 percent closed), and sawmilling has declined (35.3 percent closed) because of a probably irreversible depletion of raw materials.

FACTORS AFFECTING THE CHANGED STATUS OF MSES

The study took a closer look at firms that were no longer open on a full-time basis to learn why this was the case. Significantly, *more than two-thirds of the MSEs changed status because of personal reasons of the owner.* Thus, economic non-viability may not always be the main reason MSEs close. In fact, the study reveals that death and emigration of owner-operator are the two most important reasons for the closure or part-time operation of MSEs, accounting for about one-third of the MSEs that closed and affecting about one-fourth of the MSEs that operate on a part-time basis or have been sold.[1] Among the economic factors for business closures, the lack of adequate demand is by far the most frequently cited reason. Lack of working capital or bad credit sales is rarely mentioned.

The data allowed researchers to make some interesting observations about the survival and closure of firms. First, the number of workers appears to be a factor in survival rates among the MSEs studied: the larger the firm, the more probable that it will continue to operate. The research indicated that MSEs still operated by the founder or inherited by relatives averaged four to six employees, whereas closed firms averaged only 1.3 employees. In addition, researchers noted that, of the firms that closed, nearly one-fifth closed in the year following Hurricane Gilbert (1988-1989) and almost 25 percent closed in the year following the devaluation of the Jamaican dollar (1991-1992), suggesting the powerful effect of external forces on MSE survival.

CHANGES IN THE LABOR FORCE OF JAMAICAN MSES

Although a wide array of business indicators can be used to identify growth over time, this analysis focuses on changes in the labor force as its primary indicator of growth. The report examines variations in the number of employees in two periods: between the 1978 census and the 1980 study, and between the 1980 study and the 1992 study. As Table 1 indicates, the rate of change among the selected firms varies widely in the two periods:

Table 1
Changes in Growth of Jamaican Microenterprises Studied

Variable	1978-1980	1980-1992
% of firms that grew	17.7%	29.5%
% of firms that shrank	39.2%	27.4%
% of constant firms	43.1%	43.1%

The magnitude of growth of among the firms studies is particularly interesting. *Among firms that grew, most expanded a great deal*: although only 17.7 percent of MSEs studied expanded in the 1978-1980 period, most businesses (13.8 percent) grew by more than 50 percent. The 1980-1992 period showed a similar magnitude of growth: 29.5 percent of firms grew, with most (23.6 percent) growing by more than 50 percent. Although this is an impressive growth rate, none of the firms studied "graduated," or ended up with more than 25 employees at the time of the 1992 study. Of course, some firms contracted in these periods: from 1978 to 1980, almost 40 percent of firms contracted, and from 1980 to 1992, 27.4 percent of firms studied contracted. One quarter of the firms shrank by more than 50 percent in the earlier period, and 19.6 percent shrank by more than 50 percent from 1980 to 1992. Finally, the existence of a sizable percentage of firms that did not change at all is interesting: in both periods, 43.1 percent of the MSEs studied remained the same size. The existence of this constant group suggests that the microenterprise sector may be less volatile than many people think. Although this stability does not indicate prospects for dynamic growth, it does imply the existence of a reliable source of primary or secondary income for many entrepreneurs.

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[1]Although emigration often reflects economic forces, deeper probing of the respondents in Jamaica indicates that the decision to emigrate is driven primarily by personal reasons.

ENTERPRISE STATUS AND BUSINESS PRACTICES

An examination of business practices or characteristics reveals some interesting associations between business closures (or sale) and the presence or absence of various business practices. For example, it is surprising that *paying taxes, registering a business, and other steps in formalizing an enterprise do not seem to be a significant factor in firm closures.* None of the closed or sold MSEs were licensed or registered, paid General Consumption Tax, or participated in the National Insurance Scheme. In contrast, the data found that these practices were common among full-time MSEs still operated by their original proprietors, suggesting that the legal structure is not so onerous that it limits the survival of microenterprises. Another contrast appears when one compares the proprietors' propensity to plan ahead and keep personal and business expenses distinct. *None of the proprietors of the closed MSEs saved or set aside funds for future purchase of tools or machinery, and none separated business money from nonbusiness uses.* In comparison, more than 25 percent of current full-time businesses save for future investment and keep separate accounts of business and personal expenses. The one practice shared by MSEs past and present is the extension of commercial credit to customers. Closed MSEs proportionally exceeded the open MSEs in accepting credit; although it was not cited as a reason for closing, one wonders if such a practice might have contributed to enterprise closure.

The research team asked the proprietors of MSEs currently operating to identify the qualities of a good manager. *Good treatment of customers was the management skill most frequently mentioned, followed by quality of work and harmonious relations with workers.* When asked to explain why their enterprise still operated while so many had failed, most proprietors responded that their success was the result of hard work, although others reiterated that good relations with customers and the quality of their work were the most important factors. In addition, some proprietors attributed their success to diversification of products and activities. In contrast with the studies carried out in 1980, results of the 1992 study indicate a heightened awareness of the need to pay more attention to the marketing aspect of an enterprise. This realization may have been forced upon proprietors as a result of tough product competition from other MSEs or from imports.

ABSTRACT I-4

CHANGES IN THE SMALL-SCALE ENTERPRISE SECTOR FROM 1991 to 1993: RESULTS OF A SECOND NATIONWIDE SURVEY IN ZIMBABWE

GEMINI Technical Report No. 71

Lisa Daniels
March 1994

This study was conducted to provide information on the changes in the micro and small enterprise sector in Zimbabwe from 1991 to 1993. During that period, two major externalities occurred: the introduction of the Economic Structural Adjustment Programme and the drought of the 1991/92 agricultural season. Yet the combined effect of these two factors has not been well understood. This survey examined several elements of the MSE sector — for example, the size and structure of the sector, births and closures of MSEs, employment levels, and MSE constraints — and compares this information with results from a 1991 survey.[1] The current study accounts for variations in the methodology of the two surveys.

CHANGES IN THE MSE PROFILE

Comparison of the two surveys reveals several important changes in the structure of the Zimbabwean MSE sector.

- ***The MSE sector is growing faster than the population.*** In 1993, the MSE sector consisted of 900,000 enterprises, and employed 1.56 million people, representing an 8.5 percent and 14.4 percent increase, respectively, over the 1991 figures. The population grew approximately 3.13 percent over the same time period. ***Most of the MSE growth has taken place in rural areas.***

- ***The proportion of MSEs in trade, transport, and services grew, while the proportion involved in manufacturing declined.*** The shift reflects both the new opportunities afforded by economic reforms and an increase in the proportion of low-profit firms, where the largest number of firm births and closures in the three-year period occurred. It also supports a central hypothesis of the study: that firm births are driven primarily by an excess supply of labor rather than by demand for MSE products.

- Over time, ***both firm births and firm closures appear to be negatively correlated with economic growth.*** During periods of slow economic growth, the MSE birth rate is higher than the closure rate, suggesting net entrance into the sector in difficult economic times, and can be expected to be highest in low-profit sectors. As the economy improves, the rate of expansion of the MSE sector should decline, but the proportion of high-profit firms will increase.

- The MSE sector provides a substantial amount of employment in Zimbabwe. Twenty-nine percent of the working age population is engaged in MSEs, and one in three households operate an MSE. Employment growth within the sector is also high, and ***most employment creation occurs through***

[1]Michael McPherson, "Micro and Small-Scale Enterprises in Zimbabwe: Results of a Country-wide Survey," GEMINI Technical Report No. 25, December 1991.

new firm creation. Although the proportion of jobs created through firm births is nominally higher (an average of 152,125 jobs per year) than through firm expansion (20,230 jobs), the latter is a more sustainable form of job creation. Brick-making, construction services, and auto repair had the highest proportion of job creation through expansion. However, the percentage of firms that expanded and firm growth rates have declined since 1991.

- ***The number and the proportion of women in the MSE sector increased between 1991 and 1993***, and currently 70.6 percent of all MSE proprietors in Zimbabwe are women. The most notable increase in female participation occurred in the paper, chemicals, and non-metallic mineral processing sectors. A large increase of women in trade activities is similarly striking. Yet these increases do not reflect new economic opportunities under the Economic Structural Adjustment Programme because women remain in the lower-profit sectors.

- Constraints facing MSEs did not vary by gender. ***Both male and female entrepreneurs cited marketing, finance, and inputs as their primary constraints.*** Ninety percent of all entrepreneurs had never received any credit, although a higher proportion of male-owned firms (0.8 percent) had received credit from a formal institution compared with female-owned firms (0.2 percent).

- ***Most MSEs are owned by black Zimbabweans, and this proportion has increased slightly since 1991 (from 98.2 to 99.1 percent).*** However, the minority of firms owned by non-blacks tend to be larger and more profitable than the black-owned firms. Furthermore, blacks tend to be concentrated in low-profit sectors such as knitting and basket-making.

IMPACT OF THE ECONOMIC STRUCTURAL ADJUSTMENT PROGRAMME AND THE DROUGHT

In addition to the main survey tool, open-ended interviews were conducted with government representatives and owners of some of the more successful firms from the 1991 study to address their perceptions of the impact of the Economic Structural Adjustment Programme. Questions about the drought were also posed.

- Although it is difficult to separate the effects of the drought from those of economic reform, ***it is likely that the drought caused decreases in income levels*** (which resulted in lower demand for MSE products) ***and lessened the availability of inputs in sectors tied to agriculture*** (and raised prices for these inputs). Seventy-six percent of proprietors reported that the volume of their business activity decreased during the drought, most of which picked up once the rains began again.

LEGAL AND REGULATORY ENVIRONMENT OF MSES

The four main components of the Economic Structural Adjustment Programme — deregulation, trade liberalization, fiscal policy reform, and monetary policy reform — had a significant impact on the legal and regulatory environment of MSEs. The study analyzed some of the more salient legislation and the manner in which the reforms had affected operations of these firms.

- ***Zoning and licensing laws do not appear to affect the majority of MSEs***, in part because the entrepreneurs are uncertain of the regulations and unaware of any changes that may have been made. Such a climate of uncertainty inhibits investment and expansion, yet street vendors and other businesses continue to operate without harassment from government officials. Under the Economic Structural Adjustment Programme, there are plans to relax and simplify the rules for such street-side economic activity to encourage entry into the formal sector, but the legislation had not yet been passed at the time of the survey. ***Only 6.7 percent of MSEs were officially registered in 1993.*** In any event, the current infrastructure may not be sufficient to administer registration and licensing procedures that would be necessary to ensure public health and safety.

- The heterogeneity of the MSE sector has important implications for regulatory reform. For example, the potential advantages to a firm of registration (such as access to foreign exchange) or the benefits to society of zoning laws (such as public health) are of limited relevance for a home-based basket-maker. ***Future legislative reform should be targeted to specific groups within the MSE sector***, and should clearly state which groups ***are*** or ***are not*** required to abide by the legislation.

- ***Trade liberalization under the Economic Structural Adjustment Programme***, which called for the reduction of import restrictions and changes in the foreign exchange allocation system, ***appears to have had a positive impact on the MSE sector.*** Over half of MSEs in the survey reported that inputs were easier to come by in 1993 than in 1991, as the number of imports increased and exchange rate depreciation lowered the prices of many domestic inputs. Access to foreign exchange has also improved, although few entrepreneurs reported the need for foreign exchange to run their businesses.

- Because the majority of MSE firms operate in the informal sector and do not pay taxes, ***fiscal policy reforms***, including tax and expenditure reductions, ***are not likely to have a measurable impact on the MSE sector.***

- ***Only a small minority of firms had improved access to credit as a result of sectoral initiatives and monetary policy reforms.*** Although the removal of interest rate controls should increase the availability of funds for MSEs, the proportion of firms receiving credit from a formal institution remained at 0.7 percent in 1993, up from 0.3 percent in 1991. Anticipated reforms in land ownership policy should increase the number of firms that can claim a title deed as collateral.

The findings of the 1993 study reflect a period when Zimbabwe was still in the middle of economic and regulatory reform. Further research will be needed at the end of the Economic Structural Adjustment Programme to assess more accurately the overall changes in the MSE sector.

ABSTRACT I-5

SMALL ENTERPRISE DEVELOPMENT IN POLAND: DOES GENDER MATTER?

GEMINI Technical Report No. 73

C. Jean Weidemann and
Carol Finnegan
March 1994

Poland has one of the most dynamic economies in Europe, with an 8 percent increase in gross domestic product in 1993. In this environment, the small and medium-sized enterprise sector (SME) can play a significant role in the transition to a market economy.[1] Since women make up 46 percent of the labor force in Poland, it is crucial to ensure that appropriate resources and support systems are in place to maximize their productivity within the country's emerging entrepreneurial pool. This report summarizes the findings and recommendations of a two-person GEMINI team that visited Poland in July 1993. The team conducted semi-structured interviews of 50 individuals (including entrepreneurs, government staff, and donor agencies) in eight geographic areas. The numbers are small and are not intended for statistical inference. Rather they provide snapshots about gender and enterprise development in Poland.

The team found that male and female entrepreneurs face similar obstacles in forming SMEs, principally a lack of access to credit and ineffective nonfinancial assistance. The researchers argue that Polish women face additional inequalities at home and at work — inequalities similar to those observed in many countries around the world. Furthermore, economic and entrepreneurial opportunities for women vary in different regions. The report suggests that women are beginning to recognize their situation and to organize themselves. The team identifies several areas for further research: there is a tremendous need for gender-disaggregated data, as well as information indicating whether regions showing high unemployment correlate with larger numbers of unemployed and poor women.

PROFILE OF WOMEN ENTREPRENEURS IN POLAND

A 1991 USAID study determined that women owned or managed only 20 to 25 percent of newly created firms in Poland. Enterprises owned by women were found to differ from those of men in three key ways:

- **Age.** Women tended to defer the creation of their enterprises until their major child-rearing responsibilities were completed, whereas men started businesses at a younger age;

- **Motives for Starting a Business.** The fear of job loss or actual job loss was a key factor in prompting women to start an enterprise but was less of a concern for men; and

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[1]The SME sector, as defined in Poland, is the population of businesses that have 1-100 employees.

- **Areas of Specialization.** Men operated larger businesses in capital-intensive industries such as manufacturing, wheresas women were inclined to own smaller businesses in commerce or the service sector.

Staff of business advisory services reported that men and women alike tend to diversify their activities in light of economic uncertainties. Several interviewees observed that men tended to leave sectors when returns are low, only to return when the outlook was better, suggesting that women may be most active in marginalized sectors. The interviews noted that women took their businesses seriously; prepared careful business plans; and, although open to new ideas, were cautious in their approach to loan sizes and risk.

GENDER-SPECIFIC CONSTRAINTS TO WOMEN'S ENTREPRENEURIAL AND EMPLOYMENT ASPIRATIONS

Because the level of work experience affects an entrepreneurs's ability to operate a business efficiently and effectively, the experience of Polish women in the work force merits examination. Socialist ideology worked to the advantage of women after World War II; Polish women are well educated and make up almost half of the labor force. In practice, however, Polish women did not have the same work opportunities as men and consequently could not acquire the same skill base. For example, fewer women than men hold upper managerial posts; presumably, individuals with prior management experience will have a competitive edge in operating a business. In addition, position in the work force determines salary, which in turn dictates the ability to accumulate assets. Since women typically hold lower paying positions, they will have less start-up capital or collateral if they wish to start a business. Lack of time resources — especially during child-bearing years — affects women's inclination and ability to engage in productive and entrepreneurial endeavors, as does the lack of affordable day care in the emerging market economy.

Although women make up 46 percent of the work force, they make up almost 60 percent of Poland's 2.5 million unemployed. In Poland, employers may advertise positions in terms of gender, physical attributes, and age (usually preferring women under 35). A former member of Parliament estimated that 90 percent of the jobs listed in employment office advertisements are for men and only 10 percent are for women. Such figures are consistent with the belief that men need jobs more than women to support their families. Yet the reality is that many women must work for family economic survival, especially with increasing taxation and inflation. This is true even among intact families, and especially in female-headed households. When high unemployment converges with large numbers of female-headed households, such as in the Lódz region, serious disparities emerge between opportunities and income for women versus men.

Combined, these factors create a push-pull effect. The lack of management experience, assets, and time hinders women's ability to become entrepreneurs, yet the lack of jobs available to women leaves them few alternatives except self-employment.

ORGANIZATIONAL SUPPORT FOR WOMEN'S ENTREPRENEURSHIP, EMPLOYMENT, AND RETRAINING

Polish women are beginning to recognize the benefits of organizing themselves. Emerging from this recognition are entrepreneurship and retraining programs that can serve as prototypes for maximizing Polish women's productive capacity and alleviating poverty. The team observed that these courses combine several crucial elements: provision of day care, skill-building along with self-esteem and empowerment training, and links between training and financial assistance mechanisms. The research team interviewed many organizations active in providing services to small businesses and to women; described below is a sample of some of their findings.

The Foundation for the Development of Polish Agriculture (founded in 1988) runs a Women in Rural Enterprise Development Program, providing training and financial services to support solidarity group lending. In 1993 approximately 475 women received training. Only a few loans have been extended, and it is too early to calculate the program's effectiveness.

In 1992 the Central European Small Business Enterprise Development Commission, sponsored by the U.S. Congress and the Polish Chamber of Commerce, founded the Polish-American Small Business Advisory Foundation. Modeled after the small business development centers of the U.S. Small Business Administration, the Foundation provides counseling and training to entrepreneurs. Available data suggest very high female participation initially, followed by a precipitous decline. In the Gdansk office, for example, female participation fell from an initial level of 85 to 90 percent to only 14 percent in the most recent data. A careful analysis should be undertaken by program managers to find reasons for this decline, with a view to bolstering the number of female participants.

Rural Women's Circles were created 130 years ago in Poland to represent and promote the interests of rural women. Activities are determined at the local level, and there are currently 36,000 circles and 1.3 million members nationwide. The circles are now involved in the creation of women-owned SMEs and have been active in savings mobilization. These circles could potentially be linked with Women's World Banking.

RESEARCH AGENDA

The lack of gender-disaggregated data, especially for programs providing financial and nonfinancial assistance to SMEs, hampered the researchers' efforts. The Polish government, donors, and the Polish private sector could collect this information in a cost-effective manner. Gender-disaggregated data on financial services would be particularly useful; information on savings rates and on loan applications and rejections could identify gender-based disparities. Additional areas to be explored include the nature and magnitude of the relationship between high female unemployment, family dependence on female income, and the propensity for women to become entrepreneurs. Does this relationship cause higher growth rates of female-owned enterprises in some regions? More information is also needed on child care. A study could be undertaken to identify the impact of existing and possible child care options on women's entrepreneurial and employment behavior.

ABSTRACT I-6

EGYPTIAN WOMEN AND MICROENTERPRISE: THE INVISIBLE ENTREPRENEURS

GEMINI Technical Report No. 34

C. Jean Weidemann in collaboration with Zohra Merabet
March 1992

Female entrepreneurs in Egypt make up a dynamic class of business owners that has gone unnoticed in official circles. Largely in the informal sector, female-owned businesses are typically small, self-financing, sole proprietorships that are unregistered, do not maintain bank accounts, do not apply for credit from mainstream credit sources, and do not keep public records. Their owners are invisible entrepreneurs. Yet, at the same time, the micro and small enterprise sector has become increasingly important to Egypt as the liberalization of its economy continues.

This study of Egyptian women and the MSE sector was conducted to determine the nature and extent of female economic participation in the informal sector, to identify constraints to the development of this sector, and to make recommendations to USAID for enhancing opportunities for women. The study was designed as a pilot endeavor of the GEMINI project to begin to form a picture of a female entrepreneur.

BACKGROUND AND INTRODUCTION

The Egyptian Economy. The main living areas in Egypt are some of the most densely populated in the world. The country's economy, which was severely strained during the 1991 war in the Persian Gulf, is now undergoing major reforms. The resulting structural adjustment program threatens to exacerbate already high levels of unemployment and poverty. In this climate of change, the MSE sector can serve as an important buffer, particularly since the geographic location of many MSEs in slum and squatter settlements allows them to provide inexpensive goods and services to the poor. But as important as MSEs are to the Egyptian economy, they have traditionally been beset by an unduly restrictive policy environment.

USAID/Cairo and other development agencies have instituted numerous programs directed at micro and small entrepreneurs. These programs, which deliver credit, training, and/or technical assistance, have been generally successful, yet have had only limited participation by women. In addition, there is little interaction between small-scale industries and the rest of the industrial world. Barriers to the exchange of new information affect female entrepreneurs to a greater extent than male entrepreneurs because of the relatively greater isolation and lower literacy levels of the female entrepreneurs.

Women in the Egyptian Economy. As in many developing countries, women in Egypt tend to be more illiterate than men, are more affected by poverty, and do not enjoy the same social status as men. Little was known about the participation of women in the MSE sector prior to this study because earlier research relied too much on data from larger, more formal businesses. The general understanding of the literature, however, seems to indicate that women lack access to financial services because they lack collateral, because low literacy makes them less comfortable with bookkeeping, and because of the pervasive sociocultural attitudes towards women.

FINDINGS, CONCLUSIONS, AND IMPLICATIONS

The researchers conducted a general survey of 323 entrepreneurs (182 men and 141 women), of whom 215 were randomly selected from two USAID/Cairo projects, as well as two smaller surveys (one of program participants only, and one of the loan officers involved in the programs). The main findings are highlighted below.

Women are more likely than men to go into business to seek increased income. Male entrepreneurs, in contrast, are likely to acquire their businesses through inheritance. A large number of entrepreneurs of both genders learned their trade through apprenticeships.

Informal savings and lending groups such as gamaye (rotating credit and loan associations) play a particularly important role in financing new business start-ups. Most of the surveyed entrepreneurs (80 percent of women and 72 percent of men) started their businesses themselves, primarily with money from their personal savings.

Female entrepreneurs indicated that the lack of access to working capital was a major constraint for business development (46 percent of female respondents mentioned it as a start-up problem, and 59 percent said it was a current problem). They are also less likely to have access to supplier credit (70 percent paid cash in advance or cash on delivery for supplies, materials, and products), yet more likely to extend credit to their clients (87 percent). Men similarly have found the lack of working capital to be a major obstacle at start-up (73 percent), but this result seems to taper off in the later years of the business. Eighty-seven percent of women listed lack of working capital as the first or second major obstacle, compared with 69 percent of men. Despite these problems, both men (77 percent) and women (87 percent) indicated their intention to expand their businesses.

Fifty-six percent of the female entrepreneurs surveyed were in service businesses, compared with 35 percent of males. Service businesses require less capital investment and are easier to run out of the home than other types of businesses. Just over half of the female-owned businesses were home based, and fully 70 percent were started in the home. In contrast, only 41 percent of women run their businesses from a shop, as compared with 84 percent of male entrepreneurs surveyed.

Because they are involved in services, ***women are more likely to get their business supplies from retail sources than from a manufacturer or wholesaler,*** and tend to sell their products or services directly to the consumer.

Women prefer a home base to higher earnings. Major gender differences existed in the stated preference for conducting business at home versus establishing a more profitable business outside the home: 50 percent of women would prefer the home-based business versus 10 percent of the men. Both men (96 percent) and women (90 percent) indicated a preference toward earning a higher income versus having more leisure time once the business began to operate efficiently.

Female business owners tend to have smaller households, yet 38 percent of surveyed households were dependent on the woman's income for survival (although this figure may have been skewed by the temporary unemployment caused by the war in the Persian Gulf). Female business owners have a significantly lower educational level than their male counterparts and are also more likely to have been widowed.

Women are more likely than men to try to balance domestic and family obligations with their business (75 percent versus 58 percent for men), and are likely to choose to go into business precisely because it can be conducted out of the home. Female-run businesses are also more likely to be associated with the informal sector, when the latter is defined by the following characteristics: a tendency to be unregistered (65 percent), the use of family labor, conducting business from the home (53 percent), and operating at less than full time (90 percent).

Yet few gender differences exist in the use of income derived from the business. Slightly less than two-thirds of both male and female entrepreneurs use the income to support personal and family consumption, while 35 percent of men and 30 percent of women reinvest income back into the business. Men were somewhat more likely than women to have full personal freedom in deciding how to use the income (88 percent versus 71 percent).

Because much of the sample was culled from ongoing loan programs, ***71 percent of respondents had applied for a loan from a formal financial institution in the previous 12 months***, but only 6 percent had gone to a commercial bank. Particular formal programs were chosen because of a preference for small loans, approachable officials, and the lack of a collateral requirement. Many entrepreneurs also received credit from informal sources during the previous year, although men and women differed on their reasons for choosing an informal source. Very few of the entrepreneurs maintained a bank account (8 percent of females and 12 percent of males). Twenty-six percent of women were required to obtain the signature of their spouse to open an account while only 9 percent of men were subject to this restriction.

Non-financial services, such as business and technical training, were not a high priority for the respondents. Only about one-third had received some type of training in the past, most of which was offered in the area of production. Forty-five percent indicated that they would be interested in training should it be offered, the others citing lack of time as the primarily deterrent. Of the women who were not interested, 15 percent claimed they would need the permission of their spouses to participate, while 9 percent said they were too shy.

USAID program participants revealed additional clues about tailoring programs toward women. Enumerators asked those respondents who were clients of one of the two USAID/Egypt projects additional questions related specifically to their participation in the programs. Forty-four percent of respondents had learned about the projects from a project officer, while 28 percent heard from a relative or neighbor and 16 percent heard from colleagues in their trade. Women appeared to need more encouragement to apply than men, and often listed spouses and work colleagues as being the most influential in their decision-making process. Once approved for a loan, most participants preferred dealing with a male loan officer, although 26 percent of female respondents indicated a preference for a female loan officer. ***Participants generally indicated satisfaction with the services being rendered, but indicated that improvements could be made in loan size, repayment period, interest rates, evaluation of loan amounts, and loan officer visits.*** Details on what these improvements might be were not given.

Loan officers from the USAID projects voiced frustration at female business owners for not expanding or introducing new features into their businesses. Enumerators also interviewed 47 loan officers (4 female and 43 male) separately for their opinions regarding the gender-related behavior of borrowers. In general, the respondents indicated that female borrowers had less knowledge of the financial and technical aspects of their business than their male counterparts.

Loan officers felt that increased access to credit, moving businesses out of the home, hiring better workers, expanding the premises, and getting better equipment would be appropriate ways to improve the businesses of their clients. In turn, the programs could be improved by adding supplementary services including loans for retailing and services, marketing assistance, and technical training. Finally, 78 percent of respondents suggested they could meet a quota of 20 percent of female borrowers in their portfolio if required. Loan officers do not appear to understand the different values and responsibilities of women, and their particular entrepreneurial growth patterns and preferences.

IMPLICATIONS FOR USAID PROGRAMMING

The results of the main survey and the two supplementary surveys suggest that female participation rates in existing and proposed USAID and other projects could increase if certain, directed measures are taken.

Loan officers need to be more proactive in identifying prospective female clients, while project management should be sensitive to the fact that women are more likely to experience discouragement from neighbors, relatives, and spouses when applying for loans. Different communication vehicles should be considered to publicize the program to women, keeping in mind their higher illiteracy levels and their particular reasons for choosing home-based businesses.

Programs should be geographically decentralized since the majority of respondents (both male and female) work within 15 minutes of the home. Women can be targeted through additional emphasis on the informal sector, or through assistance to the apprentice system that is so widespread in Egypt. Programs can also encourage female entrepreneurship by helping to establish a subchapter for women in the Alexandria Businessmen's Association or to create other women's groups. These efforts would increase women's awareness of where remunerative markets are, and would expand MSE programs beyond the manufacturing sector to industries that are likely to attract women (such as services or retail trade).

The provision of working capital is the key to supporting microenterprise development, especially for women. Program designers should also design techniques for mobilizing savings, a financial service that few women use. Although training appears to be the least important service at present, steps could be taken to expose women to alternative technologies. Finally, assistance programs should be designed with consideration of women's work schedules and other time commitments.

Loan officers should be sensitized to working with female clients. Loan officers should be given additional training on the dynamics and differences between male and female businesses, perhaps using the survey results as a basis for the curriculum. It is particularly important for loan officers to understand that home-based businesses are viable and should be given as much consideration as those in other locations. More efforts should be made to attract female loan officers because 26 percent of the female entrepreneurs surveyed prefer them.

Conduct follow-up research. This survey was one of the first anywhere to examine extensively the nature of the female entrepreneurship in the MSE sector and to contrast female entrepreneurs with male entrepreneurs. However, further in-depth analysis and comparison with similar data from other countries would lead to other pertinent recommendations for planning new, program initiatives that are sensitive to gender.

ABSTRACT I-7

THE GROWTH AND DYNAMICS OF WOMEN ENTREPRENEURS IN SOUTHERN AFRICA

GEMINI Technical Report No. 47

Jeanne Downing and Lisa Daniels
August 1992

In light of the poor performance of African economies throughout the 1980s, donors and governments alike have sought policy and micro-level prescriptions to ignite an engine of economic recovery. Many donors view the informal sector as holding potential for broad-based employment generation and for spurring widespread economic growth. Some have argued that assistance to micro and small enterprises should target dynamic sectors to maximize job creation. Since the sectors in which women are concentrated have grown less than those dominated by men, some observers maintain that women-owned MSEs have little potential for contributing to the growth of the macroeconomy.

This paper challenges this widely held premise and attempts to answer several questions related to it. Do women's enterprises, in fact, grow at a slower rate than men's? Do women's subsectors tend to be less dynamic than those in which men are concentrated? If women's firms — and subsectors dominated by women — do grow more slowly, why? This paper draws on data collected in earlier GEMINI studies in Lesotho, Swaziland, South Africa, and Zimbabwe.[1] One principal strength of this report is its huge sample size; the paper is based on surveys of over 20,000 entrepreneurs, the majority of whom were women (5,323 female entrepreneurs in Lesotho; 2,759 in Swaziland; 3,023 in South Africa, and 3,735 in Zimbabwe).

GENDER-DIFFERENTIATED PATTERNS OF ENTERPRISE GROWTH: MAJOR FINDINGS AND CONCLUSIONS

Women own the majority of MSEs is all of the countries surveyed (73 percent in Lesotho, 84 percent in Swaziland, 62 percent in South Africa, and 67 percent in Zimbabwe). Women-owned firms are more concentrated in rural areas (where there are a significant number of de facto female-headed households), but the gender ratio is changing in urban areas as the South African mines downsize and men return home in search of employment opportunities.

Survival Rates

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[1]For more information on the individual country reports, please see "Small-Scale Enterprises in Lesotho: Summary of a Country-wide Survey" by Yacob Fisseha (GEMINI Technical Report No. 14); "Small-Scale Enterprises in Mamelodi and Kwazakhele Townships, South Africa: Survey Findings" by Carl Liedholm and Michael A. McPherson (GEMINI Technical Report No. 16); "A Country-wide Study of Small-Scale Enterprises in Swaziland" by Yacob Fisseha and Michael McPherson (GEMINI Technical Report No. 24); and "Micro and Small-Scale Enterprises in Zimbabwe: Results of a Country-wide Survey" by Michael A. McPherson (GEMINI Technical Report No. 25).

The survival and death rates of women's enterprises are similar to those of men's enterprises. The data showed less than a 5 percent difference in survival rates between male- and female-owned firms, with men and women both showing higher survival rates in different time periods. That women's firms are as long-lasting as men's contradicts the often cited "marginality" of women's enterprises.

Employment Growth

Previous GEMINI studies have noted that most MSEs do not grow at all, but that a few (about 20 percent) do grow in small amounts and that very few (about 2 percent) grow a great deal. Women's enterprises make up a small percentage of the firms that grow. Female-owned firms typically remain the same size: one to two employees, regardless of location along the rural-urban continuum and sector. Within the 20 percent of growing MSEs, male-owned firms make up the majority, exhibiting a regular increase in number of employees with increase in market size. Only in rural areas did male- and female-owned firms employ roughly the same number of people.

The data found that women's firms grew more slowly than men's even in subsectors dominated by female enterprises. For example, male-owned retail enterprises outstripped their female counterparts in employment growth rates by 4 percent in Zimbabwe and 12 percent in South Africa. Restaurants and hotels owned by men grew 35 percent faster than those owned by women in Swaziland, and 18 percent faster in South Africa. The difference was also pronounced in sectors dominated by men; male-owned manufacturing firms grew 3 percent faster in Zimbabwe, 9 percent faster in Swaziland, and 15 percent faster in South Africa. Only in a few subsectors — food, beverage, and tobacco; and personal services — did female-owned firms grow more quickly than male-owned enterprises.

Constraints to Growth

Male and female entrepreneurs cited the same constraints to growth: a lack of working capital, markets, and inputs. Women said their greatest problem was a lack of market demand, while their male counterparts most often cited lack of working capital and cash flow as their biggest constraints. The data indicated that both men and women have extremely limited access to credit from formal sources.

Female entrepreneurs have not translated access to credit and training into increases in firm employment to the same extent that men have. For example, although the same percentage of men and women had access to training in manufacturing in Zimbabwe, male-owned manufacturing firms grew 5 to 15 percent more quickly than did their female-owned counterparts.

More women's enterprises are home based than are men's enterprises, which are more often located in central business districts. In addition, women's enterprises more so than men's are traditional income-generating activities and are concentrated in a narrow range of subsectors. Typically, these subsectors (such as beer brewing, vending, and sewing) have less dynamic product markets than do subsectors dominated by men (carpentry, electrical repair, and masonry).

CONCLUSIONS BASED ON THE LITERATURE ON WOMEN IN DEVELOPMENT

The literature on Women in Development provides explanations for the relative lack of growth of women's enterprises that complement and enrich the findings of this survey. Foremost among the explanations given for this lack of growth are the dual domestic and productive responsibilities of women. Women simply lack the time to invest in the growth of their businesses. Some authors note that women's enterprises are further hampered by the siphoning off of profits into household consumption and investment in human capital. Others maintain that women have different business objectives and strategies from men. This argument contends that female entrepreneurs tend to grow laterally, engaging in multiple income-generating activities. They do this to spread risks, even out their income stream, and manage capital needs.

The data gathered in Southern Africa suggests that relative access to markets also affects the ability of women's enterprises to grow in size and profitability. Female entrepreneurs are, in essence, the last bidders for markets. Large firms, with the backing of government funds and policies, are able to dominate the most lucrative national markets, typically in product markets that allow for economies of scale. Small producers are competitive only where economies of scale cannot be realized by large producers or in rural areas with shallow and dispersed markets.

Within the segment of the market that small entrepreneurs are able to capture, men — with their greater political and economic power — are generally able to control more lucrative and less laborintensive activities than women. Women, in contrast, are restricted by their combined productive and reproductive responsibilities and associated labor, time, and mobility constraints. Displacement by men further erodes women's bargaining position in the competition for markets. A breadth of literature indicates that, where investments are made to increase the profitability and decrease the labor intensity of women's income-generating activities, these activities are often taken over by men. Structural adjustment policies exacerbate the competition women entrepreneurs face as men in search of an income invade markets traditionally controlled by women. Together with other constraints, displacement pushes female entrepreneurs into the most static, labor-intensive market niches that generate the lowest return.

POLICY IMPLICATIONS AND DIRECTIONS FOR FUTURE RESEARCH

These findings suggest that donor efforts to improve income-generating potential through credit and training may be necessary but are not sufficient. Additional attention needs to be paid to women's access to lucrative product markets and to the inputs needed to help them enter these markets. To improve measurement of intervention impacts, researchers need to investigate gender-differentiated business and investment strategies. Below are additional questions open to investigation:

- Is the Southern Africa data supported by patterns in other regions?
- Where women have access to dynamic markets, do their enterprises grow and is this growth similar to that of men's enterprises, given equal access to inputs?
- When women have access to lucrative markets, what factors explain this success?
- What strategies have women used to achieve growth and guard against displacement by men?

This information is essential for determining the current and potential role of women entrepreneurs in a growth-oriented strategy.

SECTION TWO

FINANCIAL SERVICES

NOTES ON FINANCIAL SERVICES ABSTRACTS

Whereas the first volume of *GEMINI in a Nutshell* examined the most up-to-date thinking on financial services to microentepprises, *Nutshell II* focuses on specific examples and also includes information from recent reports on financial services to the poor.[1] Thus, *Nutshell II* includes an analysis of FondoMicro, one of the most-well-known second-tier organizations channeling funds from commercial sources to microenterprise programs. *Nutshell II* also includes a closer examination of credit unions. Abstract II-2 is based on two papers: "Attitudes and Practices of Credit Union Members and Nonmembers in Malawi and Grenada," and a paper by the World Council of Credit Unions describing how microenterprise lending will strengthen credit unions. Pearson and Garland's report (Abstract II-3) examines the Financial Institutions Development Project in Indonesia, one of the most important projects to date of the U.S. Agency for International Development on the development of financial institutions. The report analyzes the essential elements of the institution and makes several recommendations for the design of future projects. Finally, the Grant report provides conclusions and recommendations for financial assistance to microenterprises based on an examination of 17 micro and small enterprise (MSE) development projects in Africa.

As described earlier in the gender note, GEMINI has made important advances in our understanding of women and informal employment, and particularly of appropriate financial services for women. The first Weidemann paper (Abstract II-5) provides a broad overview of the experience of women who run income-generating businesses, detailing their limited access to credit and identifying characteristics of lending programs appropriate for female clients. Finally, the abstracts on female entrepreneurs in country-specific settings (Abstracts I-6 and II-6) provide the reader with examples of the experience of women in microlending programs: in one case a formal financial institution in Indonesia, and in the other a USAID project in Egypt.

Other important findings in this section include the following:

- Local nongovernmental organizations can be reliable partners in sustainable microcredit programs (Abstract II-4); however, donors should not underestimate the time and resources that may be necessary to strengthen local institutions if they are intended to play an important role in provision of credit to microenterprise entrepreneurs (Abstract II-1).

- Accessibility is a key factor for the inclusion of women in MSE credit programs. Programs that take women's limited mobility into account result in better repayment rates for women than for men in spite of the cultural and logistical barriers that make repayment difficult for women (Abstract II-5). The quality of management also plays a significant role in the repayment rate of female clients (Abstract II-6).

- Savings products are the most valued services among both credit union members and nonmembers in Grenada and Malawi, but most members prefer to hold savings accounts in other financial institutions (Abstract II-2).

For further reading on financial assistance issues, please see the GEMINI publications list and also *GEMINI in a Nutshell, Volume I*, Section Two, which includes abstracts of the following reports:

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[1]Many of the papers in the financial assistance section of *Nutshell I* were included in *The New World of Microenterprise Finance*, edited by Maria Otero and Beth Rhyne (Kumarian Press, 1994).

"Banking on the Rural Poor in Malaysia: Project Ikhtiar," GEMINI Working Paper No. 6, David A. Lucock, October 1990.

"A Financial Systems Approach to Microenterprises," GEMINI Working Paper No. 18, Elisabeth Rhyne and Maria Otero, April 1991.

"The Microenterprise Finance Institutions of Indonesia and their Implications for Donors," GEMINI Working Paper No. 20, Elisabeth Rhyne, June 1991.

"Credit Unions: A Formal Sector Alternative for Financing Microenteprise Development," GEMINI Working Paper No. 22, John Magill, September 1991.

"Steps to the Creation of a Viable Financial Institution for Microenteprise Development in the Philippines: Notes on a Process for the Staff and Board of Tulay sa Pag-Unlad, Inc.," GEMINI Working Paper No. 24, Doug Salloum and Nan Borton, November 1991.

"Village Banking: A Cross-Country Study of a Community-Based Lending Methodology," GEMINI Working Paper No. 25, Sharon L. Holt, December 1991.

"Dynamics of Small- and Micro-Scale Enterprises and the Evolving Role of Finance," GEMINI Working Paper No. 26, Carl Liedhom, December 1991.

"Poverty Lending and Microenterprise Development: A Clarification of the Issues," GEMINI Working Paper No. 30, Mohini Malhotra, May 1992.

"The Solidarity Group Experience," GEMINI Working Paper No. 31, Shari Narenbach and Diego Guzman, June 1992.

"A New View of Finance Program Evaluation," GEMINI Working Paper No. 32, Elisabeth Rhyne, November 1992.

"The Role of Savings in Local Financial Markets: The Indonesian Experience," GEMINI Working Paper No. 33, Marguerite S. Robinson, November 1992.

"Bancosol: A Private Commercial Bank. A Case Study in Profitable Microenterprise Development in Bolivia," GEMINI Working Paper No. 35, Amy Glosser, February 1993.

"Transformation Lending: Helping Microenterprises Become Small Businesses," GEMINI Working Paper No. 37, Larry Reed and David Befus, April 1993.

"Should Principles of Regulation and Prudential Supervision Be Different for Microenterprise Finance Organizations?" GEMINI Working Paper No. 38, Rodrigo A. Chaves and Claudio Gonzalez-Vega, April 1993.

ABSTRACT II-1

FONDOMICRO: LESSONS ON THE ROLE OF SECOND-TIER FINANCIAL INSTITUTIONS IN MSE DEVELOPMENT

GEMINI Working Paper No. 45

Mohini Malhotra
February 1994

Begun in 1990 and scheduled to run through 1997, USAID's Micro and Small Business Project in the Dominican Republic (D.R.) has the overarching goal of increasing the productivity and the employment-generation capacity of the micro and small enterprise sector. FondoMicro — a private nonprofit organization created with financial support from USAID — provides an institutional home for the project. FondoMicro is a second-tier funding organization that wholesales donor, government, and commercial funds to nongovernmental organizations (NGOs) for MSE credit programs; it also provides technical assistance to upgrade the lending capacity of NGOs. With the help of USAID, FondoMicro is working to become a viable, financially self-sustaining institution. In designing the Micro and Small Business Project, USAID envisioned that FondoMicro would become a permanent structure in the Dominican landscape, serving as a bridge between the formal financial sector and the MSE sector, and thereby increasing the capacity of local financial markets to address the financial needs of the MSE sector on market terms.

FONDOMICRO'S SUCCESS

In its first three years of operation, FondoMicro has earned a reputation for competence, efficiency, and integrity. It has established lines of credit totaling $5.1 million with five NGOs and two credit cooperatives. As of December 1993, FondoMicro was covering 235 percent of its operating costs from revenue (excluding research and technical assistance costs, which are funded by USAID/D.R.). The total outstanding loan portfolio was $4.5 million. FondoMicro had lines of credit of $160,000 with local banks, which it had not yet drawn down, given access to cheaper funds. Equity reserves stood at $4.1 million.

FondoMicro has also succeeded in becoming more than just a financial intermediary. Its clients consider its technical assistance its most valued service, and FondoMicro is close to surpassing its project performance indicators in this area. FondoMicro's clients also mentioned as an invaluable service the quality of its courses and its institutional computer systems. Currently, FondoMicro is creating an in-house team of five financial experts to service its current and potential clients. Respect for FondoMicro's services has spread: the Inter-American Development bank is approaching FondoMicro to provide the technical assistance component of its Small Projects in the D.R.

FondoMicro staff are increasingly being invited to speak on television and radio talk shows on economic issues and the role of the MSE sector in national economic development. Three cabinet secretaries and the primary opposition's presidential candidate attended the FondoMicro book fair in August 1993. With the publication of four books on the MSE sector, FondoMicro is establishing itself as a full service center — combining research, technical assistance, finance, and a role in policy making.

PLANNING ASSUMPTIONS VERSUS REALITY IN PROJECT IMPLEMENTATION

Although FondoMicro has had a significant impact, project planners made some inappropriate assumptions about the needs of the MSE sector in the D.R. and the role FondoMicro should play. These assumptions restrict FondoMicro's ability to provide the services it perceives as necessary. Project planners correctly noted that there was an unsatisfied demand for credit from MSEs, that this was limiting the sector's development and employment opportunities, and that the supply of credit was constrained by the lack of institutional capacity to deliver it. However, the Project Paper grossly overestimated both the number of NGOs fitting USAID's criteria and their absorptive capacity and technical abilities.

Although the Project Paper assumed the existence of "scores of NGOs" with the capacity to absorb a predetermined quantity of credit in a specified time frame, with some technical assistance, only 8 NGOs had MSE lending programs at the time of project start-up. And only 3 of these conformed to USAID's criteria (a minimum of one year of experience in lending to MSEs and at least 200 active clients); only 1 — ADEMI — was creditworthy. Instead of providing short-term technical assistance, FondoMicro had to address systemic weaknesses within the intended client base, requiring ongoing assistance on an on-call basis in almost every aspect of institutional development. FondoMicro has adapted to this role well, instituting financial rigor in incipient NGOs with good intentions but poor financial discipline.

The project design also assumed the need for a bridge between microenterprise lending programs and the formal banking sector. However, four of these programs already had lines of credit established with banks at the prime interest rate. FondoMicro currently offers loans at 80 percent of prime, giving it an advantage in providing credit to these four programs as well as to others. Once USAID funds are disbursed, however, FondoMicro will no longer be able to fill this niche, because it is already being met by the banks themselves.

Moreover, FondoMicro's NGO clients resent having to pay close to market rates for capital to a financial institution that receives grants from USAID. They argue that FondoMicro is an additional stratum that increases the cost of funds to MSEs. FondoMicro responds that this resentment stems from having to share their interest rate spread with FondoMicro (the increased cost is not passed on to the MSE borrower) and that the technical assistance provided by FondoMicro will reduce the operating costs of client NGOs.

Finally, the funnel function of FondoMicro was based on the premise that donors have similar objectives and usually act in unison. Efficiencies would be gained for the donors because they could deal with a one-stop institution — FondoMicro — to channel resources to diverse NGOs, and NGOs would benefit from the increased efficiency drawn from fulfilling standardized information needs for only one institution. In reality, donors do not coordinate with one another to the degree anticipated. The NGOs have continued to receive funds directly from a host of heterogeneous donors, on terms ranging from grants, to 2 percent loans with 40-year grace periods, to bank loans at commercial interest rates.

LESSONS LEARNED

FondoMicro realizes that it will be a largely irrelevant financial player if it restricts its activities to serving only NGOs and credit unions as its original mandate specifies. Its growth is encumbered by several factors: the small number of NGOs and their limited absorptive capacity, the high portfolio concentration in one NGO (90 percent of its portfolio is concentrated in ADEMI), and the contractual restrictions with USAID that limit activities to disbursement of USAID funds and do not include mobilizing local deposits.

FondoMicro submitted proposals to USAID to expand the scope of work, but USAID refused to permit FondoMicro to increase the client base or to take on additional functions.

Growth is not, however, hindered by a lack of demand for credit. A recent baseline survey revealed a much higher number of MSEs than previous estimates: 330,000 enterprises employing 761,000 people. Seventy-seven percent of these MSEs had never had access to credit. In light of this finding, several lessons emerge that are applicable in the D.R. and elsewhere:

- **Study the market carefully.** Both the MSE sector and the institutional capacity to serve it should be examined prior to designing the project. In the case of FondoMicro, the market of MSE clients is much larger than originally estimated and the number of capable institutions willing to provide credit competently is much smaller.

- **Specify a portion of project funds for capitalization of the NGOs.** FondoMicro found that most NGOs were undercapitalized, even to serve their current MSE clients. The author advocates providing loans to NGOs on an inclining scale, beginning with a first tranche at 20 percent of prime. Over time, the average weighted rate should be above the prime rate.

- **Devote more time to strengthening credit retailers.** Assistance projects frequently underestimate the difficult process of institutional development. In designing second-tier projects, planners should be sure to allocate time and resources to strengthen the institutional capacity of the credit retailers.

- **Do not restrict the intended client base of the second-tier financial intermediary to NGOs.** All institutions serving the MSE sector that meet the lending criteria should be considered part of the potential client base. This better fits with the objective of self-sustainability and development of financial markets.

- **Localize the technical assistance to the extent possible.** Technical assistance becomes powerful and permanent if delivered in a sustained and ongoing manner by the same group of solid technicians who become knowledgeable about NGO needs, rather than by a series of short-term outside experts.

- **Ensure that the concept is applicable to the context.** The idea of a second tier financial institution makes sense when the initial assumptions underlying the design hold true — it has to be created to fill an unmet need.

- **Launch the project concept only after building consensus among a coalition of donors supporting the MSE sector.** The funneling component is an important element of a second-tier financial institution, but donors must agree to use it.

- **Institute flexibility so that a project can be redefined in light of reality.** That a design may be premised on incorrect assumptions is to be expected, given the unknown variables at any one time. However, donor project management should be flexible enough to allow diversion from the original design when there are clear indications that change is warranted.

ABSTRACT II-2

ATTITUDES AND PRACTICES OF CREDIT UNION MEMBERS AND NON-MEMBERS IN MALAWI AND GRENADA: SYNTHESIS REPORT

GEMINI Technical Report No. 58

John Magill
November 1993

and

CREDIT UNIONS AND MICROENTERPRISES: THE WOCCU PERSPECTIVE

GEMINI Technical Report No. 64

World Council of Credit Unions
December 1993

The World Council of Credit Unions (WOCCU) paper is based on two earlier works titled "Credit Unions and Microenterprise Development," and "Savings Mobilization and Small and Micro Enterprise Lending." The second paper on credit unions is based on recent surveys in Malawi and Grenada and also draws on the WOCCU experience and current initiatives. For his study, John Magill interviewed more than 400 credit union members and nonmembers in each country as part of a multifaceted approach to assessing credit unions (CUs), their involvement in small and micro enterprise financial services, and the growth potential of this activity. This study examines a rural and an urban credit union in Grenada and a company-based credit union in Malawi. The goal of the survey was to test the understandability of the questions themselves to an international subject population, and to identify and precode likely responses to permit simplified data handling by individual CUs.

THE STRENGTHS OF CREDIT UNIONS

An earlier GEMINI publication (Working Paper No. 22) noted that the principal strength of credit unions is that they operate on self-generated capital, independent of government or donor subsidies. Moreover, they are well established and target the group that commercial banks typically avoid — small savers and borrowers. There are an estimated 17,000 credit unions in the developing world serving 8.7 million members. To the MSE practitioner, any entity providing financial services to this group on such a large scale merits close examination.

The study in Malawi and Grenada identifies some of the strengths that CU members and nonmembers perceive in credit unions. The majority of credit union members interviewed felt that credit unions were more friendly and courteous than banks, a factor that CUs have been able to capitalize on worldwide. Members interviewed also agreed that credit unions have more convenient hours and locations than traditional financial intermediaries. More than half of the members polled thought that it was easier to get a loan from a credit union than a bank and that CUs required lower service charges. The nonmembers had less-well-defined attitudes toward the credit union; about two-thirds responded "don't know" to many of the comparison questions asked. Still, those that did have an impression of credit union services confirmed the attitudes of the members: credit unions are more convenient, friendlier, and easier to get a loan from than banks.

WEAKNESS OF CREDIT UNIONS: FAILURE TO MOBILIZE SAVINGS

Both papers argue that the inability of credit unions to mobilize sufficient savings is the most serious hinderance to the growth of CUs today. Many CUs in developing countries offer only one primary instrument for mobilizing member savings: an illiquid Share Account for which a results-based (and therefore uncertain) dividend is paid annually and upon which eventual loan requests are based. Surveyors in Malawi and Grenada found that most CU members — from 44.5 percent in River Sallee to 86.8 percent in St Georges — prefer to keep some of their savings in other financial intermediaries. Frequently, those interviewed said they held most of their savings in other institutions, and many hold savings in more than one intermediary. An interesting side note is the small number of respondents who said they had no savings account at all, implying that they did not consider their credit union shares to be "savings" accounts.

Many developing country CUs argue that their primary purpose is to serve their borrowers. Such an outlook neglects two important factors. First, to have the funds to supply the needs of borrowers, they must attract more savings, but they cannot attract savings when the services they offer are so unattractive that members prefer to save elsewhere. Second, the philosophy that serving borrowers is most important belies the fact that there are many more savers than borrowers. All credit union members save, only a third to a half borrow. The survey found that 5 of the 8 top financial services used by members were savings services. The service most CU members mentioned was education savings (35.1 percent), retirement savings (34.4 percent); in contrast loan services were mentioned by 10 percent fewer clients (business loans, 25.7 percent; personal loans, 24 percent).

Among nonmembers, the 4 most frequently used financial services were all savings instruments. Nonmembers were far less likely than members to mention that they had access to loans. The top loan service was for education, ranked eighth with only 9.5 percent of respondents mentioning it. The low use of loan sources by nonmembers probably reflects the lack of loan sources for poor people, rather than an absence of interest in obtaining loans.

Other GEMINI studies indicate that poor people voluntarily save surprising amounts of money when given attractive options (see Working Paper No. 33). Yet the survey of Malawi and Grenada indicates that few CU members save exclusively at their credit union if they have an alternative; the illiquidity and uncertain returns of the Share Account make it an unappealing savings option. These results suggest that credit unions should adjust the savings products offered to reflect the needs and preferences of their clientele.

WOCCU'S EFFORTS TO STRENGTHEN CREDIT UNIONS

WOCCU is working to improve the financial management of credit unions by focusing on savings mobilization, financial stabilization, and financial soundness. WOCCU hopes to provide greater safety for deposits in credit unions by developing a strong regulatory and supervisory environment. Such an environment is imperative *before* credit unions expand their savings services to protect savers from risk caused by unsound practices or failure to accumulate adequate institutional capital. To increase the financial stabilization of credit unions, WOCCU plans to develop systems, procedures, and controls that promote financial discipline. By improving regulation and supervision and putting stabilization mechanisms in place, credit unions will be adequately strengthened to target the third WOCCU component, savings mobilization, without imposing undue risk on clients.

To mobilize savings, credit unions must offer attractive savings products. The Passbook Savings account — offering competitive interest rates and unlimited access to deposits — may represent the next major step for CUs interested in providing more services to current and future members. A liquid deposit facility could potentially attract far greater sums of money than the amount captured in Share Accounts, enabling CUs to expand lending services. However, liquid savings instruments increase risk for financial intermediaries by creating the need for improved liquidity management and matching assets and liabilities. Microenterprise lending can help credit unions reduce both of these hazards.

CREDIT UNIONS AND MICROENTERPRISE

Surveys of credit union members consistently indicate that a high percentage of members possess independent income-generating activities. The studies under review here confirm this view; 20-36 percent of credit union members interviewed own their own businesses. When the members themselves do not own a small business, their spouses often do. Both papers argue that MSEs represent an important market for credit union services; however, it is inaccurate to refer to CU programs as "microenterprise" programs, given the wide variety of individuals served by credit unions.

(from Technical Report No. 58)	Grenada		Malawi	
	St. Georges (urban)	River Sallee (rural)	Railway (company)	Nalipuri (community)
% CU members owning MSE	36.4%	25.4%	20.9%	25.4%
% CU members whose spouse owns MSE	13% (approx)	8.6%	13% (approx)	23.7%
% CU members owning MSE who borrowed from CU for their MSE	38.5%	54.5%	6.2%	33.4%
% CU members who have savings accounts in other financial institutions	86.8%	44.5%	69.8%	50%

The Magill survey found an array of borrowing patterns among credit union members who own businesses. Of the CUs studied, only in the Railway credit union do members not borrow from the credit union to finance their businesses. The author speculates that in this case the rate of MSE borrowing may be low because it is an employee-based credit union that may discourage borrowing for small businesses. Except for the St. Georges credit union, very few respondents reported having loans from any institution other than the credit union. Because the St. Georges CU had extremely restrictive credit practices, many of its members took MSE loans from banks, reflecting the more competitive urban environment this credit union faces.

This study also found that the types of businesses owned by the members (small-scale trade and commerce activities) are typical of MSEs in these countries. Most members who borrowed to support their businesses invested in inventory, supplies, and materials; some used loans to buy equipment. Credit unions should note that the size and duration of loans requested by most microenterprises are similar to the personal loans requested by other members. Because personal loans do not require the feasibility studies, special collateral, and business plans of major business loans, providing personal loans to MSE borrowers would help credit unions reduce their lending costs.

MICROENTERPRISE LENDING CAN STRENGTHEN CREDIT UNIONS

Microenterprise lending can strengthen credit unions by improving liquidity management and reducing interest rate risk. The GEMINI project is helping WOCCU explore the microenterprise sector as a potential market for credit union services. Successful microenterprise loan programs typically provide very short-term loans (less than three months) paid in weekly installments; small initial loans lead to incremental increases in subsequent loans pending prompt repayment. By making these regular payments, microenterprise borrowers generate a steady cash flow and could provide an additional layer of protection for credit unions. This would allow the CU to lend out most of its money (thereby maximizing returns), but still provide for savers in need of access to their deposits.

Microenterprise lending can also help credit unions diminish interest rate risk, a mismatch of the term to maturity of assets and liabilities when lending rates are fixed at a given level. If the market drives interest rates up, financial intermediaries must pay more for liabilities (savings accounts) but their assets (loans outstanding) remain fixed. Insolvency will result if the financial intermediary has too many long-term loans on terms that cannot be adjusted to reflect the higher market rates. However, microenterprises usually have an ongoing need for short-term, working capital loans. If market interest rates rise, CUs with a microenterprise clientele can cover their liabilities by offering new loans to this group at higher rates — rates that reflect the new cost of funds.

ABSTRACT II-3

FINANCIAL INSTITUTIONS DEVELOPMENT PROJECT IN INDONESIA: DEVELOPING FINANCIAL INSTITUTIONS TO SERVE SMALL ENTERPRISES

GEMINI Working Paper No. 41

Roland Pearson and Dallas Garland
July 1993

This report analyzes the essential elements of the USAID-funded Financial Institutions Development (FID) Project and makes several recommendations for the design of future projects. FID, which lasted from 1985-1993, raised the capacity of small financial institutions (SFIs) to deliver financial services to low-income groups in Indonesia and respond to changes in policy, demographics, and other factors in various provinces and branches. Most of the almost 2,000 FID SFIs serve mainly rural markets, are owned by provincial governments, and are supervised by Provincial Development Banks (known by their Indonesian acronym, BPDs). The clients of these SFIs are involved primarily in farm-related trade, but are also found in light industry, general services, transportation, and handicrafts.

INTERNAL SYSTEMS OF FID SFIs

Credit Policies and Procedures

Rather than relying on traditional character-based analysis, FID institutions have produced several innovations for assessing credit risk, including the development of collateral proxies that change according to local market conditions, the size of the loan, and type of business. For example, rural SFIs often use the authority of local traditional or government leaders to determine borrower eligibility and enforce repayment. Urban SFIs depend more on collectible securities because their borrowers are more transient and traditional hierarchies are much less evident in urban regions. In either case, loan decision-making authority is concentrated in the hands of full-time SFI staff, who remain in close contact with the borrower.

Procedures to trace and chase delinquent borrowers have been less successful. Because FID SFIs do not have standardized procedures to pursue bad debts, it is usually not cost-effective to initiate formal collateral seizure. Loan officers are personally responsible for visiting the client, and, eventually, for bringing BPD supervisors and local leaders into the process.

The report suggests that SFIs should maintain flexible policies and procedures to address varying market conditions and borrower and business sophistication. To improve on the collection of bad debts, especially in areas where traditional village bonds are weak or absent, SFIs should increase their ability to secure title documents and other similar certificates of ownership as a sign of borrower commitment and as a threat of seizure of collateral. Finally, SFIs can maintain the policy of setting incremental increases in loan amounts for good customers without setting rigid minimum and maximum amounts.

The Importance of Savings Mobilization

Voluntary savings mobilization is perhaps the most essential element of successful financial service institutions because:

- Savings give clients a sense of community ownership in the institution without incurring cumbersome and frequently inefficient owner-management;
- Provide a source of local capital that reduces dependence on donor funds and susceptibility to external financial and political shocks;
- Offer poorer clients a source of liquidity;
- Supply local capital that produces a cash flow and velocity more consistent with local loan patterns than would be true of outside funds;
- Lower the average financial cost of capital; and
- Allow an institution to become more closely allied with the local community.

Voluntary savings also strengthen an institution's credit function by testing a client's capacity to repay debt, testing the propensity of the client to frequent the SFI, and acting as a form of financial collateral to which the SFI could legally attach in the event of delinquency. Forced savings, on the other hand, tend to destroy incentives to the borrower to voluntarily set aside money, and to the financial institution to collect voluntary savings.

However, an SFI must prove to potential clients that it can be trusted to keep savings. Projecting an image of safety, locating close to the market, and offering competitive interest rates can enhance such trust. By offering a mixture of term and passbook savings, the SFI can collect savings from a large cross section of the market and generate more stable sources of funds.

Assuming adequate loan portfolio performance and management, SFIs should institute a pilot voluntary savings scheme within six months of SFI start-up so that deposits can be backed up with a limited-term, soft money reserve. To further encourage savings, they should offer interest rates that yield real positive returns for savers and are competitive with other financial institutions in the same market; apply sound and basic financial logic to interest rate setting, giving lower rates for more liquidity and shorter terms; and avoid forced savings schemes.

THE FID MARKET NICHE

FID SFIs have captured a niche market in the farm-related economy — primarily in simple and light manufacturing — by bringing together otherwise unlinked economic actors. As financial institutions, and not targeted credit programs, they have been able to satisfy the liquidity needs of the low-income, rural community they were designed to serve. In most instances, these institutions can achieve adequate portfolio diversification and viability through the disbursement of small loans and the collection of savings. Branches in provinces such as West Java and Bali, where there are vibrant industrial economic sectors (for example, clothing and shoe manufacturing and tourism), have even greater opportunities to diversify the loan portfolio with larger and more sophisticated borrowers and businesses, as well as poorer borrowers who have access to wealthier clientele.

FACTORS CONTRIBUTING TO SUCCESS

To best capitalize on the FID advantage in these markets, project planners can employ a subsector approach to single out the microeconomic sectors in a given area that are the most vibrant and have the most potential to be integrated into the larger industrial economy. They can also pay attention to other factors such as location, professionalism, and management information systems.

Institutional Location

Perceived proximity to the market can affect the outreach, savings mobilization, credit review, disbursement, and collection functions of an SFI. In addition to increasing direct exposure to the local community, locating service close to the market lowers the transport and opportunity costs of outreach and client transactions, and establishes a sense of community ownership. Indonesian SFIs should thus locate at a level below the district level and set up part-time and permanent village posts in the more remote villages.

Professionalism of SFI Management

Professional and experienced management of a branch, at whatever level (village, subdistrict, or district) makes an absolute difference in branch performance, as seen by comparisons of institutions in the FID project and other Indonesian SFIs. Higher levels of education, on the other hand, did not seem to have any impact on staff performance. In addition, branch indicators appeared to improve when management incentives were tied to the profitability of the branch.

Sustainability and MIS

A well-functioning management information system (MIS) is crucial for determining the current level of performance of an SFI. However, the under-reporting of true costs and the temporary cushion perceived as a result of high effective interest rates have prevented many SFIs from truly accounting for their poor repayment performance. If economic or social pressures warrant future interest rate decreases, the continuing existence of poorly performing branches will be severely jeopardized. Unfortunately, significant barriers exist that hinder the development of better management reporting functions that could prevent such problems. Many SFIs are owned by provincial governments that have an incentive to show profits as retained earnings or community contributions, rather than write down bad debts or set aside adequate reserves. Furthermore, staff are weak in their knowledge of accounting principles, specifically in the ageing procedures used on arrears.

FID's technical assistance team has introduced several innovations in MIS tailored specifically to the needs of Indonesian SFIs. In many cases, the innovations involved computerized systems designed to be compatible with widespread hand-tabulated accounting techniques. Where these have been implemented, the capacity to manage effectively has been greatly enhanced. Monitoring and evaluation systems have also been enhanced by the introduction of modified balance sheet and income statement forms, a revised monthly activity report, and expanded client application and transaction forms which assist in the collection of data on portfolio performance, branch profitability, and client demographics.

NONFINANCIAL SYSTEM FUNCTIONS

Supervision

Except for Central Java and West Sumatra, the lines of reporting for the SFIs are too centralized and do not make enough use of branches to carry out routine daily and monthly supervisory tasks. In some cases, Bali and West Java in particular, multiple and overlapping bodies claim responsibility for supervision, creating inefficiencies and reverse economies of scale and no better supervisory diligence. Unfortunately, the Bank of Indonesia does not have the human resource capacity, either in number or competency of staff, to monitor even the current number of institutions adequately. This situation will only worsen as more branches are established and the work load of individual supervisors is increased. In addition, costs of training and supervision are heavily subsidized by provincial and district governments, and subsidies do not contribute to a sustainable solution to this important component of the system..

Training

The provincial development banks have established training facilities in three FID provinces (West Sumatra, Central Java, and West Java) as a means of contributing to the development of the SFI network. However, the banks did not plan adequately for how these centers would be used and it is unlikely that their use will be cost-effective. In addition, the lack of a national system to standardize training services makes it difficult to capture economies of scale in training provision. FID advisors have prepared several training materials — such as an operating manual for accounting and reporting, an auditing and supervision procedures manual, instructions on lending procedures, MIS guidelines, and pamphlets on savings mobilization — and established a core curriculum for courses at the branch level to offset this trend.

To improve the provision of training, the provincial banks must build the costs of training into their annual budgeting while the Government of Indonesia should assist in the development of standards at the national level.

EXTERNAL FACTORS

Macroeconomic Environment

The quality of the external environment can have serious implications for the success of a FID SFI.

- **Macroeconomic conditions:** Stable and relatively low inflation impacts positively on FID institutions by allowing nominal interest rates to be held down and a strong capital base to be maintained. Indonesia has benefitted a great deal from low inflationary pressures over recent years, with national figures for 1991 and 1992 remaining between 9.5 and 9.9 percent.

- **Population density**: High population density can be an advantage to SFIs because it lessens the costs of locating close to clients. However, SFI location and viability are more accurately determined by a three-way framework incorporating density, infrastructure, and diversity of the client base.

- **Externalities**: In the early 1990s, tight monetary policy, a recession, and drought indirectly constricted the rural credit market, leading to poor lending decisions by many rural SFIs.

Policy and Regulatory Issues

Influence at the national level. The Government of Indonesia, in particular the Bank of Indonesia, has been notably accommodating and responsive to FID SFIs and other similar institutions, allowing for the development of a secondary banking system. Although such entities have been allowed to flourish unregulated since 1970, in 1988 the government enacted Packto 27, which was the first formal attempt to recognize and register SFIs. The following year, the Bank of Indonesia (BI) introduced a bank rating system to monitor SFI performance, while the FID assistance team developed uniform accounting and reporting systems for all provinces to follow. Other policy directives have helped strengthen the market-oriented approach of FID SFIs to economic development and paved the way for increased access to resources. The BI would like to continue its trend of accommodation, and has recognized the problems it has supervising the SFIs. BI does not have the staff or experience to monitor the sector effectively.

Influence at the provincial level. FID institutions located in those provinces where local officials have taken a keen and supportive interest in them are the best run and most responsive in the country. In Central Java and Bali, for example, both local and traditional officials have encouraged and financed regulation, training, infrastructure development, and communication, and included the institutions in broad village development plans. Conversely, where government ownership and supervision have been meddlesome, FID SFIs have performed below institutions in the private sector and those with more autonomy to establish their own credit and savings policies. In some provinces, notably East Java, the government has issued regulations that, in effect, micromanage the branches and limit their ability to meet changing market and management needs. As more and more SFIs operate with a view toward self-sustainability, the provincial governments' direct involvement should decrease.

Intervention by Donors and Government

Capitalization. This review of FID SFIs has confirmed the belief that capitalization with soft loans or grant funds is not only unnecessary in most cases, but can also be counterproductive to SFI institutional development. When done properly, financial intermediation, and bridging between informal and rural financial systems and large formal financial systems, meets market needs at both ends and encourages a breadth and depth of financial and institutional development not possible through targeted programs.

Technical assistance. The FID advisors were able to standardize and upgrade numerous skills at many institutions by operating primarily on the provincial and national levels. Intervening at the national level gave legitimacy to the process, opened access to influential decision makers, and increased the scale achieved by the project. Lower-level intervention clearly would not have had the same impact. The high-level institutional mode of technical assistance delivery also ensured that SFIs would not become dependant on expatriate staff to perform operational tasks. The project developed flexible and comprehensive guidelines that have determined product design, mix, and delivery and have given SFIs a solid foundation in fundamental management information.

CONCLUSION

The number of programs operating concurrently in Indonesia has provided a laboratory for the provision of financial services to the poor, allowing for real and sustained comparisons of techniques and institutional structures. The length and complexity of the FID experience can provide solid leads to setting correct financial performance measures, making more use of public-private partnerships, or suggesting effective alternatives concerning the size, distribution, and use of commercial rate, soft loan, and grant capital. As a result of this experience, the FID model has been replicated in other institutional settings and in diverse parts of Indonesia, and may serve as a model for programs worldwide.

ABSTRACT II-4

A REVIEW OF DONOR-FUNDED PROJECTS IN SUPPORT OF MICRO- AND SMALL-SCALE ENTERPRISES IN WEST AFRICA[1]

GEMINI Technical Report No. 54a

William Grant
February 1993

Over the past decade, MSE support projects in West Africa have gradually changed their focus toward long-term sustainability, cost-effectiveness, and institutionalization. Those projects that employ a financial systems approach (in other words, that have captured local resources and employed efficient operating procedures) have been the most successful at achieving such goals. This report examines donor-funded projects in support of the development of micro and small enterprise in 15 countries in West Africa.[2] Researchers reviewed written material from more than 100 projects and selected 17 of the more innovative for intensive study and field visits.[3]

FINANCIAL ASSISTANCE

The organizations that provide primarily financial services to enterprises and individuals in the MSE sector — including those that offer solely savings and credit services, venture capital investment companies, and loan guarantee firms — vary widely in terms of stated purpose, levels of outreach, repayment rates, and overall financial viability. *The most successful programs tailor their service to fit their specific market (for both savings and credit), find creative ways to slash administrative costs, and use special techniques on the credit side to motivate repayment.* In addition, several programs are now adding a savings mobilization component, and many have learned to treat their borrowers and savers as clients rather than beneficiaries. Programs that combine the operating principles of membership organizations credit unions) with those of lending-only organizations may be most effective in providing steady finance to MSEs in West Africa because they can tap into local resources *and* lend effectively.

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[1]The reader may note that, although this abstract covers programs that offer both financial and nonfinancial services, the editors have placed the abstract in Section Two because the majority of programs offer financial services and the majority of recommendations are related to financial service delivery.

[2]The countries covered by the review are Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Mali, Mauritania, Niger, Senegal, and Togo. Cameroon and Chad are also included in the study, even though they are nominally in Central Africa.

[3]The 17 highlighted projects are listed in the annex at the end of this abstract. Extensive case studies, which include information on credit methodology, project achievements, organizational structure, and financial viability, among other information, are published as GEMINI Technical Report No. 54b.

NONFINANCIAL ASSISTANCE

Nonfinancial assistance programs have also become increasingly important in the region. There are several categories of such programs:

- **Training programs**, which usually offer classroom courses in technical, managerial and marketing skills, have been the most common source of nonfinancial support for MSEs. Some of these programs have been reasonably successful, as measured by rising customer demand even when fees are charged. The most popular programs are those that offer focused services to existing entrepreneurs, rather than entrepreneurial training for individuals without an enterprise. The report cites several successful examples such as the specialized financial training packages offered to clients of the Agence de Crédit pour l'Entreprise Privée (ACEP) in Senegal.

- **Business advisory projects** target their services either to existing entrepreneurs who wish to strengthen an ongoing concern or to clients who wish to create an enterprise. Relatively few projects focus specifically on technology development and transfer, although this element is considered critical to the creation of competitive enterprises. In either case, the costs associated with this type of assistance are prohibitively high. Many programs are thus heavily subsidized.

- **Projects designed to improve the environment** facing business people and informal sector operators range in focus from the organization of artisan support groups to policy projects. Artisan organizations, which concentrate on organizing private operators to better access resources, capture new markets and defend themselves against negative government actions, have flourished in recent years, and several have begun to develop group mutual funds to become financially independent. Policy programs are new but are becoming increasingly significant. Important studies on the effect of government policies on enterprise development have been conducted in Senegal, Benin, and Niger.

Nonfinancial assistance programs can provide several elements that complement financial services, but they face the daunting challenge of developing ways to provide such training in a cost-effective, or even profitable, manner. The report identifies three organizational models for the future delivery of nonfinancial services — a private, for-profit firm; an NGO that relies on a partial subsidy; or a government program that has its recurrent costs covered by the state. However, none of the projects covered by the report had been operating long enough to reveal measurable results.

DONOR TRENDS AND IMPLICATIONS FOR FUTURE PROGRAMS

In recent years, donor agencies have increasingly emphasized the long-term sustainability of their projects. As part of this strategy, their focus has changed from one of using local government agencies to implement MSE support programs, to one of encouraging local governments to develop policy and regulatory environments that support the development of MSEs. Although donors perceive the new strategy to be successful, two procedural elements limit its implementation. In general, negotiations between donors and government officials take place without the direct involvement of the private sector, and thus without a proper understanding of that sector's needs. In addition, donor agencies do not share information about the achievements of different programs with each other, limiting their ability to achieve consensus about the best use of their resources.

Donor collaboration has been successful in Mali, however. There, a consortium of donors, including USAID, CIDA, IBRD, and UNDP, created a monthly roundtable to address the problems of employment creation in that country. Although each country or agency continues to have its specific agenda, the enhanced dialogue and sharing of ideas has added transparency to the process, avoided needless replication of programs in a given country, and kept the actors more intellectually honest. In its four years of operation, the focus of the consortium has shifted to enterprise development.

LOCAL NONGOVERNMENTAL ORGANIZATION

The report noted the recently enhanced role of NGOs as reliable partners for enterprise development in West Africa. Donors are giving them more financial support as the number of NGOs, and their level of economic sophistication, increases. Many NGOs have evolved away from a purely social agenda to a more balanced series of activities — sponsoring economic activities, developing financial systems, and assisting enterprises. An important result of this evolution is to allow for more group autonomy as well as develop better managerial skills within the villages and localities.

DIFFICULTIES IN INSTITUTIONALIZATION

Five important elements present constraints for projects that define institutionalization as one of their goals: establishing proper legal status and rapport with the state, determining the right funding structure, establishing sound financial status, installing sound administrative and financial management systems, and installing a good local management team. Often, donor-funded projects carry a special legal status and are not covered by normal regulatory standards. This ambiguity can place the assets of the programs' portfolios in jeopardy once the term or funding of the project ends.

RECOMMENDATIONS

Based on the above findings, the report developed several principal recommendations for donor agencies to strengthen their MSE support programs to develop sustainable institutions.

Project Design and Implementation

- **Take a systems approach to project design and implementation** by concentrating on the development of new technologies and tools that can be maintained after the project is completed.

- **Respect market incentives** when working in market arenas to facilitate the institutionalization of systems and sustainability. Rather than being a source of distortion in the economy, donor projects should base income sources from interest rates and fees on the prevailing commercial rates, create linkages between the formal sector and MSE finance, institute a market orientation from the beginning of the project, and avoid undermining existing private sector initiatives with subsidized donor services.

- **Respect the higher standards of project implementation** set by the achievements of other programs in West Africa. Project managers should be informed of successful project assistance across the region to encourage the development of new tools and methodologies.

- **Continue to foster links between credit unions and credit projects.** Organizations whose philosophies once split into either savings-based or credit-based methodologies are now becoming more closely allied, and donor agencies should explore further the possibilities of such synergy.

- **Provide increased institutional support to local NGOs.** Donor agencies are well positioned to diagnose the needs and limitations of NGOs, and then to invest in them — helping them to do better and increase their leverage.

- **Support more flexible project design and implementation** that allows for enhanced interaction with the target group, greater creativity, and sufficiently long periods of time for project development.

- **Monitor projects closely, but maintain a hands-off approach.** Donors should continue to carry out regular financial audits to ensure that projects are meeting their targets and that resources are being appropriately allocated, but they should not try to second-guess project managers.

Donor Coordination and Relations with the State

- **Promote increased cooperation and collaboration among the donors within a given country.** Although different donors may not agree on all aspects of MSE programming, their representatives can work actively together to develop broad guidelines about such issues as interest rates, viability, project overlap, and the integration of MSE-support activities into the local economy.

- **Share information on results and techniques among the donor community.** As in the private sector, the free flow of information leads to greater transparency and more efficient projects. Donor agencies can sponsor more regional and national activities that match project implementers and allow them to share results and experiences.

- **Continue to promote the recent attention given by host governments to improving the enabling regulatory and policy environments for MSEs.** Limitations on the direct management of private sector support projects has resulted in more creative and better-managed projects with greater potential for long-run survival. Donors should therefore promote the increased participation of the private sector in the elaboration of the policy agenda.

ANNEX: SELECTED PROJECTS
(Commonly known acronym or sponsoring agency)

Credit Programs

These nine programs seek primarily to provide credit to MSEs, either by seeking to create enterprises with credit as the major component, or seeking to provide credit to existing enterprises or individuals involved in ongoing productive activity.

Maradi Microenterprise Development Project (CARE), Niger
Small and Medium Enterprise Development Project (EDF), Senegal
Small and Microenterprise Development Project (PAPME), Mali
Enterprise Creation Project (EDF), Mali
Enterprise Creation Center (EDF), Cameroon
Women's World Banking (WWB), Ghana
Private Enterprise Credit Agency (ACEP), Senegal
Integrated Rural Enterprise Development Project (PRIDE), Guinea
Agricultural and Rural Credit Project (PCAR), Guinea

Projects with Untraditional Approaches to Enterprise Support

Unlike many projects that concentrate on credit delivery (or on developing access to credit by advising on business plans, for example), the projects reviewed here concentrate on nonfinancial assistance. Although they vary from offering training and consulting services to organizing for empowerment, they all seek to work within the existing system to eliminate constraints in a sustainable manner.

Action Consulting Associates (ACA), Senegal
Senegal Public Works and Employment Project (AGETIP), Senegal
Niger Public Works and Employment Project (NIGETIP), Niger
Improve Your Construction Business (IYCB), Ghana
Ghana Regional Appropriate Technology Industrial Service (GRATIS), Ghana
Small Enterprise Development Pilot Project (SNS), Togo
Strengthening Cameroonian Enterprises, Cameroon
Support to the Informal Sector (SNS), Mali

ABSTRACT II-5

FINANCIAL SERVICES FOR WOMEN

Technical Note/Tools for Microenterprise Programs
Financial Assistance No. 3

C. Jean Weidemann
March 1992

As the third in a series of technical notes designed to assist microenterprise development practitioners in program design and in the creation of customized training materials or practices, this note examines strategies for expanding financial services to reach more women.

WOMEN AND FINANCIAL SERVICES: MYTH VERSUS REALITY

Myths about the nature of women's businesses and the consumption patterns of women have led to misconceptions about providing financial services to them. A female-owned enterprise may be perceived as secondary to domestic responsibilities or as otherwise culturally unacceptable. Similarly, financiers may dismiss such enterprises as insignificant activities that have little growth or income potential, and neither need nor deserve financial services. Such assumptions lead to the conclusion that women are not serious about their businesses and therefore do not make good credit risks.

In fact, recent experience has shown that women contribute substantially to economic growth and family welfare. Rather than using credit for short-term consumption, as is widely believed, economically active women will invest heavily in human resources (like health and education) that, in the aggregate, enhance national development goals. Women may also reinvest profits in their enterprises. Furthermore, women are more likely than men to spend their income locally (in the purchase of food or other inputs), augmenting income generation and regional multiplication efforts. During periods of economic contraction, particularly as a result of structural adjustment, the number of female businesses in the informal sector tends to expand along with household dependency on income from women's enterprises. Finally, data from several — though not all (see Abstract II-6) — programs in vastly different societies reveal that women's repayment rates are better than those of men.

CHARACTERISTICS OF WOMEN AND THEIR BUSINESSES

Evidence shows that poorer households are more likely to depend on female income for survival, even when there are working males in the family. Many women resort to informal sector activities and self-employment as a means of support because they either lack employment opportunities or need to balance domestic and work activities.

Lack Assets

Cultural and legal conditions often preclude women from building an asset base. Women receive less inheritance than their brothers in countries governed by Islamic law, and land titles are often given in the names of male household members. Where women do hold title to land and property, the quality of their assets is weak, often appearing in illiquid forms, such as jewelry or household furnishings, or, in rural areas, less valuable, smaller livestock. Problems associated with indebtedness are exacerbated when this already-limited asset base is sold or pawned to meet basic survival needs. Finally, women have little capacity to build assets, because they are usually paid less than men for the same job, or tend to work in enterprises with lower earning potential.

Run Businesses Differently

Women around the world face conflicts between their multiple roles as wage earners, mothers, and homemakers, although the relative pull of any of these roles differs widely in various cultural settings. As a result of this conflict, women are likely to maintain home-based businesses that are smaller, more part-time, and more seasonal than male-owned businesses. Female workers are found primarily in the commercial sector or services; the few found in manufacturing work in light industry (apparel, leather goods, and handicrafts) where profits are lower. Finally, women's growth strategies differ from those of men. In what appears to be a typical pattern worldwide, one study revealed that during business expansion, women hire additional labor, rather than investing in machinery and equipment.

SPECIFIC NEEDS OF WOMEN AND OF THEIR BUSINESSES

Traditionally, financial institutions have not taken the specific needs of women or of their businesses into account. Consequently, the transaction costs associated with accessing financial services are so high as to preclude women. For example, the responsibilities of family meal preparation and child care leave women with less free time and less mobility than men. Women have less cash for transportation and are less likely to own a vehicle. In some situations, cultural and religious barriers further inhibit their mobility.

The standards of formal financial institutions are similarly prohibitive for female clients. Literacy remains a prerequisite for loans at some institutions, despite the fact that women in developing countries suffer from extremely high levels of illiteracy. Women tend to be less experienced than men in interacting with formal financial institutions, and can find them intimidating. Because of the low asset bases discussed above, women are unable to meet collateral requirements.

Finally, financial institutions do not target the types of businesses that are typically owned by females. The predominance of women in the commercial sector results in a heavy demand by female entrepreneurs for a continuous flow of short-term, working capital. Given the rapid turnover of trading and vending, loans carrying a short term and with frequent payment periods are much easier for such entrepreneurs to meet. Women are therefore reluctant to take out the larger, long-term loans offered by traditional financial institutions. They are further unwilling or unable to invest additional resources to access information, inputs, and improved technologies that could otherwise increase the efficiency, productivity, and growth potential of their businesses.

AVAILABLE FINANCING FOR FEMALE ENTREPRENEURS

Despite these traditional views, more and more practitioners worldwide are developing ways to attract and serve the financial needs of women and the poor. Three major categories of institutions have come out of the new strategy:

Programs Targeted Especially to Women

Programs designed specifically to reach women develop a methodology that can bridge the gap between poor women and the formal financial system, although the specific methodology employed depends, to a large extent, on how the target group is identified (for example, female entrepreneurs; illiterate, female workers; or rural women). Prominent examples of such programs include:

- The Self-Employed Women's Association (SEWA) Bank created to help the members of SEWA, an Indian trade union for illiterate women, to access financial services;
- Village banks, a credit and savings methodology pioneered by the Foundation for International Community Assistance (FINCA) and now practiced by at least eight international assistance agencies worldwide; and
- Women's World Banking (WWB)'s affiliates worldwide.

Nontargeted or Mainstream Programs that Attract Significant Numbers of Women

Other lending programs are designed to reach a specific economic stratum, such as microenterprise entrepreneurs or farmers. For some of these programs, the methodology alone attracts a significant proportion of women, as a recent comparative study of two Indonesian programs illustrates. The study looked at the unit desa system of the Bank Rakyat Indonesia (BRI), a vast network of small, village-level retail units, and the village financial institutions of the provincial development banks (known by their acronym, BPD). Although the participation of women in the BRI program ranges from 24 to 30 percent, it is highest (60 percent) in a subset of the BPD system, BKK, where the services offered adequately meet the needs of female clients: its village bank offices are convenient for female entrepreneurs, it has lower collateral requirements, and its smaller loan size corresponds well to women's trading activities. The BRI system serves the clientele of a slightly higher economic stratum, with an average loan size of $440 (1990).

The experience of the Kenya Rural Enterprise Program (K-REP)'s Juhudi credit scheme reveals similar results. Loosely modeled after the Grameen Bank, the Juhudi scheme works with groups of five people who pay monthly deposits into a savings and loan guarantee fund. More males participated in the program initially, but they have been less willing to work in groups than their female counterparts, and their repayment rates have been lower. Over time, the participation rate of females has risen and now stands at 60 percent.

Programs that Evolved toward Targeting a Female Clientele

As with K-REP and the Indonesian programs, many programs begin as mainstream ventures, but soon attract a predominantly female clientele. In some of these cases, the consistently higher repayment rates of female clients convince managers to target the program's services specifically to women. This shift occurred in group lending programs in several different cultural settings, such as the Grameen Bank in Bangladesh, PRODEM in Bolivia, and the Get Ahead Foundation in South Africa.

OPERATIONAL ISSUES: DESIGNING FINANCIAL SERVICES FOR WOMEN

The experience of many programs, including those outlined above, reveals certain characteristics of financial services that are appealing to female entrepreneurs in terms of both cost and methodology.

Groups

Lack of collateral is a primary constraint to female participation in the formal financial system. *Methodologies that tap into workable alternatives for collateral have been the most successful in attracting women clients.* Joint liability and solidarity groups, pioneered by ACCION International and Grameen Bank, have proved to be just such mechanisms. Basing an entire group's qualification for a loan on the default history of each member creates tremendous peer pressure on all the members and is one of the most effective and least costly ways of motivating repayment.

Groups serve other needs as well, because they help women find work, spread information, offer training, and obtain access to resources. This is particularly true in societies in which women might be excluded from formal networks. Groups provide a setting in which women can learn and practice new skills before embarking on their activities. Group decisions can carry more weight and group cohesion often fosters peer learning.

Nevertheless, practitioners should follow certain guidelines to achieve appropriate group formation. For example, groups formed for political purposes should not be used for credit purposes, although the record is less clear for other types of preexisting groups. Groups of varied sizes have also had mixed success. Smaller solidarity groups of 5-7 members, work well in terms of joint liability, while the larger groups found in the Juhudi and village bank programs serve more complex functions such as management and decision-making.

Identifying, Attracting, and Targeting New Clients

To identify new clients, particularly women found in commercial and service sectors or those operating out of the home, *loan officers must be proactive and look beyond areas with high concentrations of manufacturing enterprises.* They must also develop creative radio advertisements or other audiovisual techniques because women are likely to be less literate than men. Practitioners may consider establishing programs for female clients only under specific circumstances, such as where women are in seclusion, where cultural values prohibit women from taking advantage of financial services, or where women have been bypassed so consistently that action is required to compensate. However, *the ultimate goal of a program should be the full participation of women in mixed-gender savings and credit programs.*

When targeting women is a short-term goal, the establishment of quotas can be a powerful tool to stimulate the incorporation of additional female borrowers. If they are to be employed properly, quotas should be determined during project design, should realistically reflect the proportion of women involved in the target group of microenterprises, and should be seen as positive motivators. *High percentages of women may also be attracted to a program simply because of appropriate project design, even without quotas.* For example, by emphasizing certain sectors, such as services and trade, a project is likely to reach significant numbers of female clients. Targeting loans in the manufacturing sector, on the other hand, will result in low female participation.

Gender of Loan Officers

The choice of male or female loan officers can affect the level of female participation in certain social contexts. Female promoters are necessary in strictly Islamic areas such as Pakistan, or where social norms would limit the acceptable interaction between married women (clients) and men (loan officers), such as in rural areas of Latin America. Female loan officers can also serve as positive role models for female clients.

In areas where female loan officers are more desirable, some programs suffer from a shortage of qualified women either because women lack educational opportunities (Egypt, for example) or because safety issues preclude women from visiting clients at night (in urban areas). In such cases, it has been more acceptable for men to work with groups of women than to work with individual clients. However, the experience of the Grameen Bank suggests that *appropriately trained male bank workers can reach out to female clients.* Even though Grameen operates in an Islamic context, less than one-third of its field workers are female. Nevertheless, Grameen maintains its female participation rate of nearly 90 percent because its field staff are trained to understand the special dynamics and constraints of women and their businesses, and to develop qualities that inspire trust and confidence among rural women.

Deposit Services

Savings services should be designed to meet client needs and preferences. *In general, women want savings instruments that offer safety, convenience, ease of deposit, ready access to money, and a positive real return.* Financial institutions can also attract savers by creating products that mimic traditional savings products, such as rotating savings and credit associations (ROSCAs). By offering attractive savings instruments, projects can tap new clients and reach deeper into the community. In many cases, lending can then be largely financed by local savings deposited into the same institution.

Nonfinancial Services for Female Clients

Although several microenterprise programs offer technical assistance and training as part of their services, *training for women may require special attention.* Because first-time female clients may have not interacted previously with a financial institution, initial training should focus on credit consciousness, the responsibilities of the client, and how to be good savers and borrowers. Subsequent training could include courses on marketing and input supply, or on nonbusiness topics geared toward women, such as household budgeting, use of income, family planning, child care, and personal empowerment. Many programs, often referred to as minimalist credit programs, have been successful without offering any training or technical assistance. Managers can assess the relative merits of a training program by charging cost-based fees for training services, ensuring that they are demand-driven.

RECOMMENDATIONS

The most important elements of a financial service program designed to attract more female clients are:

- **Loan terms:** Credit should be available for entrepreneurs involved in trade and services, in addition to those in manufacturing. Loans should be approved in small amounts for short-term working capital, and repayment schedules should be frequent to correspond with women's business cycles. Loan size may be increased upon satisfactory repayment of first loans.

- **Qualifications:** Alternative guarantees to collateral (solidarity groups or character references) should be available. Neither the signature of a husband or male relative nor literacy should be a requirement. Home-based businesses should receive due consideration. Training should be optional and the approval process should be swift.

- **Services:** Deposit services offering safety, convenience, and a positive return should be available. Hours of operation should correspond with women's business and domestic obligations. Location should be accessible and safe for women. Operations should be decentralized, but should reflect strict banking rigor and discipline.

- **Training:** If offered, activities should be participatory and visual, and convenient for women to attend. Females should be used alongside males in illustrations and in any language referring to entrepreneurs. Training should be tailored to the literacy and educational levels of the audience.

- **Impact analysis:** Data collected for any project purpose should be disaggregated by gender, particularly the number and amount of loans and savings accounts, the numbers of clients receiving technical assistance, and the number of clients by industry, sector, and activity.

ABSTRACT II-6

WOMEN IN THE BPD AND UNIT DESA FINANCIAL SERVICES PROGRAMS: LESSONS FROM TWO IMPACT STUDIES IN INDONESIA

GEMINI Technical Report No. 19

Sharon L. Holt
September 1991

This report compares the lessons concerning gender and financial services from impact studies of two Indonesian programs: the Unit Desa network of the Bank Rakyat Indonesia (BRI) and the Bank Pembangunan Daerah (BPD) village-level financial system. Although women typically comprise a very small percentage of clients in government-owned financial programs, the female proportion of the clientele in these two programs is high. By examining these studies and their different service delivery methodologies more closely, this report reveals several influential factors that may affect female participation rates.

INSTITUTIONAL BACKGROUND

The BRI unit desa and BPD systems are the primary sources of credit and savings services for MSE entrepreneurs throughout Indonesia. Moreover, these programs offer financial services to their clients in a profitable and sustainable manner, and continue to grow rapidly.

The BRI unit desa system is a countrywide network of very small retail outlets that were created originally as conduits for highly subsidized farm credit. In 1984, the units were transformed, and new services were introduced — beginning with KUPEDES (an acronym for General Rural Credit), a largely character-based loan offered to any productive enterprise, and, later, a package of savings instruments including SIMPEDES (General Rural Savings), a passbook savings program carrying market interest rates and offering unlimited withdrawals. BRI's retail outlet department made 7.9 million loans averaging $437 between 1984 and early 1990, and collected $646 million in deposits by 1991. Most of the system's diverse clientele had not been served by financial institutions prior to their association with BRI. However, the system has reached neither the poorest stratum of the population nor the smallest rural centers, and less than half of its borrowers were women.

The BPD network is made up of seven separate institutions operating in each of seven provinces. Of the five that are treated by this study, all are owned by the provincial and district governments and supervised by the provincial development banks (the BPDs). All charge market or near-market interest rates. However, each BPD institution differs in its structure and maturity, which can affect the clients it serves. The BKK and KURK systems are the most decentralized components of the BPD network.

Finally, both programs have received support from USAID through the FID project (see Abstract II-3). Phase I of FID provided $22 million in technical assistance, training, commodities, and system capitalization to the BPDs. Phase II provided $16 million in support to BRI's unit desa system.

PROFILE OF FEMALE CLIENTS IN FEATURED PROGRAMS

The two impact studies provided considerable descriptive information about the clients of the BRI and BPD systems.

- **Female participation rates are higher in the BPD systems than at BRI.** Women comprise 55 and 72 percent, respectively, of the clients in the BKK and KURK systems. The proximity of the financial service to women's homes and workplaces of these two programs and the simple processing procedures and lack of collateral requirements act as incentives for female participation. The BRI unit desa and the other BPD programs, which tend to be located in subdistrict towns, are less accessible. These results suggest that *female clients will have higher participation rates in the simpler, more decentralized financial institutions*. Accessibility appears to be the most significant factor here.

- At all the programs reviewed, the **loan sizes of female clients tend to be smaller than those of men.** Across the BPD, the average loan size for men is $87 compared with $59 for women. Although the evidence is not totally conclusive, there appears to be an inverse correlation between the average loan size for the program and the number of female participants: the BRI and West Java programs have larger loan sizes ($437 and $77, respectively) and serve few women clients, whereas the BKK and KURK systems, whose clients are mostly female, each maintain a low average loan size ($26). The latter programs also tend to have shorter average maturities, usually about three months, and require weekly installments. The net effect of these differences is that *women pay more for their credit than men*, demonstrating that they are willing to pay for it.

- The programs with a higher proportion of female clients were found to have relatively high arrears rates, yet this position was likely tied more to the effectiveness of their management than to the gender or income level of their clients. **Neither study produced conclusive results about the financial performance of female clients**, although the BPD study confirmed that women will save when offered the appropriate savings instruments.

- Indirect evidence, using the programs as a proxy for gender, suggests that **female-run businesses are smaller than those that are male-run**, and are more likely to be involved in commerce. The data also suggest that women benefit both as employers and as employees under either system.

- **Women are likely to rely disproportionately on informal financiers**, because men are more likely than women to have access to alternative sources of credit such as family, friends, or raw material suppliers.

- Using loan size as a rough proxy for income status, the study concluded that in some regions, particularly Central and East Java, **the BPD clients (mostly women) tend to be poorer than BRI clients**. This is less true in West Java and West Sumatra.

- **The studies arrive at opposite conclusions regarding the impact on clients of the access to financial services.** The BRI study found that credit led to an increase in client income, enterprise employment, profits, and standard of living. In contrast, the BPD study found that although client income and businesses grew, the growth was not significantly different than that of the surrounding population. However, it is likely that survey methodologies exaggerated the findings in both cases. Further research will be needed to adequately assess the impact of these programs on their clients and client businesses.

In sum, the author found sufficient evidence to support the initial hypotheses, alth ugh she recognized the need to conduct additional studies. To design future research, she recommend gathering extensive information on a well-constructed, nonborrower control group, and developing alternative methods of assessing program impact.

SECTION THREE

NONFINANCIAL ASSISTANCE

NOTES ON NONFINANCIAL ASSISTANCE ABSTRACTS

The two first abstracts in this section of *Nutshell II* continue the discussion of subsector analysis begun in *Nutshell I*, applying this approach in several countries. The Bear report, "CARE and Subsector Analysis," summarizes an application of the subsector approach to the silk industry in Thailand and describes how this study helped CARE to promote the participation of poor people in its silk projects.[1] The Magill paper, "Bridging the Gap Between Equity and Impact: A Subsector Approach to Export Promotion in Ecuador," demonstrates how the subsector approach helped project planners to identify possible intervention points in selected subsectors with both a concentration of microenterprises and export potential, as well as to see the possible effects of these interventions.

Important innovations in nonfinancial assistance have also emerged from the proliferation of small business centers (SBCs), which offer training, advisory services, and information to small businesses, and small business associations (SBAs), which may offer some of the SBC services but tend to focus more on organizing businesses by sector or common interests and bringing these interests to the attention of lawmakers. Several papers look at the role of SBCs and SBAs in industrialized countries in hopes that lessons may be distilled for development specialists. "Principles for Effective Design and Management of Small Business Development Centers" profiles shared characteristics of effective SBCs in Western Europe and the United States in order to identify cross-cutting principles that may be applied in Eastern Europe and the New Independent States. Tom Gray's paper, "Private Business Organizations and the Legislative Process," examines the role of U.S. private business organizations in providing small and medium enterprises a voice in the legislative process; and Kenneth Angell's report, " Private Sector Business Associations in South Africa and Zambia," examines the constraints faced by SBAs in those countries and discusses the potential role these organizations could play.

Salient findings about nonfinancial assistance to micro, small, and medium enterprises include:

- **Intervention at strategic points in production systems can have a more widespread impact on producers than direct assistance to end-producers only.** Bear and Magill each document how assistance projects can expand outreach by providing leveraged intervention at different points in the production chain where value is added to goods destined for export.

- **"You get what you pay for."** SBC clients in industrial countries indicated that they would rather pay a reasonable amount and be entitled to expect professionalism than receive inappropriate, lower-quality services for free. However, in developing countries, small business associations are often weak and lack the political clout to properly address economic issues. Depending on country circumstances, donor assistance may best be targeted to strengthening the ability of these organizations at the local level to provide services of value to potential clients.

Readers interested in nonfinancial assistance should look at William Grant's report (Abstract II-4) in the financial assistance section of *Nutshell II* for information about technical assistance components of selected MSE projects in Africa, and at the abstract discussing assistance to small businesses in the New Independent States (Abstract IV-1). For further reading on nonfinancial assistance, please refer to both the GEMINI publications list and *GEMINI in a Nutshell*, Section Three, which includes abstracts of the following reports:

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[1]The Thai silk subsector is explored in detail in the GEMINI Technical Note series and is the example used in the GEMINI training module on subsector analysis.

"Ecuador Microenterprise Sector Assessment: Summary Report," GEMINI Technical Report No.8, John Magill and Donald Swanson, April 1991.

"Technology - The Key to Increasing the Productivity of Microenterprises," GEMINI Working Paper No. 8, Andy Jeans, Eric Hyman, and Mike O'Donnell, November 1990.

"A Subsector Approach to Small Enterprise Promotion and Research," GEMINI Working Paper No.10, James Boomgard et al., January 1991.

"Opportunities for Intervention in Thailand's Silk Subsector," GEMINI Working Paper No. 27, Steven Haggblade and Nick Ritchie, January 1992.

ABSTRACT III-1

CARE AND SUBSECTOR ANALYSIS: A REPORT ON CARE'S FORMATIVE EXPERIENCE

Working Paper No. 43

Marshall Bear
October 1993

Microenterprise practitioners share a growing interest in the application of subsector analysis concepts and tools in microenterprise development projects. This report examines CARE's formative experience with the implementation of subsector analysis in its Thai silk project. To add useful insight into the use and application of subsector analysis, the study also draws on CARE's experience in Bangladesh with the bamboo subsector as well as CARE's efforts to provide subsector analysis training in Egypt. Finally, the study raises important institutional questions about the use of subsector analysis in program design.

SUBSECTOR ANALYSIS: CORE CONCEPTS AND TOOLS

A subsector is a network of firms — micro, small, and large — that transforms raw materials into finished products and distributes them through supply channels to final consumers. A subsector includes economic activities from different sectors. For example, the silk subsector includes agricultural enterprises — small farmers who grow mulberry, and manufacturing enterprises — weavers of silk cloth and reelers of silk yarn. Any given economic subsector is made up of *participants* who engage in several activities, called *functions*, that transform a raw material into a marketed product. Participants who perform similar functions using similar technologies are linked together in a *vertical production and distribution chain* called a *channel.* A subsector normally consists of several different channels, each competing for market shares. Participants within particular channels operate within a *coordinated system of exchange*, through interaction in the market. A *subsector map* provides a picture of the economic relationships among all participants in a subsector, enabling the analyst to analyze inter- and intra- channel dynamics and pinpoint *leverage* points where an intervention could affect a maximum number of subsector participants. In short, subsector analysis provides a set of concepts and tools used to assess where and how to intervene within this economic system.

If microenterprises are to raise their productivity and grow, the enterprises must either narrow their range of functions and specialize, or get larger and integrate vertically with different production and market functions. The subsector analyst assumes that the entrepreneur may know more about her business than any external business support agency, but she lacks perspective and important information about the larger economic system is which her business operates. The subsector analyst hopes to assist the growth of microenterprises by providing a window to the larger system and with this perspective help guide decisions at the core of business growth.

CARE'S SMALL ECONOMIC ACTIVITY DEVELOPMENT PROGRAM

CARE/Thailand's Silk Project

CARE/Thailand worked with 500 rural households in helping them make the shift from traditional to modern silk raising methods. The subsector study of silk production conducted in December 1990 stemmed from the desire to gain a more precise understanding of the opportunities and risks in silk product markets to design future interventions and greatly expand the number of producers reached.

In preparing a subsector map, the study identified five distinct production channels ranging from traditional silk producers performing all production functions for personal consumption and ceremonial dress, to the Jim Thompson Company, the market leader who defines the quality standard and has enjoyed excellent sales and profitability with the growth of the tourist market. The study identified the following forces driving change in the subsector: a growing domestic tourist market for quality silk products and a converse decline in demand for traditional garb, a demand for upgraded technology in each function of production in response to the growing tourist market, a shortage of hybrid eggsheets and mulberry from government suppliers, and a government yarn policy that vacillated between strict quotas and no quotas on white warp yarns.

In response to this environment, the subsector study recommended the following interventions for maximum leverage: concentrate on yellow weft production, improve access to hybrid mulberry, increase output of hybrid eggsheets by lobbying for reduced subsidies, distribute improved reeling technologies, and disseminate information at assembly points. CARE adopted several of these recommendations. CARE:

- Concentrated in the more stable yellow weft yarn market;
- Linked rural producers to commercial growers of improved mulberry in an arrangement by which the former could cut improved stakes from the latter for a fee;
- In field trials, demonstrated improved hand reelers, which local skilled furniture makers quickly copied and sold; and
- Began to explore the concept of a silk bazaar as a venue to share information on silk production.

The subsector study contributed to profound changes in CARE/Thailand's understanding of the silk subsector and the strategic importance of the project in promoting the participation of poor people in this growing market. The study provided CARE with a comparative assessment of risks and benefits of different market niches for rural households, allowing CARE to identify stable markets and key leverage points. This choice of market niches also allowed CARE to clarify its project goals. Rather than focusing on a limited number of households within a specific geographic region, CARE could scale up and reach a larger number of households interested in and able to make the shift to yellow weft yarn. Finally, the focus on yellow weft production over white warp silk permitted the entry of traditional households as valued participants in the growing segments of the subsector.

CARE/Egypt: Subsector Analysis in Loan Fund Financing

CARE/Egypt conducted a three-week field orientation in subsector analysis to familiarize senior staff with the methodology and to determine its usefulness in better focussing the Community Initiated Development (CID) Program, a project providing assistance to community-based NGOs to help them establish and manage small revolving loan funds. CARE's previous efforts in CID centered on setting up effective loan management policies and systems and left the type of activities financed to the NGOs. In light of a growing concern that the increased economic activity was simply dividing a static market, CARE hoped to use subsector analysis to point the NGOs' loan portfolios to economic activities with greater potential for community economic growth.

After the workshop, however, CARE determined that subsector analysis was an inappropriate tool for the following reasons: effective application of the methodology would require a significant amount of staff time and resources; the wide range of activities funded by CID would require numerous subsector analyses, requiring unjustifiable expenditure; and the skills to use the subsector tools effectively required a higher level of analytical capability than was present in most CID and NGO staff. The practitioners concluded that subsector analysis would be a more appropriate tool for a financial services project if the loan portfolio were concentrated in a few specific activities, like tailors or carpenters.

CARE/Bangladesh: Analysis of the Bamboo Subsector

CARE/Bangladesh conducted a study of the bamboo subsector in hopes of designing a project using subsector concepts and tools. As in Egypt, however, the study determined that the subsector methodology would not be the most effective tool for intervention. Poor management practices and planting materials meant that small and large village bamboo suppliers alike were not able to increase supply or quality in spite of the financial incentives to do so. Forest bamboo suppliers were responding to market signals, bur supply was being depleted as permit holders mined this natural resource for short-term return without a view of long-term sustainability of supply. The analysts determined that the concepts of leverage did not apply particularly well to the bamboo subsector.

Although bamboo did not fit the subsector methodology, the study did help CARE/Bangladesh identify and later implement several other cost-effective interventions. These interventions included management trials, experimentation with branch cuttings, and the investigation of the toxicity of existing chemical-based preservatives as a precursor to a study of consumer preferences for higher-quality building materials.

CONCLUSIONS AND OUTSTANDING ISSUES

Whether it was formally adopted or not, the use of subsector analysis in all three cases gave the programmers concepts and tools necessary to get an understanding of the bigger picture. Subsector mapping offers a picture of relationships between all the key players — not just producers and suppliers, but also consumers and government officials. Listed below are some of the issues arising from the use of this methodology.

- **Indirect versus Direct Assistance Strategies.** Subsector analysis shifts away from direct interventions to target groups in favor of intervention at points in the economic system where actors at key leverage points (such as traders, larger private sector processors, or government policy makers) can provide needed services to rural households. In Thailand, this leveraged intervention was successful, but this shift away from direct service to the poor raises some tough questions for CARE project and management staff. CARE's approach to project design is target-group-focused. Can CARE be accountable for delivering benefits to poor people if there is no direct contact with them? The use of indirect interventions like subsector analysis places a premium on the installation of appropriate monitoring and evaluation systems to track the impact on the target group.

- **Changing Roles, Changing Partners.** Typically, CARE works directly with individuals and community groups and in counterpart relationships with government or NGOs. Adopting subsector recommendations could result in a very different mix of partners; the Thai silk study advocated establishing relations with yarn traders, larger silk companies, and policy makers in addition to operational staff in the field. The implication is that CARE should form effective partnerships with public or private sector entities unfamiliar with NGO and rural development programs and philosophy to have the most widespread impact. Are operational agencies (like CARE) in the best position to implement such leveraged interventions?

- **From Research to Project Design or Redesign.** Conducting a subsector study typically requires at least two people working full time for 4-6 weeks — a significant investment. The first step — identifying a subsector — is the hardest and most important. The latter parts of a study — analyzing the dynamics and identifying leveraged interventions — require quality data to estimate market size and trends as well as staff with strong analytical skills and prior training in market analysis in addition to subsector techniques. Many tools require common sense and can be taught to staff, but CARE missions interested in selecting subsectors to study may need the assistance of trained economists and technical specialists with knowledge of the history and dynamics of a specific subsector. Initially, CARE may find subsector research most useful in the redesign of existing projects where CARE is knowledgeable about a subsector. In addition, one should note that a subsector study indicates possible interventions, but not the methods of delivery or potential donors. Programmers will need to develop workable partnerships and delivery mechanisms.

- **Subsector Analysis as a Project Design Tool.** Experience to date suggests that subsector analysis should be considered as one important tool, among many. In many circumstances, it would not be the tool of choice. Feasibility studies, technical analyses, and rapid rural appraisals are alternatives that should be considered. Subsector analysis is most useful when backward and forward linkages involve a network of actors from diverse geographic regions, and when there are several participants in different channels who compete with each other using different technologies.

ABSTRACT III-2

BRIDGING THE GAP BETWEEN EQUITY AND IMPACT: A SUBSECTOR APPROACH TO EXPORT PROMOTION IN ECUADOR

GEMINI Working Paper No. 47

John Magill
April 1994

The U.S. Agency for International Development and other international donor agencies emphasize export promotion as an approach to economic growth and development. Micro and small enterprises are typically ignored in these programs, partly because of a desire to cause a large impact with a small project, and partly because of an underlying assumption that MSEs cannot export. However, such assumptions raise concerns about the equity of targeting only large firms; consequently USAID also has an interest in incorporating small-scale producers into export promotion projects. GEMINI work around the world has shown that, given a greater understanding of the role of MSEs in export industries, ways can often be found to help both the growth of MSEs and export growth, achieving greater equity along with greater impact.

Such an approach appears applicable in Ecuador. Earlier GEMINI studies in Ecuador (Technical Reports No. 8-No. 12) indicate that although few MSEs currently export directly, there are many MSEs in industries with strong export potential. In 1992, USAID/Ecuador, the Corporación Financiera Nacional (CFN), INSOTEC (an Ecuadorian NGO), and the GEMINI project conducted a study of selected industries that possess both a concentration of MSEs and a potential export market. Using the subsector approach, the participants analyzed the wood furniture, ceramics, and leather garments and accessories subsectors to determine the key constraints to production as well as the feasibility of combining the two goals of microenterprise growth and export growth in an export promotion project.

THE SUBSECTOR APPROACH

Subsector analysis is not a specific methodology, but is instead a strategy for looking at development opportunities. A full analysis of this approach and examples of its application may be found in GEMINI Working Paper No. 43 (see Abstract III-1 in this collection). To summarize, subsector analysis looks at the entire production chain and identifies the participants and the key impediments to making significant improvements. Rather than working with a few individual firms, a subsector study identifies opportunities for leveraged interventions that can produce a positive impact on groups of firms at different points in the production chain. Such an approach contrasts with traditional approaches to export promotion. Instead of looking only at producers at the end of the production chain, subsector analysis looks at the cultivation and collection of raw materials, all steps of processing and transporting those materials, as well as the final manufacturing and marketing of goods. This is a rapid appraisal technique designed to quickly provide information and insights for practical decision making; local professionals or project personnel can use this tool in planning, designing, and implementing projects with a relatively small investment in training.

MICROENTERPRISE INVOLVEMENT IN THE WOOD, LEATHER, AND CERAMICS SUBSECTORS

The research team divided the selected subsectors into discrete activities within the larger tasks of cultivating and collecting raw materials, processing materials into usable forms, transportation, manufacturing finished good, and marketing. Researchers determined that MSEs exist at every production point in the wood and leather subsectors, but are more concentrated in production of finished goods in the ceramics industry.

In the wood subsector, there are a few vertically integrated firms, but MSEs dominate most stages of production. The study estimates that about 89,000 microenterprises are involved in processing the wood for manufacturing and producing furniture. Most of the harvesting, rough cutting, drying, and transportation of wood is performed by individuals or very small firms. Firms of all sizes manufacture furniture. Some microenterprise artisans produce complete pieces, others subcontract specialized ancillary services. Researchers found very few women working in this subsector. Similarly, MSEs dominate most stages of production in the leather subsector. MSEs are largely responsible for slaughtering, transportation, and leather tanning. There are a few medium-sized and large producers of finished leather goods who target the export market, but small firms produce most of the leather clothing in Ecuador. By one estimate there are more than 10,000 MSEs manufacturing leather clothing alone, not including shoes or the large number of MSEs that add value to the hides at earlier stages. Women play an important role in the later stages of production, cutting and sewing the leather into clothes and accessories.

In contrast to the proliferation of microenterprises in the leather and wood subsectors, a few large producers control the ceramics industry. This subsector has fewer processing steps: MSEs are involved only in the production of artistic ceramics sold in the domestic market for discretionary family consumption. A few large firms completely control the early stages of production: mining, mixing, and transporting the clay. These firms produce primarily for their own needs and sell only their surplus to MSE ceramics producers. In spite of this lack of access to materials, the number of microenterprises producing finished ceramics goods is not insignificant; the data indicates that there are more than 1,200 MSEs producing artistic ceramics in the country. Women do not have a strong presence in this field, but are engaged in glazing and selling ceramics.

Production Constraints

In all three subsectors, investigators identified critical weaknesses in the supply of raw materials. The furniture subsector uses primarily wood that is a by-product of forest colonization, not the product of deliberate harvesting of a commodity. The low species density of Ecuadorian natural forests makes it difficult to obtain a sufficient supply of homogenous wood to satisfy the quantity and quality requirements for exported goods. Similarly, leather is a by-product of the meat industry: because all hides command the same price, there is no incentive to improve the technology in cutting and preserving hides. Crude processing techniques to refine lumber and leather result in tremendous waste of raw materials in both of these subsectors, further reducing the quantity of useful materials. Finally, the ceramics subsector suffers from an unreliable supply of raw clay; the large companies sell only what they do not need, and stockpiling is common among MSEs. Furthermore, there is no supplier of blended clay. Consequently, the clay is of uneven quality since MSEs must dry, sift, blend, and knead the components of the clay themselves.

All three sectors also suffer from a lack of knowledge about current designs and styles and a lack of familiarity with the demands of the export market. Small-scale leather producers would not only need better materials to work with, but better finishing techniques to compete in the export market. Although larger leather goods producers are aware of the importance of quality, smaller producers currently compete among themselves by lowering prices, with predictable results on the quality of their wares. Demand for high-quality products similarly affects small furniture producers, requiring more costly production techniques that reduce profit margins. Researchers in the furniture subsector also detected excess capacity in many furniture manufacturers, suggesting that outside assistance might not necessarily create more jobs in this part of the production chain. In the ceramics subsector, artisans lack information on foreign markets, including requirements for design and quality of ceramics, knowledge of export procedures, and the costs involved.

Appropriate Interventions

This analysis suggests that traditional approaches to expanding exports (such as credit, technical assistance to individual firms, and trade fairs) would have a limited impact on the microenterprise entrepreneurs in these sectors because the key constraints are related to the supply of raw materials. Thus, in the case of the wood subsector, investigators felt that the introduction of forest management techniques, of modern processing technology, and of industry standards and measures would be the most appropriate intervention to improve furniture production. In the leather sector, donors could make a significant contribution by offering technical assistance to improve the quality of raw hides, or providing assistance in modernize tanning and splitting techniques and introducing a system of grading hides. In the case of ceramics, an indirect investment in a mining and blending operation to serve as a wholesale distributor, or the formation of some sort of producer association or cooperative would be most beneficial.

MICROENTERPRISE, EXPORT PROMOTION, AND EQUITY

Although microenterprises did not export in significant quantities in any of the subsectors studied, they did play a key role at various points in the production chain. Programs that succeed in expanding exports will indirectly benefit MSEs by creating demand for the intermediate goods and services supplied by them.

Subsector analysis helps planners to identify these indirect impacts by studying the whole production chain rather than isolated players. Planners must examine carefully these indirect effects; efficient solutions that benefit participants at one level of production may have a negative impact on other industry players unless other actions are taken. For example, efforts to improve output of the large producers in the ceramics subsector will reduce the availability of clay for small producers unless parallel activities are undertaken to ensure continued access to raw materials for small-scale producers. Efforts to minimize lumber wastage with improved processing technology could put many microprocessors out of work. This is not to suggest that such interventions should not be undertaken; rather it underscores the usefulness of subsector analysis in identifying positive and negative consequences of possible interventions.

Subsector analysis can be used to investigate a variety of equity issues as well. In studying the larger question of who is involved in each step of production, researchers can also address questions such as gender, ethnicity, or geographic impacts. If a donor agency wants to support employment opportunities for women, a subsector study can help identify the potential effect of different interventions. For example, the Ecuador initiative found that women were almost nonexistent in the wood subsector, but that women play an important role in the manufacture of leather goods and glazing ceramics. The same approach could be used to explore other social issues during the design phase.

APPLICATION OF SUBSECTOR ANALYSIS TO THE DESIGN OF EXPORT PROMOTION PROJECTS

Perhaps the most important lesson learned from the Ecuador experience is that subsector analysis offers donor agencies a low-cost rapid appraisal tool that can quickly provide useful information and guidance for project design. It allows a team of local personnel to scan the options available and validate interventions strategies. This process can quickly:

- Identify the specific constraints on expanding exports in selected commodities or products, allowing donors and host government agencies to plan the most appropriate strategies to address the specific problems that need to be resolved, increasing the likelihood that beneficial changes will occur;

- Distinguish between situations that respond well to infusions of capital and situations that do not, allowing donors and host governments to focus capital resources on industries that can make effective use of them and to avoid those that cannot. In this situation, subsector analysis improves the allocation and impact of development resources; and

- Identify subsectors that involve small producers, women, or other subgroups to a greater extent than others, either as direct exporters or as providers of raw materials and components — offering a mechanism for bridging the gap, currently developing within USAID programs, between rapid growth and equity considerations.

In summary, subsector analysis offers donors and host country agencies a powerful tool for making preliminary design decisions. As a first-level diagnostic tool, it can be used to cull viable options and alternatives and to assess the potential impact of different types of intervention. Although it will not take the place of detailed feasibility studies, subsector analysis can point the way to more in-depth analysis when needed.

ABSTRACT III-3

PRINCIPLES FOR EFFECTIVE DESIGN AND MANAGEMENT OF SMALL BUSINESS DEVELOPMENT CENTERS

Technical Report No. 62

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October 1993

BACKGROUND

Small business development centers (SBCs) are receiving renewed attention as a potentially appropriate means of assistance for small businesses in the emerging economies of Eastern Europe and the New Independent States (NIS). Theoretically, these centers can provide one-stop training, advisory services, and other specialized assistance to entrepreneurs of small enterprises, while serving as a hub for information on other resources in the community. Services are usually subsidized, if not free.

In developed industrial countries, SBCs have a successful track record of helping to level the playing field for small businesses to allow them to succeed in the national economy. Yet donor experience with SBCs in developing countries has been mixed; the centers require significant investment, offer such a wide range of services that quality often suffers, and frequently do not satisfy the needs of the clients. In light of the deep-seated needs of the private sector in the former Soviet bloc, however, the U.S. Peace Corps — with many development planners — is reconsidering SBCs as a vehicle for providing assistance to private enterprises in that region.

The Peace Corps has been active in small business development since the early 1980s. As part of the process of reexamining small business development centers, the Peace Corps commissioned a study under the GEMINI project to examine the experience of SBCs in the United States, Western Europe, and Eastern Europe. The purpose of the study was to observe how SBC technology from Western countries has been extended to locally funded and donor-funded SBCs in Eastern Europe and the NIS and to discover cross-cutting principles of effective SBC program design and management.

The team carried out preliminary interviews with a broad range of SBCs and selected 28 programs for in-depth review. Each SBC was visited in person. Researchers interviewed managers and staff using a specially developed questionnaire that solicited information on program goals and objectives, organizational structure, services, staffing, client profiles, program financing, institutional collaboration, monitoring and evaluation, and lessons learned. The team also interviewed clients from most of the programs to obtain their impressions on usefulness of services.

SHARED CHARACTERISTICS OF SUCCESSFUL SBCs

From the data collected, the team discovered several principles for effective design and management of SBCs that apply across widely varying program and country contexts. Listed below are the most salient findings:

Clear Definition of Objectives

The primary objectives of a program help shape the approach that makes the most sense — the number and quality of managers and staff required, the mix of services that should be offered, and the procedures that should be adopted for implementing the program. *One of the key issues that must be clarified from the outset is whether creation of a permanent institution is a primary objective.* SBC programs can be classified according to the emphasis they place on institutional development as opposed to direct delivery of services. When institutional development is a primary objective, as is the case for many donor-funded SBC initiatives in Eastern Europe, an explicit, adequate level of human and financial resources must be committed to this objective from the start. It is not possible to say that one approach is inherently better than another. The appropriateness of a particular approach depends on the primary objectives of the principal funding source as well as on the context.

Assessment of Context and Needs

Supply-driven programs featuring inappropriate services result in limited impact and are unlikely to achieve financial self-sufficiency. Assessment of context and needs is a critical step in program design. Assessments should cover the policy and regulatory environment in which small enterprises operate, cultural and social characteristics of the client group, and the specific services entrepreneurs require. Assessments should also identify systemic (as opposed to firm-specific) constraints hindering small enterprise growth, as well as niches in which small business can have a competitive advantage.

Strong Leadership

Sound management of an SBC requires *continuous and committed program leadership.* SBC managers must have a stake in the center's continued operation, a clear understanding of the program mission, a vision of its future development, and responsibility and authority for shaping program services and procedures.

Clear Financial Plan

Once an SBC's primary objectives and basic approach have been clarified, a clear financial plan should be developed and implemented that reflects these objectives. For time-limited, fully funded SBCs, the emphasis may be on developing systems and procedures that make the most cost-efficient use of project resources, ensuring that services are delivered to the targeted groups. For programs that include a long-term institutional development objective, the plan should indicate the course to be followed in securing long-term financial support, including introduction of fee structures and fundraising plans. The financial plan must be linked to accurate ongoing monitoring and management of operational and program expenses.

Qualified, Dedicated Staff

Most SBCs point to their staffs as both their biggest asset and their biggest potential liability. Attributes most valued include dedication, hands-on business experience, effective counseling and communication skills, sensitivity, and objectivity. Qualified staff are hard to retain. Most programs are not in a position to offer competitive salaries, given low levels of funding and the uncertain conditions under which many operate. This factor, combined with the demanding nature of the assistance, promotes high staff turnover — a serious impediment to effective program management and service delivery. To ensure effective staffing, *SBCs should hire the best staff that can be found and pay them as well as possible; invest in ongoing staff development; provide other incentives to motivate staff, including performance-based bonuses and interesting training opportunities; and create an environment of certainty about program operation*, even if this is for a known, limited time.

In the United States and Western Europe, volunteers tend to be of limited usefulness. Although they may be effective in filling certain niches, problems in using them often outweigh the benefit (the fact that they are free). Limited time availability and inadequate or inappropriate skills are the most frequent constraints. In the Eastern European programs, foreign volunteers are often hindered from providing one-on-one advisory services by limited knowledge of local situations and customs and inability to speak the language. Despite these constraints, volunteers can make useful contributions by assisting SBCs to develop and implement plans for institutional sustainability, develop local networks to support small business, design databases and monitoring and evaluation systems, and develop training materials.

Focused, Businesslike Approach to Service Delivery

Given the limited funding and scarcity of qualified staff that most programs face, *a focused, businesslike approach to service delivery is imperative*. When asked about the problems they face, several SBC staff interviewed mentioned the mistake of trying to do too much at one time. This tendency stems in part from a lack of clearly defined program objectives and in part from pressure to demonstrate impact, which often is reduced simply to counting the number of clients served. This type of pressure is particularly pronounced in Eastern Europe, where institutional support for private business is still limited and there are few, if any, alternatives to the services that a given SBC provides.

When programs spread themselves too thin geographically and programmatically, the quality of services drops off. Strategies for coping with high demand for a broad range of services include establishing clear objectives, improving coordination with other donor-funded initiatives, building and improving linkages with other local business support organizations, and accurately assessing the most important needs of entrepreneurs. With clearly defined objectives and an accurate assessment of the local context and needs, SBC program managers can narrow the target client group, identify appropriate services, and concentrate deployment of resources.

Charging Fees

Fees are a useful mechanism for separating serious, dedicated clients from those just shopping around. Clients who invest some of their own resources are likely to place a higher value on the services they receive and to take more responsibility for ensuring that they get what they need from counseling or training. Fees also contribute to the financial self-sufficiency of an SBC. Those interviewed made it clear that they believe that "you get what you pay for," and indicated that they would rather pay a reasonable amount and be entitled to professional assistance than receive inappropriate, lower-quality services for free. By charging fees, SBCs practice what they preach and become more like the private sector entities they are helping to create than like public sector vehicles dispensing hand-outs.

Collaboration with Other Institutions

Developing working relationships with other local institutions that support small business development is a critical step in planning for sustainability. The types of organizations SBCs need to collaborate with include local government agencies, financial institutions, trade and professional associations, chambers of commerce and industry, universities, technical high schools, training institutes, consulting firms, accounting firms, law firms, and other private service providers. Developing a local institutional network strengthens the fabric of support for small business development within a given community. At the same time, it lays the groundwork for the sustainability of SBC services, by allowing selected services to be transferred to another permanent institution or by mobilizing financial support from some combination of these other institutions. An *effective referral network is one of the most important sources of program leverage an SBC can achieve*; with such a network in place, an SBC can safely concentrate on its areas of specialization, connecting clients with assistance from other sources as necessary.

Links to the Private Sector

Some SBCs, particularly in England, have found creative ways of stretching public funds and harnessing the private sector by forging linkages between clients' small firms and large industries. To develop these subcontracting, mentoring, and sponsorship ties, the staffs of SBCs must be aware of local and regional economic opportunities and see ways small businesses can be integrated effectively. *Involving the private sector stretches program resources and provides clients with the most hands-on, effective assistance.*

Impact Evaluation

Impact evaluation is important for ensuring that services are benefiting clients and that benefits are worth the investment of public and private funds. However, measuring the impact of discrete services on small business performance is extremely difficult. Data provided by entrepreneurs after the fact are often unreliable, and growth, when measured, is hard to attribute to the services of a particular program. Despite these problems, almost all SBCs are required to collect data that indicate the impact of the programs and help justify their continued existence. Unfortunately, there are few examples of good monitoring systems to draw on. Devising effective monitoring systems that are not a burden to staff or clients remains a challenge. *In the end, monitoring systems may be more useful as management tools for assessing and modifying service delivery than as vehicles for providing conclusive evidence about program impact.* Indicators such as number of repeat clients, number of clients received through referral from prior clients, and number of requests for specific services provide a measure of the usefulness of services. These indicators have more meaning when services are not free but have some fee attached to them. Market validation in the form of clients' willingness to pay may ultimately be the best test of service effectiveness.

ABSTRACT III-4

PRIVATE BUSINESS ORGANIZATIONS AND THE LEGISLATIVE PROCESS

GEMINI Working Paper No. 40

Thomas A. Gray
June 1993

This paper examines the role of private business organizations in providing small and medium-sized enterprises (SMEs) a voice in the legislative process. Although this study analyzes this process only in the United States, the issues involved in representing the interests of SMEs are similar worldwide. This summary will focus on these shared issues, and thus will not include the report's detailed analysis of the law-making process in the United States. The findings in this paper may be particularly relevant for donors and practitioners interested in small business advocacy in the emerging economies of Eastern Europe and the New Independent States.

SMALL BUSINESS AS A SPECIAL INTEREST

In a democratic society, it is assumed that the various personal, social, or business groups that may be affected by a proposed piece of legislation will defend their interests by providing information to their representatives in the legislature. In the United States, small businesses are active participants in this process, providing facts, statistics, and economic arguments to defend their interests, and actively supporting representatives sensitive to their needs in elections. Worldwide, SMEs are also a potentially powerful constituency. In addition to their sheer numbers, there is a growing realization that small businesses are important contributors to the general welfare, both as providers of jobs and incomes and of needed goods and services. Yet small businesses have needs and interests that are distinct from their larger counterparts and can be easily harmed by legislation, either directly or indirectly. For example, although health care reform will have an impact on the cost structure of all businesses in the United States, it raises fundamental issues of survival for many small businesses. As a result, it is important to assist SMEs to organize so that their voice is heard in the legislative process.

FACTORS THAT MAKE IT DIFFICULT TO ORGANIZE SMALL BUSINESSES

Although circumstances may vary from country to country, there are several common problems in organizing small businesses. Key issues include the independence of small business owners, the diverse needs and interests of firms, the size distribution of firms in a given industry, the problem of free riders, high organizing costs, and the influence of geography. Each of these is examined in more detail below.

The Independence of Small Business Owners

By definition, SMEs are independent businesses, almost always closely held, with ownership by a single owner or by a family. Many SME owners have gone into business because they prefer to work for themselves, rather than taking orders from someone else. Individuals that place great value on independent action are typically difficult to organize into any kind of group.

Diversity of Small Businesses

One problem that makes it difficult for small business owners to effectively communicate with their representatives is that small businesses do not form a monolithic group., and therefore do not have identical interests. With the exception of tax policy (all businesses share an aversion to higher taxes), most suggested legislation and most regulations proposed to implement new legislation are favorable to some small businesses, but unfavorable to others. For example, legislation to reduce air pollution will require those businesses emitting unacceptable levels of pollution to purchase new equipment or hire specialized companies to bring emissions down to newly mandated levels. This will be costly and the firms affected will oppose the new law. On the other hand, small firms producing antipollution equipment will support the legislation. Meanwhile, those small businesses not emitting this type of air pollution will have no opinion on the subject. This disparate array of responses from SMEs prevents small businesses from presenting a united front to legislators.

The Size Distribution of Firms by Industry

Representing small business interests by organizing along industry lines also has pitfalls, because many industries are populated with both small and large firms. In such cases, large firms are likely to control the industry organization, which consequently may not represent small business interests well.

Diversity of Trade Organizations

Effective organization may also be hindered by too many organizations attempting to represent the SME population, leading to an unfocused voice. In the United States, for example, trade and industry associations are completely independent of all levels of government. Members of these organizations (which may or may not specifically cater to SMEs) join voluntarily and continue to pay dues only as long as the organization convinces them that membership benefits are worth the costs. In such settings, maintaining a large, multi-interest organization becomes a difficult task.

Free Riders

Many small business organizations organized geographically are successful in representing all of the smaller businesses within their geographic area but are not able to attract more than a small minority of the total business population. In part, this problem is caused by free riders — those nonparticipants who can enjoy the benefits achieved through the efforts and expense of active participants, but without paying the accompanying costs. In such cases, business owners may disguise their degree of interest in a costly initiative, hoping that the effort is successful, thus allowing them to benefit from the actions of others. Only in situations where organization membership is compulsory is the free-rider problem eliminated. When membership is voluntary, however, this problem has hindered the development of broad-scale small business organizations.

Private organizations can address this problem by bundling other attractive services and benefits along with their representational activities.

Transaction Costs

Another major difficulty in organizing small businesses is the high cost associated with communicating with any group made up of millions of independent members. First, it is difficult to obtain a complete listing of smaller firms, and almost impossible to keep the list up-to-date with the frequent entry and exit of small firms In the United States, for example, it is estimated that the typical private business listing deteriorates 1 percent per month because of the closure or movement of firms. Because listings are usually about a year out of date when first published, 10 to 12 percent of the names on the list will not be usable. Also, U.S. federal authorities will not provide names or addresses of SMEs; thus listings must be obtained from private providers. These lists are expensive to buy, but this expense is small relative to the cost of mailing to millions of businesses. Mailing costs can be defrayed by membership dues, but the cost of mailing to potential members can be prohibitively expensive. This helps explain why organizations are often organized geographically, so that other methods of contacting members, such as advertising, can be used effectively.

Geography

Geographic factors have a large influence on the manner in which small businesses organize to protect their political and economic interests. Where population is dense and travel time between cities relatively small, small businesses are likely to organize regionally. For example, in New England, where there are six small states, small firms are organized into a regional association. Total membership is small relative to the number of small businesses in the region, but the association effectively represents New England businesses at all government levels, from issues before the U.S. Congress down to testimony on issues discussed in major cities throughout the region. In the Midwest, in contrast, organizing on a regional basis has proved impossible because of the distance between large cities; consequently business organizations are more effective when organized along state lines.

TYPES OF BUSINESS ORGANIZATIONS

The challenges outlined above have led to a variety of small business organizational structures offering different combinations of services. Perhaps business organizations can best be understood as existing on a continuum between pure lobbying and pure services, though few exist at either extreme. In the United States, most organizations take an active lobbying role but also provide needed services such as provision of health care; publication of industry journals; or conducting research on regulatory, tax, and financial issues relevant to SMEs. Individual organizations generally work by themselves at the local or state level, then form permanent or short-term coalitions with other organizations to work effectively at the national level.

One type of organization, the Chamber of Commerce, is a powerful voice of business interests in many countries. Membership may or may not be required, and the chamber may or may not be industry-specific. Structurally, local chambers belong to the national chamber, and the government confers with the national chamber when it seeks business input to legislative or regulatory issues. However, Chambers of Commerce represent the interests of firms of all sizes; hence, they may be controlled by larger businesses that pay a majority of the dues. As might be expected, the interest of small and large members frequently conflict. In such cases, small business issues are unlikely to be carried forward to the national level by the local chamber.

SMALL BUSINESSES AND THE LEGISLATIVE PROCESS IN THE UNITED STATES

When proposed legislation affecting small businesses is under consideration, U.S. small business organizations take an active role in the process by lobbying in the interests of their members. Effective lobbying ultimately means the provision of information and reasoned argument about the probable effects of a proposed piece of legislation. The path of a proposed bill is not linear, nor does it adhere to a set calendar; in the end, the passage or defeat of a bill may depend on factors outside the control of most participants. The level of activity and the nature of the activity vary over time, and are critically dependent on the strength of the groups supporting or opposing the proposed legislation. Listed below are the principle activities that small business owners and their lobbyists engage in.

- **Monitoring the entire legislative process.** From the moment a bill is proposed, SME owners, trade association officials, and other lobbyists supporting small businesses monitor the progress of the legislation. By being aware of the current status of a bill, businesses can keep track of the issues at stake, and lobbyists can plan the most effective intervention in a changing environment.

- **Carrying out research on the issues raised by the proposed legislation.** Small business owners and their organizations may not be able to conduct sufficient research because they lack the funds to support such work. For this reason, several small business organizations in the United States focus primarily on this aspect of lobbying. Small business groups can also make use of research done by larger businesses, by the U.S. Chamber of Commerce, by universities, or by other public policy groups.

- **Informing small business constituents, members of Congress, and the general public about the nature of the issues.** If SME owners want to convince people that the proposed legislation is not in the public interest, they must educate both the Congress and the public about its potential effects through testimony, networking, and advertising. Good information will lead the discussion to resolution, with the proposed bill being defeated or amended into more appropriate form. The quality of lobbyists' efforts is crucial; if they cannot move the debate forward by focusing on critical questions and by proposing believable and creditable solutions, their work will be ignored or quickly dismissed.

- **Networking and coalition building.** As legislation develops, small business groups seek like-minded leaders from other groups such as big business, industry and trade associations, economic development officials, federal, state, and local officials, and other interest groups to form a coalition of interests that oppose or sponsor the proposed legislation. History demonstrates that members of Congress respect strength, and will carefully weigh the strength of the coalition that small business develops on a given issue.

- **Developing leadership.** Lobbyists working for small business organizations are knowledgeable on many issues, but it is unusual for them to act as leaders on every issue. Often, a small business owner with a strong interest in the proposed legislation makes an excellent spokesperson for a broader coalition. This function is often accomplished by a senior manager of a major small business organizations, since few business owners have the time to act as coalition managers.

- **Calling and writing members of Congress.** After all of the research, delivery of testimony, and other organizing activities described above, telephone calls and letters from small business constituents may be the deciding factor influencing some of the votes in the Congress. The question of when to call and when to write is critical, but the results are clear: members of Congress appreciate and respond to informed constituents who take the time to state their opinions about proposed legislation.

CONCLUSIONS

Proposed legislation can have a major impact on small business. Small business owners must take action to protect their interests before federal, state, and local governments. These actions include becoming informed about representative organizations, joining them, and supporting their activities.

In trying to draw lessons from the U.S. experience, small businesses, donors, and small business advocates in other countries obviously must tailor small business organizations to the needs and conditions of the specific case. Local circumstances will indicate whether business advocacy groups should be formed by industry, by geographic location, or by size. When forming business groups, small businesses must be careful to identify what mix of advocacy and services will best suit their needs. Should local circumstances indicate that advocacy is an effective tool, lobbyists must have a thorough knowledge of the legislative process and an ability to work effectively within that process.

ABSTRACT III-5

PRIVATE SECTOR BUSINESS ASSOCIATIONS IN SOUTH AFRICA AND ZAMBIA: ADVOCACY FOR MICRO AND SMALL ENTERPRISES

Kenneth Angell
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March 1994

In most developing countries, small business associations are active in promoting the interests of the business sector, in general, and in advocating in the interests of the micro and small enterprise sector in particular. This report assesses the role of SBAs in promoting micro and small enterprise development in South Africa and Zambia.

CHARACTERISTICS OF SMALL BUSINESS ASSOCIATIONS IN SOUTHERN AFRICA

South Africa

South Africa has four main umbrella associations that claim to represent small business to some degree: two Chambers of Commerce that cater to white, largely small and medium-sized businesses, and two black associations that vie for membership from businesses in the MSE sector.

Other black associations can be characterized as either professional associations (formed by members in the legal, medical, and financial fields) or trade associations (industry or service associations, such as those serving hawkers, builders, or handicraft manufacturers). In the past, these black associations — all founded as reactive organizations — were united by a common political platform to ameliorate conditions of apartheid, particularly monopolistic business practices. Now that apartheid barriers have been dismantled and a new government is in place, these associations must transform themselves from reactive bodies, with a strictly political outlook, to active advocates that can truly address economic matters, work to improve the economic environment for small business, and present creative policy alternatives to the new political leadership.

Zambia

In Zambia, government constraints during the First and Second Republics forced the private sector to assume a low profile. Businesses hesitated to join associations advocating change in government policies because this could result in their closure. Existing organizations were viewed as government organs, and were poorly organized and operated. Instead, the private sector developed its own network of informal contacts and information sharing and, today, it fails to see the value of formal business associations.

Despite this perception, several associations claim to represent MSEs. There are also trade associations for groups such as farmers, export growers, or transportation workers that also lobby for the MSE sector. However, trade associations are concerned only with interests that affect their particular industry or trade, and not the MSE sector as a whole.

Common Challenges

Most business associations around the world are formed in response to a common grievance against government policies or regulations; most endure because they develop and provide members with good services, which in turn pay for continuing advocacy. Yet SBAs in both South Africa and Zambia are generally weak and immature, lacking the political clout and managerial capacity to properly address economic issues. They tend to be organized solely at the national level, and are underdeveloped at the branch level. Finally, associations in both countries are experiencing declining membership and lack the credibility to attract new members.

Small business associations in South Africa and Zambia must demonstrate to their members that their services have economic value and convince nonmember small businesses of the benefits of joining and supporting associations. In short, the associations must lessen their dependence on donors to become self-sustaining, independent organizations that can actively represent the views of their members.

South African associations are faced with an additional problem of oversaturation. There are too many business and trade associations for the business community to maintain and they tend to duplicate each others' work. Efforts should be made to consolidate their resources.

BUILDING ADVOCACY CAPACITY AMONG SMALL BUSINESS ASSOCIATIONS

SBAs can attempt to overcome these obstacles via several means:

- **Expand membership.** Associations must broaden their coverage to take in the entire country, including rural areas. A larger membership leads to greater credibility in the eyes of those bodies that associations are trying to influence.

- **Become more member oriented.** Associations must develop and deliver services that meet the members' need and demonstrate to them that such services can be of considerable value.

- **Voice members' views more effectively.** Associations should initiate dialogue about the current economic policy environment for MSEs, particularly by working through the legislative process.

To best meet these goals, associations can tailor different services to be offered at the national and local levels. At the national level, SBAs are well suited to lobby on behalf of their members to the appropriate government agencies. For example, they can draft and disseminate position paper; conduct research on the effects of policies or perform cost-benefit analyses; attain consensus by informing members, decision makers, and the public about relevant issues; and build coalitions with groups that have similar interests. At the regional and branch levels, associations can offer technical training through courses or seminars; determine certification standards for particular products; disseminate information on recent technology, legislation or market conditions; link member businesses; and provide group benefits, such as group or medical insurance policies.

But an association must also strive to develop its infrastructure, particularly at the local level. Branches should develop ways to raise diverse sources of funding (by charging fees for certain services or raising corporate or foundation support) to lessen their dependence on the national organization. Associations must also establish proper systems to communicate with branches and members, and to properly maintain financial records.

IMPLICATIONS FOR USAID AND OTHER DONOR AGENCIES

Traditionally, donor assistance to business associations has been directed primarily at building capacity at the national level. However, this survey suggests that donor assistance would be best utilized at the branch level to broaden member services and strengthen operations. For example, donors can help develop partnerships between local organizations and foreign affiliates that can provide technical assistance and other advisory services. Donors can contract specialists in association formation and membership service development to work directly with an association at the regional or branch level.

Additional recommendations are made for the formation of a business association unit (BAU), which can provide broad technical assistance to both trade and business organizations. Through a BAU, donors can assist several SBAs at once, for example, by developing a common database or organizing study tours of the United States or other African countries for the leaders of associations to observe the workings of similar associations. Such exposure can be supplemented with a program of technical assistance.

ABSTRACT III-6

NEW COMPETITIVENESS AND NEW ENTERPRISES IN PERU: SMALL BUSINESSES IN AN INTERNATIONALIZED ECONOMY

GEMINI Technical Report No. 61

Ernesto Kritz
Fidel Castro Zambrano
August 1993

BACKGROUND

Although the 1980s were a "lost decade" for many industrial firms in Peru, a set of small enterprises concentrated in a few subsectors managed not only to survive but to thrive. This study follows two earlier papers for USAID examining microenterprise, structural adjustment, and employment creation in Peru. The businesses on which the authors focus are those that, within the informal setting, were able to rise above the subsistence level and to grow rapidly in the internationalized Peruvian economy. Also included in the sample are small businesses started by professionals who left larger companies or governmental institutions, or who received training abroad. The study investigates firms only in the manufacturing sector; the researchers interviewed 51 business owners (9 shoe manufacturers, 33 clothing manufacturers, and 9 metalworkers) and carried out three group sessions with sectoral associations. This summary spares the reader the extensive detail presented in the paper, concentrating instead on shared characteristics of successful enterprises.

Earlier studies (1990) in Peru found that, although about 75 percent of the informal sector was engaged in subsistence activities with no growth potential, about a quarter of the informal sector (equal to a tenth of the urban labor force) had a significant and sometimes high level of capital accumulation. In about 15 percent of the cases (or around 6 percent of the economically active population), accumulation was higher than in the modern sector. Who were these high-growth firms? Why were they successful?

REASONS FOR THE SUCCESS OF THESE FIRMS

Direction, Management, Administration

The authors found that the successful small enterprises adapted to a fast-changing environment through a combination of niche identification, improvement in production efficiency, and selective cooperation with other small firms. Most of the success factors for these businesses are similar to those of a modern business class anywhere, namely the development of competent management teams, a committed orientation to clients, the ability to adapt to current process and product technology and a capacity for technological learning, a strong tendency toward saving and reinvestment, a strong corporate sense that encouraged specialization and efficiencies, and a more international perspective.

- **Clear Targets.** All successful firms strive to meet a target or an objective; no business grew without this kind of vision. This target may be one person's life goal, or based on the skills the emerging entrepreneur acquired through technical training elsewhere. Typically a strong goal provides encouragement in a highly adverse environment and is a guiding factor in a confusing and changing context.

- **Openness to Change, Learning, and Progress.** Successful firms possess an openness to change and progress. Given everchanging environmental conditions, successful small entrepreneurs are avid seekers of information, using their findings in a conscious rather than informal matter. In the opinion of the entrepreneurs interviewed, dynamic firms make a transition from learning through trial and error to more conscious and systematic methods, thus moving up the learning curve rapidly.

- **Outward View.** The authors stress the new, international orientation of competitive small enterprises. This refers not only to foreign markets and visits abroad, but also to a need to remain informed on what happens in the world and on training opportunities abroad. Thus not just 1 entrepreneur, but 4-6 will attend specialized fairs or internships sponsored by more structured or similar firms abroad, sharing their findings through business associations (described below).

- **Business Associations.** Most expanding businesses are members of specialized associations or are part of specialized sections within multisectoral groups. These relationships are an important part of the development of these sectors. The specialized associations constitute a critical mass of businesses in which the affiliated firms discuss and adapt strategies, have access to specialized information, and improve their access to supplier markets and clients. Many trade associations also have quarterly newsletters or bulletins to exchange information and provide comments on administration, marketing, and trade from the sectoral leaders. In this environment, firm owners meet to compare notes — sometimes on an informal, daily basis, sometimes only at trade shows — and to establish, follow up on, and modify strategies.

Investments In Products, Processes, And Technology

Although there have been few technological advances during the years considered, internal conditions are being created so that the businesses can improve processes and invest and expand in the coming years. Most of the firms under study lack efficient support industries; they have had to develop advantages in design, marketing, or manufacturing to succeed. One of the salient features of successful firms is their tendency to constantly seek out new technology through the means mentioned previously and invest in it wisely.

- **Human Capital.** The leading entrepreneurs emphasize their concern over the human factor, including themselves, as a crucial element for increasing productivity within the firms. Most of the technicians, even those with previous experience, are trained in the small firms to learn the practices of small and medium-sized enterprises. In addition, entrepreneurs attempt to keep abreast of current trends in the field by travelling as described above.

- **Capital Investments.** Rather than rushing to take advantage of a bargain or upgrading to the newest machines, successful small firms carefully consider the compatibility of new purchases with their existing technology and make purchases only after concluding that the new equipment will satisfy a tangible goal that is currently unmet.

- **Inputs.** In recent years, Peru has developed a market that allows agents from other countries to provide the inputs small industrial firms need. Producers can obtain cheaper inputs of more consistent quality on more favorable terms internationally than they can at home. For example, firms in the garment industry can now buy cheaper denim and better-quality Chinese fabric for sweatsuits on the international market. In these agreements, producers can buy foreign supplies with 30-45-day payment terms and international interest rates, compared with much higher financial costs for domestic credit.

Finance

These firms grew in a decade of hyperinflation and without access to real financial services until well into their development. They did so through careful cash-flow management, reinvestment and high savings rates, and utilization of the open market to decrease the need for bank credit. In managing cash-flow, firms obtained the highest level of prepayment possible from clients and kept their receivables to a minimum. Most charged in cash but expected to obtain credit from suppliers. Because new government policies have reduced supply and distribution bottlenecks, firms can obtain inputs more easily and therefore no longer tie up valuable capital in inventory. In addition, successful firm owners generally have very high savings rates, again suggesting a forward-looking orientation. Investments are carefully weighed, but the overall rate of investment is high. Also, many firms capitalize on relations with the government that can help them obtain machinery at a reduced tariff. In very few cases has the banking sector played a significant role in the development of the firms analyzed.

SECTION FOUR

CREATING AN ENABLING ENVIRONMENT FOR THE MICRO AND SMALL ENTERPRISE SECTOR

NOTES ON ABSTRACTS ON CREATING AN ENABLING ENVIRONMENT FOR MICRO AND SMALL ENTERPRISES

Several GEMINI reports make important observations concerning the environment for MSEs. In many countries, unnecessarily onerous regulations prevent large numbers of entrepreneurs from participating fully in economic activity. In the centrally planned economies of the former East Bloc, restrictions against private entrepreneurship kept all private sector activity in the black market. Now that these countries are undergoing dramatic economic transformations, the potential for private enterprise, and particularly for the MSE and SME sectors, is vast, yet holdover policies threaten private sector growth.

GEMINI has provided advisory services in small business development to USAID Missions operating in several of these emerging economies. This section gives the reader in-depth information on two projects. The first is the result of short-term small business sector assessments in the Russian Far East, Uzbekistan, Kazakhstan, Ukraine, and Armenia. The second, a review of several important sectors in Poland, is compiled from four different technical reports to come out of the GEMINI-Poland Small Business Project. Both present details of specific sectors and of current efforts by the donor community. The abstracts in this section are longer and more detailed than abstracts in other sections in this volume, because they examine information from several technical documents.

- The first abstract, "Prospects for Small Enterprise Development in the New Independent States," examines aspects of the legal and regulatory environment that affect private sector growth in the five countries, summarizes the prospects for privatization, profiles business and financial service as well as training organizations that support small businesses, raises gender issues, and recommends ways of exploiting the huge potential in the agribusiness sector in each country.

- Through the GEMINI-Poland Small Business Project, advisors have worked closely with Polish government officials, private sector organizations, and firms throughout Poland to identify constructive legislative and regulatory reform initiatives to be addressed by the government and to help the government create a policy formation process that incorporates input and feedback from the emerging private sector. To accomplish this mandate, the project carried out case studies of the financial sector, the construction industry, and the agroindustrial sector and used the results to provide the government with concrete recommendations for its policy formation agenda. The second abstract,"Development of the Small and Medium Scale Enterprise Sector in Poland," elaborates on these studies and the subsequent recommendations.

ABSTRACT IV-1

PROSPECTS FOR SMALL ENTERPRISE DEVELOPMENT IN THE NEW INDEPENDENT STATES

This abstract represents a summary of the following GEMINI Technical Reports:

Small Enterprise Development in the Russian Far East
GEMINI Technical Report No. 49A
Martha Blaxall, Yasuo Konishi, Virginia Lambert, Jennifer Santer, Timothy J. Smith
October 1992

Supporting Private Enterprises in Uzbekistan: Challenges and Opportunities
GEMINI Technical Report No. 49B
Nan Borton, John Magill, Neal Nathanson, Jim Packard Winkler
November 1992

Assessing the Prospects for Small Enterprise Development in Kazakhstan
GEMINI Technical Report No. 49C
Kenneth J. Angell, James J. Boomgard, Mohini Malhotra, Robert A. Rodriguez
December 1992

Small Enterprise Development in Ukraine
GEMINI Technical Report No. 49D
Dennis De Santis, Jean Gilson, Max Goldensohn, Jennifer Santer, Timothy J. Smith
December 1992

Small Enterprise Development in Armenia: Programming Recommendations for Peace Corps Volunteers
GEMINI Technical Report No. 52
Timothy J. Smith
July 1992

The U.S. Agency for International Development plans to support start-up businesses and the expansion of existing small private enterprises in the new independent states of the former Soviet Union. USAID's NIS Task Force contracted the GEMINI project to field multidisciplinary teams to several of the new countries to analyze the small business sector and make programming recommendations. All of the papers examine the legal and regulatory environments, the role of public and private institutions in encouraging private sector growth, gender issues, agribusiness, and privatization. The Armenia paper, the product of a separate contract, examines many of the same issues and thus is included in this summary to provide a broader sense of conditions in the countries forming the NIS. The research teams base their reports on interviews with national and local government officials as well as staff from universities and other training institutions, financial institutions, private sector support organizations, international donors, private voluntary organizations, and individuals from private or state-owned enterprises (SOEs). This summary abstract does not attempt to capture all of the information contained in these detailed reports, but it does provide the reader with a broad sense of conditions in late 1992 in the selected countries.

LEGAL AND REGULATORY ENVIRONMENT

Legal and regulatory conditions throughout the former Soviet Union are in a state of flux. All of the countries are reluctant to abandon the security of familiar legal environments in favor of reforms that will lead to the market economies that Soviet teachings deemed illegal and immoral. In some cases legal reform has hardly begun, in others it is still in process; in every case the laws are poorly understood and often contradictory. In many countries the authority structure governing emerging businesses is uncertain, with national and local governments making conflicting claims to power. In most cases researchers found an implicit or explicit bias against small businesses and in favor of the state. In addition, there are many unstated codes enforced at the discretion of a plethora of local officials. Together these factors leave the legal system open to interpretation and additional changes, creating tremendous uncertainty for those considering self-employment.

Russian Far East

In 1988, the Soviet Union decriminalized entrepreneurial activities. A subsequent decree from the Council of Ministers legalized small and medium-sized enterprises, and by 1990 SMEs were recognized as a critical economic entity with explicit laws set aside to facilitate and accelerate market activities among them. As the U.S.S.R. crumbled, however, SMEs suffered from lack of access to inputs, insufficient credit, and multiple taxation, all of which contributed to a higher number of bankruptcies among SMEs. The status of SMEs worsened when subsequent laws failed to acknowledge their existence, depriving them of a specific legal entity. In early 1992, further laws were introduced eliminating any remaining special incentives for small businesses. Even if the legal environment were more supportive of small businesses, the researchers noted that legal enforcement would be constrained by budget deficits at every level of government and by the lack of understanding of law and its powers to protect individuals and groups.

Laws dictating the behavior of small businesses continue to be restrictive in Russia, and the tax structure is onerous. At the time of the study, firms had to pay a 28 percent value added tax and a 32-45 percent profit tax depending on the type of business. If any offshore transactions are made, firms are further taxed on hard currency earnings. Firms may qualify for one- or two-year tax exemptions if more than 70 percent of their revenue comes from production of consumer goods. Regional governments have little leeway to support business development; all substantive laws are introduced at the federal level, and Moscow scrutinizes all regional decrees.

Uzbekistan

Until 1990, the Government of Uzbekistan had no policies to support, promote, encourage, or even permit the operation of private business entities. This policy vacuum meant that the policy and regulatory framework is in an embryonic state. The government announced a policy to promote a private market economy, and laws passed since 1990 are generally supportive, providing simplified procedures for registering new businesses. Several constraints remain, however. Taxation laws impose extremely restrictive and anticompetitive conditions on businesses, especially on the very small. In addition, there is a lack of operational policies; most of the rules issued are theoretical and legalistic. The absence of a legal system and tradition that can uniformly enforce property rights, contracts, and other aspects of a commercial code impede private sector development. These problems are exacerbated by the uncertain authority structure. Several individuals and committees in the national government have the responsibility of examining proposed laws for their impact on business, although it is not exactly clear wh .

As in many countries, the registration and much of the regulation of small private businesses occurs at the local level in Uzbekistan. The lack of clear lines of authority for business regulation permits a breakdown between the intent at the national level and implementation at the local level. Thus, even though national law places few barriers on business registration, municipal authorities impose additional restrictions and bureaucratic procedures, often using these as a means of extracting bribes to facilitate the processing of paperwork.

Kazakhstan

The Government of Kazakhstan has taken several concrete steps to create a market economy, but the country still lacks an adequate governing body and legal code for private property and business transactions. As of October 1992, three laws had been written to govern small businesses in Kazakhstan; these laws call for the expansion of property ownership and property rights. However, these laws lack operational detail and enforcement mechanisms. For example, they do not detail specific ways for entrepreneurs to protect themselves from violations of their rights, nor have such areas as contract enforcement, intellectual property rights, or transfer of property ownership yet been written. There are no bankruptcy laws, no means for resolving disputes, and no means for dealing with company insolvency. Consequently, this legal uncertainty creates an environment in which new market activities are limited to agreements between parties that know and trust each other well.

The lack of legal transparency in Kazakhstan is due, in part, to continual changes of the government apparatus. No clear lines of authority have yet been established at the agency level, and many are competing for power. At the time of the study, there were four presidential committees providing analysis and advice on the private sector. The Anti-Monopoly Committee (AMC) had authority over small business development, but the AMC's lack of technical skills, actual authority, and financial resources to carry out its mandate were rapidly eroding its credibility and status. In some cases, local decrees contradict the national decrees. Moreover, researchers noted that control of the private sector is still firmly entrenched in the state and that operational practices frequently favored SOEs. For example, state enterprises frequently pay lower taxes, have priority access to the Central Bank's supply of rubles for purchasing inputs, and often resell these inputs to the private sector at inflated prices.

Ukraine

Ukraine, possibly to a greater degree than other former Soviet republics, has maintained in power the same people who ran the country under Soviet authority. Thus, the old boy networks figure prominently in the regulation of government and business. Laws governing business and banking are new. Local lawyers have little expertise in these areas, and the jurisdiction and independence of local courts are questionable. The government itself has little or no experience in governing private business, and national, state, and district governments are all battling for control of the implementation of laws and regulations.

Although official policies and statements of the Ukrainian government since 1989 support the development of small private businesses, the country's leaders have consciously adopted policies to avoid economic shock therapy. Policy makers have passed a large body of laws to encourage private sector development, but the laws are often contradictory and their application is uneven. There is a bewildering array of cooperatives, associations, and enterprises in this chaotic business environment. Legislation provides for four principal forms of business ownership roughly parallel to those found in the United States, but these ownership forms vary widely in practice and application. For example, the public may invest in a command ownership business for a share of the organization (analogous to a publicly held corporation in the United

States), but no mechanism exists to publicly trade shares of ownership stock and investors do not participate in the management of the enterprise. Agriculture, including production and processing, is specifically mentioned as a small business sector, but law on the ownership of land is still unclear. Ukrainian law mandates the establishment of individually owned private firms, but laws implementing reallocation have yet to be enforced and collective farms continue to enjoy priority access to state supplied inputs and markets.

Efforts have been made to encourage business by adjusting the tax code. New small businesses in industry, agriculture, or construction receive tax breaks in the first two years of operation, afterwards paying the standard 18 percent income tax. Tax policies favor productive activities over trade and intermediation; income from manufacturing is taxed at 18 percent, whereas income from wholesaling is taxed at 75 percent. A 28 percent value added tax is applied to manufactured and wholesale goods like a sales tax. There are also various social taxes totalling 52 percent, and a 10 percent barter tax (commonly avoided because money is not involved until the goods are sold). The level of taxation serves as a barrier to entry for start-up enterprises and makes real calculations of profitability difficult or impossible. In addition, constant changes in the tax rules and the tendency of local authorities to interpret rules arbitrarily increase the difficulty of forecasting revenues and profits.

Armenia

Armenian entrepreneurs face a legal environment similar to that outlined for the previous republics. In 1989, under Gorbachev, new cooperative legislation was enacted that introduced notions of a market economy and the private ownership of productive assets, but the lack of a legal infrastructure, slow privatization, and a variety of other problems hampered the development of a market economy. In 1992 Armenia adopted its Law on Enterprises and Entrepreneurs; based largely on former Soviet definitions of business activities, it identifies more gaps in the legal framework than it corrects. Taxes on small businesses are quite high (nearly 70 percent) and appear to be imposed in an unplanned and ad hoc fashion. Finally, within the context of democratization and market transformation, the roles and lines of authority between municipal, regional, and national governments have yet to be defined.

PRIVATIZATION

Privatization of state owned enterprises is a stated priority of all of the countries considered in this report; however it is being initiated unevenly across the NIS. Small enterprises are usually at the top of the list to be privatized, but it is difficult for governments with a history of central economic control to relinquish their hold on factors of production. Many countries are concerned about the social impact of privatization, and potential investors are leery of unclear property rights. Frequently, vague legislation at the national level supports privatization, but there is a lack of clear, operational guidelines to allow it to occur at the local level. Many countries are constrained by a lack of capital to invest in the newly privatized enterprises, whereas in other places a voucher system quickly loses its usefulness in an inflationary environment. Nearly all of the studies reported that, in spite of current constraints, privatization was expected to pick up speed in the coming years.

Russian Far East

Nearly 4,600 SOEs have been identified for privatization in the Primorski Kray — the territory in which Vladivostok is located. Almost 40 percent will be privatized by the city's authorities, but only 6 percent of this group had actually been privatized at the time of this study. On average, 50 to 60 percent of all industries are expected to be privatized. The Russian government determined that enterprises most likely to be privatized are those suffering from insufficient profits, holding the largest market share in a given sector, or having recently been refurbished. Enterprises are selected for privatization on a quarterly basis. Small enterprises are usually sold through an auction or competitive bidding; larger enterprises are converted to joint stock companies and sold through shares.

Although relevant data were not available, preliminary interviews with government officials and bank managers suggest that the region is cash-poor and does not have the capacity to support the privatization of SOEs currently under consideration. Governments, associations, and the private sector, among others, are setting up privatization funds to consolidate investment monies to channel scarce capital into priority enterprises with high-growth potential. One possible source of funds, the proposed Primorski Regional Fund, recognizes and specifically addresses the need to support SMEs. Although this recognition is significant, little has been done to define the role of the Fund in supporting SMEs.

Uzbekistan

Under the centralized planned economy of the past 70 years, virtually every trade, service, and productive activity regardless of size was under the control of the state. Since then, the government has announced its intention to privatize a large segment of the SOEs, but the course of these efforts is still difficult to predict. There is a lot of talk about it, a lot of external pressure to do something about it, numerous top-level pronouncements in favor of it, and considerable internal bureaucratic resistance impeding it. The government is concerned about the possible impact of privatization on unemployment, ethnic conflicts, and prices, and is reluctant to move very rapidly in this area.

At the time of the study, it appeared that the respective ministries intended to privatize a sizeable percentage of small retail shops, service businesses, and businesses in light industry. Privatization of larger industries were predicted to proceed slowly, if at all. The resulting businesses may not look very "private" to outsiders (for example, "collective ownership of the private shares of the company" may be an option), but freeing firms from state control over supply, pricing, and marketing activities would be significant. The study comments, however, that government control structures are not likely to disappear anytime soon. The state ministries have been planning service contracts, supply contracts, and even management contracts for the newly privatized firms, which may result in continued dependency on the state.

Kazakhstan

Kazakhstan's privatization process was at a standstill at the time of this study. Of more than 30,000 SOEs, only 1,500 of the smallest had been privatized. The private sector contributes only a tiny amount to the economy; more than 90 percent of all manufacturing output is by the state. Newly created firms and newly privatized enterprises alike are constrained by a deteriorating state-controlled command system, because no alternative exists for markets, inputs, or access to credit. The slow growth of private enterprise reinforces the government's perceived need to protect jobs and production in inefficient state owned enterprises, thereby slowing the privatization process.

Ukraine

Ukraine has passed laws and regulation to carry out a privatization program but has not yet begun to privatize its small or large SOEs. Many constraints to the privatization process exist: legislative gaps on the transfer of SOEs into stock corporations; social issues ranging from labor dislocation to infrastructure development to food security; competition, pricing, and regulatory needs; a lack of credit that precludes many from participating in the privatization process; ownership distribution concerns; and the lack of a developed capital market.

Privatization is to proceed as follows: every Ukrainian will receive nontransferable vouchers worth 30,000 coupons; these coupons will be managed through special accounts at the National Savings Bank. Privatization methods include purchase by workers, auctions, and public bidding; foreigners may bid on enterprises using foreign exchange. The State Property Fund and local privatization bodies will value and sell the small businesses. Several elements have slowed the progress of privatization: most of the 54 million Ukrainians do not have bank accounts in which to deposit the coupons, and the vouchers have quickly lost value due to inflation. The current privatization bill provides for competitive bidding only if a workers' collective does not exercise its right to lease the premises with option to buy within three years. Finally, local authorities have taken far more control of the state's assets than originally anticipated. The local municipalities are inclined to privatize only "whatever we do not need."

Armenia

Privatization of Armenia's industries and smaller enterprises proceeds at a slow pace. Initial decrees permitted limited privatization of smaller enterprises, but the lack of operational legislation clarifying the privatization process has imposed a halt to the sale of SOEs. At the time of the study, the needed laws were being drafted, and the Privatization Committee anticipated rapid implementation once the final laws were approved. Critical issues under debate include the role and use of vouchers; restrictions on the resale of vouchers, enterprises, and assets; standards for valuation and appraisal; and voluntary versus mandatory privatization. Equally important is the need to develop an institutional structure to implement privatization. Armenia, to a greater extent than other members of the NIS, appears inclined to retain a high degree of centralized political and economic authority. Thus national authorities will probably manage valuation of enterprises, negotiation of terms of sale, and monitoring of compliance with relevant regulations.

INSTITUTIONAL PROFILES

Investigators found an array of institutions providing assistance to small businesses in the NIS, ranging from universities, to private organizations, to commercial banks and government agencies. Few of these entities, however, provide services of value to the small businessman. Business associations are frequently used as political vehicles or represent the interests of the state, and there is a chronic lack of instructors who are qualified to teach the theory and practice of market economics. Often, programs target recent graduates or retrenched civil servants, rather than individuals with experience in sectors with growth potential in a liberalized economy. Most bankers lack a working knowledge of market economy lending techniques, and very few banks target the small enterprise sector. Financial intermediaries often impose unrealistic requirements on prospective borrowers. With few exceptions, there is a critical need for technical assistance to strengthen the institutions that serve small businesses.

Business Services

Effective institutional support for private small enterprises was largely undeveloped in all of the countries examined at the time of this study. There is an acute need throughout the NIS for assistance and advocacy on a range of start-up and operational issues affecting small businesses, as well as training in basic skills such as accounting, marketing, and advertising. Although a few private and quasi-commercial organizations have emerged, in most cases, the state continues to be the main actor providing business services. In Uzbekistan, for example, five of the six business associations interviewed were created by the state. The Government of Kazakhstan recently created a Council of Entrepreneurs, but entrepreneurs are skeptical and even government officials admit it is a way to quiet any voice for small entrepreneurs.

Another common problem is the use of business organizations for political ends or as a staging site for political clashes. In Kazakhstan, the unions that claim to represent the voice of the private sector are, in fact, repackaged remnants of state collectives representing the interests of SOEs. The heads of these organizations are often very powerful politically and appear to see political access and clout as a primary goal for their associations. In Ukraine, the role that the state plays in business organizations depends on the outlook of the particular political supporters in question. These may be representatives of the national Rukh party, ex-communists seizing on the opportunities presented by economic reform, or members of the old guard concerned about defending former party privilege. To the extent that these state-supported organizations are actively providing services, they tend to focus their efforts at the industrywide level rather than at the level of the individual or small business. The investigators found almost no autonomous intermediary institutions that specifically targeted business services to small and micro enterprises.

A few organizations do provide valuable support for private businesses. For example, the Business Women's Association of Uzbekistan — the one truly private organization by U.S. standards — has a primary mission to assist individual members in registering their businesses and to help them understand and overcome the many constraints facing small businesses. In Ukraine, the National Association of Ukrainian Farmers provides strong advocacy and support services to its members. Started as a political movement, this organization assists members with access to credit, materials, and technical and management training. Two other increasingly important sources of support for businesses in this country are the growing Ukrainian-American community and international donors. Ukrainian-Americans are involved in most of the 70 U.S. corporations in Ukraine, either as employees or joint venture partners. Together they represent a critical force in the development of small private business in the Ukraine, imparting knowledge, attitudes, and skills as well as capital to their Ukrainian counterparts. Foreign agencies such as the Peace Corps, Volunteers in Overseas Cooperative Association, the Kennedy School of Government, and the Center for International Private Enterprise are also addressing different private sector needs.

Training Capacity

Training is a widely recognized need in the NIS and investigators found business education offered in all of the countries examined; however, the quality of these services varied widely. Typically the best programs are joint programs involving partial study in the West; for example, the University of Maryland has an arrangement with the Far Eastern University in Vladivostok. These programs are prohibitively expensive for most people — the Maryland program costs more than $10,000. Many organizations offer more affordable training, but typically instructors lack practical experience in capitalist business management or are moonlighting university faculty steeped in Marxist economics. Researchers found that much coursework was very general, or geared to large, international businesses. Another common problem is the targeted client base for these courses. Often, these courses focus on current day students, recent graduates, or retrenched civil students, none of whom has practical experience in operating a small business. The research teams found no examples of training specifically targeted to the needs of small businesses. Even in Ukraine, where there is an array of educational options on the principles and techniques of market economics, those interviewed reported that there was still substantial unmet demand for training. Reasonably priced courses covering such topics as developing financial plans, pricing and marketing strategies, accounting, advertising, interpreting tax laws and other regulations, and applying for credit would be well received throughout the NIS.

Researchers did note several institutions in the former Soviet Union that provided valued business training in their respective countries. Most of these programs, such as the Kazakh Institute of Management and Economics, the Kiev International Management Institute, and the Tashkent State University of Economics in Uzbekistan, are joint ventures or have strong links to the West. Investigators also found a few quality training programs without strong Western links. One such program is ANNA, a women's organization established as a charitable and commercial center in Vladivostok. This agency offers courses to prepare women for work in the service sector and to develop skills for management positions in industry. Structured as a collective, ANNA is a dynamic money-making enterprise that has expressed interest in developing courses for female entrepreneurs.

Financial Services

The Soviet banking system began to weaken in 1987; commercial banks were spun off from the central Gosbank and converted to joint stock companies that remained state-owned. Since then commercial banks have opened in all of the countries investigated in this study, in some cases as cooperatives, in others as foreign joint-ventures, and in still others as market-oriented commercial banks. An impressive number of these commercial banks had opened by 1992: 28 in Uzbekistan, 135 in Ukraine, and 145 in Kazakhstan. Unfortunately, this rapid growth in the banking system has not led to enhanced competition or increased efficiency in the allocation of credit. In general, the financial services sector remains underdeveloped.

The absence of operational procedures for performing basic banking functions severely weakens the banks' ability to provide client services. In many cases, banks lend primarily to their shareholders and their friends or to failing SOEs. In addition, the banking sector suffers from a chronic lack of currency. In Kazakhstan, funds are not actually transferred between parties; only paper entries are made. In Russia, the bank simply transfers funds between buyer's and supplier's accounts without any cash exchange. Businesses in Russia must cover all operating expenses through their cash flow; they may withdraw cash only to pay salaries and to purchase agricultural products. In Armenia, borrowers must pay a special "fee" to receive cash instead of a letter of credit. In most of the countries, depositors had limited access to their accounts. Such an environment is hardly conducive to mobilizing savings, and the reports state that most banks depend on the central bank to obtain lending capital.

Investigators found very few sources of credit for small businesses. Banks are fearful to lend to small businesses because of perceived risk and the banks' inexperience in commercial lending and risk assessment. Most small businesses cannot get credit for lack of collateral. The savings of families and friends — a traditional source of capital for small businesses — is insufficient in the inflationary environment that persists in many countries in the NIS. To the extent that credit is available to small businesses, it is all short term (less then 1 year). Investigators did not find any banks providing small enterprises with long-term loans for capital investments.

At the time of the study, only the Vladivostok Commercial Bank (VladCom Bank) appeared to have identified small business lending as its principal market niche and actively targeted this group. A joint stock bank, as of July 1992, VladCom Bank had R 759.6 million ($3.7 million) in outstanding loans, with an average loan size of less than $20,000. Most of the loans provide short-term credit to small private businesses, cooperatives, and municipally owned retail stores, pharmacies, and service establishments. VladCom realizes a 55 percent return on its loan portfolio. Shareholders can borrow at a preferential rate, but shareholders have no loan approval authority and have been turned down in the past.

GENDER ISSUES

Under socialism, women were legal equals to men and made up half of the work force. Soviets could point to women engineers and scientists (fields dominated by men in the United States), to the high level of female education overall in the U.S.S.R., and to full female participation in the work force, and claim that sexual equality was the norm. Such assertions ignore the "double shift" of Soviet women: they were full participants in the workforce, and they also carried the major responsibilities for the household. To its credit, the Soviet system lessened the burden of managing a family by the state provision of day care, housing, medical care, and subsidized food. All of the papers argue, however, that there was never true equality in employment in the Soviet Union. Women tended to hold lower paying positions, and women rarely reached top levels of management. Not a single woman served on the Central Economic Planning Committee. Women never had a role in shaping the policies or decisions that defined their supposedly emancipated state.

All of the studies look at the extent to which the role of women is changing in the transitional economies of the NIS and in particular at the ability of women to engage in income-generating activities. The studies were fairly consistent in their findings. In the NIS, the status of women is being eroded on several fronts. Several studies note that women are losing their jobs at a much higher rate than men. For example, during the first eight months of 1992, women made up 75 percent of the 7,200 people registered as unemployed at the Vladivostok Employment Exchange Office. Women are becoming unemployed at a disproportionate rate because they hold jobs in sectors that are being cut by cash strapped governments, namely scientific research laboratories, engineering departments of state-owned industrial firms, and small public enterprises in the service sector. Cuts in this last area hurt both the women who were employed in them and also those who depended on their services. All of the papers note a chronic shortage of acceptable day care facilities in the NIS, observing that these and other services were vital to women's ability to work outside the home.

In other sectors, women are being displaced by men. For example, banking used to be one of the traditional domains of women; in Kazakhstan, for example, women made up 80 percent of bank staff before the dissolution of the Soviet Union — although men retained control of decision-making positions. Banking was not a high status job, however; the role of credit in socialist banking was to fulfill mandated performance targets by directing resources to state-owned enterprises. In contrast, banks are central institutions in a market economy. As these positions become associated with real power, it is not uncommon to find women being replaced by men, or higher salaries being offered in order to attract men. In the words of the dean of Far Eastern University (a woman with many years of management experience in the university): "No one wants to hire women as managers."

Such quotes and other anecdotal evidence indicate prevalent attitudes and expectations about women: "A woman cannot be a serious businessman," offered the Deputy Director of the Union of Small Businesses in Kazakhstan. Several papers note a resurgence of the traditional gender division of labor. In Vladivostok, for example, planned retraining for women workers is in traditionally female and low-paid occupations such as seamstress, accountant, beautician, and secretary. The Eastern Russia paper further notes that female university graduates are having a harder time finding employment than men because their specialties are in fields not currently in demand, such as engineering and pediatrics. The options for many highly educated women faced with government cutbacks appear to be either to drop out to the labor force or to be retrained in a less skilled occupation.

Some women are increasingly engaging in supplemental income-generating activities in the informal market. The Ukraine paper argues that in some ways women are more prepared than men to jump into private enterprise. Almost all women, for example, have a working knowledge of food processing to supplement the family diet in the wintertime. Given access to appropriate financial resources and management training, women could take advantage of the tremendous market potential in this area. The danger is that by building on household activities, women will be confined to low-paying sectors, wasting the high level of education and skills they possess.

Several papers discuss the experiences of women in attempting to establish businesses or support associations. Unfortunately, there is no gender disaggregated data in the NIS (it was deemed irrelevant given the purported sexual equality); thus the reports provide only anecdotal information. Interestingly, women entrepreneurs in Vladivostok said there was no difference in access to credit for men and women; they had all received loans. Other women reported problems in founding businesses. The founder of the Business Women's Association in Uzbekistan reported significant difficulty in registering her business and acquiring a loan. A women's legal defense fund she tried to found was forbidden by the government. Women in Ukraine who want to go into private business are apparently continuing to rely on spouses or other male associates to negotiate with bureaucrats and obtain necessary permits and inputs through the old-boy communist network. The reports agreed that men and women entrepreneurs face similar constraints in founding businesses, but women are often further limited by stereotype expectations of their abilities.

AGRIBUSINESS

The agribusiness sector includes all aspects of processing agricultural output into consumer goods, including storage, pasteurization, canning, freezing, packaging, and marketing. Many of the GEMINI studies of the NIS mentioned production and employment potential in the agribusiness sector. Kazakhstan, Uzbekistan, and Ukraine were all important producers of agricultural goods within the Soviet Union: Uzbekistan produced 60 percent of the USSR's cotton and 10 percent of its fruit and vegetables, while Ukraine furnished 20 percent of the former country's meat and dairy and 50 percent of its sugar.

Under the Soviet system, however, there was no vertical integration within the republics; raw materials were either exported or processed in a region different from the one in which they were produced. For example, Uzbekistan is the world's fourth largest producer of cotton, but only 10 percent of it is processed before leaving the country. In addition, central distribution of needed inputs in the USSR led to shortages and misallocation of resources. The state purchase of outputs at below-cost prices and the goal of meeting a quota rather than making a profit deprived producers of a motive to raise productivity. The papers detail the poor quality of processing technology, note the inferior quality of much of the seed stock used, and describe existing packaging processes as archaic. In addition, storage and distribution systems are inadequate. The Ukraine paper estimated that up to 25 percent of Ukrainian agricultural production was lost to spoilage. This lack of local capacity to add value to commodities prevents these countries from building upon a comparative advantage that might generate income and increase employment.

Agribusiness could be an important source of jobs in the emerging economies. Agribusiness is already an important source of jobs in the Russian Far East. In one densely populated and politically unstable region of Uzbekistan, unemployment exceeds 40 percent. Of those who are employed, 60 percent work in the agricultural sector. Government officials estimate that 70,000 jobs in agribusiness activities could be generated were it not for the limited vertical integration.

All of the countries recognize the huge potential in the agribusiness sector, but they are in varying stages of exploiting it. Most countries hope to attract foreign investors and joint ventures to improve their production capabilities, but investors are leery of the lack of a clear, operational legal framework. For example, Kazakhstan was the first of the Central Asian Republics to enact tax incentives to attract joint ventures and foreign investment, but outsiders are still reluctant to invest given the vague property rights. In addition, many countries still maintain price controls, or mandate that a certain percentage of output be sold to the state at subsidized prices, thus reducing incentives to increase production. The paper on the Far East argues that there is tremendous potential for marketing inexpensive baby food and processed dairy goods, but the country suffers from a lack of knowledge and finance to modernize production, processing, packaging, and marketing. Together, the reports paint a picture of a sector that will be an important element of the emerging economies, once the legal environment has improved.

RECOMMENDATIONS FOR DONORS

The teams recommended an array of responses that varied according to the circumstances in each country. In Eastern Russia, the team recommended an integrated program of financial and nonfinancial assistance. In Kazakhstan, investigators concluded that USAID's assistance would be best aimed at key leverage points to improve the policy and institutional environment and thus to advance the agenda of the private sector. In Ukraine and Uzbekistan, all three types of intervention would be appropriate. In Armenia, the team recommended that volunteers work at the municipal level to assist local governments in budgeting, investment planning, infrastructure development, and strategies to privatize smaller enterprises.

All of the teams recommended technical assistance to improve business training. However, potential institutional homes to provide this information varied widely. In some cases, such as Ukraine, there are a number of existing organizations providing training and other business services that could be used, while in other countries, such as Uzbekistan, there are virtually no such institutions. In the case of Uzbekistan, the team recommended that USAID work with selected municipalities to assist in developing business centers that could provide short business courses, among other services, to fledgling private firms. However, this relationship may not be appropriate in all circumstances. Some informed observers note the lack of confidence in any service provided by the government, and therefore argue that autonomous technical assistance programs would be more effective.

Prescribed financial assistance also varied: when existing programs provide credit to small businesses (such as the VladCom Bank in Eastern Russia), loan programs based in these institutions could be appropriate. In other cases (such as Kazakhstan), where no such institution yet exists, institutions need considerable strengthening internally and legally before they will be able to manage exterior loans. In most cases, investigators also recommended training at the central bank and commercial bank level to assist the key players in developing appropriate regulations and procedures for small business lending through commercial banks.

ABSTRACT IV-2

DEVELOPMENT OF THE SMALL- AND MEDIUM-SCALE ENTERPRISE SECTOR IN POLAND

Abstracts of Four GEMINI Reports

Assessment of Policy Issues and Constraints in the Construction Sector in Poland
GEMINI Working Paper No. 34
Adam Saffer, Miroslaw Zielinski, Jerzy Zielinski, Tadeusz Marek, and Matthew Gamser
February 1993

Small and Medium Enterprise Development: A National Assessment of the Agroindustry in Poland
GEMINI Working Paper No. 44
George L. Metcalfe and Debra Wahlberg
January 1993

Investing in the Future: Report of the Task Force for Small and Medium Enterprise in Poland
GEMINI Technical Report No. 60
May 1993

Study of the Financial Sector and SME Development in Poland
GEMINI Technical Report No. 68
Bruce Heatly, Cynthia Lynn Chrzan-Lanigan, and Cathy Silverstein
February 1994

Poland stands out among the countries in the former East Bloc for its early success in transforming from a centrally planned economy into a free market system. Policies of the Government of Poland (GOP), although still not clearly defined, have nevertheless begun to create an atmosphere conducive to the development of private entrepreneurship, demonstrated by the rapid expansion of the small- and medium-sized enterprise (SME) sector.[1] However, despite such progress, policy constraints hinder the development of the private sector and can be removed (or altered) only through collaboration between the GOP and the private sector.

In September 1992, at the request of the GOP, the U.S. Agency for International Development entered into a contract with Development Alternatives, Inc. (DAI) to implement the Poland Small Business Project, a long-term program to provide advisory assistance to the GOP regarding private sector formation and investment in the SME sector. GEMINI advisors have worked closely with government officials, private sector organizations, and firms throughout Poland to identify constructive legislative and regulatory reform initiatives that the GOP should address, and to help the government create a policy formation process that incorporates input and feedback from the emerging private sector. In keeping with this collaborative spirit, GEMINI conducted several industry-specific research projects to focus on the scope of small business activity within certain sectors and to identify the operational linkages between small businesses and larger enterprises. In

[1]The SME sector, as defined in Poland, is the population of businesses that have 1-100 employees.

addition, in early 1993, a task force was created by the Group of 24 (G-24), a coalition of donor, government, and private sector agencies, to analyze the problems facing small businesses in Poland. The GEMINI project provided a Secretariat for the task force and has helped produce and disseminate its work.

BACKGROUND

The Polish Economy in the 1990s

As in other emerging economies, the transition to a market-based economy has been difficult for Poland. The macroeconomic environment is beset by high inflation, national and international recession, an unwieldy government budget deficit, and high interest rates and taxes, and the country still does not have adequate systems in telecommunications, distribution, or transport.

Despite the severe government restrictions of the pre-1989, centrally planned system, however, some private economic activity had taken place. When these restrictions were lifted, foundations existed for a relatively small private sector to expand rapidly. Statistics indicate that the number of private sector businesses increased by 15 percent from mid-1992 to mid-1993, with the greatest change in the service sector (40 percent in 1992). The private sector, including privatized, state-owned enterprises, currently accounts for nearly one-third of nonagricultural employment; more than half, when agriculture is added. Over the first three years of reform, the number of MSEs increased from 300,000 to 1.7 million, and that sector's contribution to gross domestic product reached 42 percent by early 1994. Exports have risen, as has the share of total gross domestic investment in the private sector. In general, the private sector is making a substantial contribution to the recovery of the economy. However, most private sector firms remain unincorporated proprietorships or partnerships, the only legal forms of ownership before 1986.

The Polish MSE Sector

Polish private firms take a variety of forms including new start-ups, holdovers from the former private sector, and privatized SOEs. The majority of these are very small firms involved in trade. MSEs — currently defined by the Central Statistical Office as companies with 1-5 (microenterprises) and 6-50 (small) employees, respectively — have emerged in virtually all sectors of economic life and should contribute substantially to economic growth in Poland, particularly through the creation of new jobs. As experienced in many other countries, SMEs have already enhanced competition in the markets for goods and services, guaranteeing a permanent process of creativity and innovation.

Major Constraints to Development

One of the most important constraints in the development of the Polish economy is the disparity between the restrictions of central planning and the new demands of a market-based economy. In the pretransition shortage economy, the majority of entrepreneurs were not concerned with effective business management, financial controls, or marketing techniques. Central government policy makers conducted financial analyses and made all management decisions. Demand heavily exceeded supply, so sellers simply waited for customers to come to them. There was little need for proper cash-flow analysis or inventory control. After 1989, new entrepreneurs entered the private sector with sound concepts for providing goods and services to the consuming public, but without the necessary expertise to operate a business. As private business replaces the state as the dominant contributor to the Polish economy, these issues have become increasingly important.

Several external factors also hinder the development and expansion of business. The existing laws and regulations are inadequate for a modern, market-driven economy, and change too frequently to allow for any serious business planning. For example, the current tax system encourages many entrepreneurs to operate in the informal sector, rather than stimulating investment in private businesses. Furthermore, legislators, administrators, and courts lack experience in fostering a free market economy, and thus prevent the legislative process from dealing adequately with the problems of businesses..

As in other emerging economies, Poland lacks a developed banking system. Routine payments required to operate a business become time-consuming, credit is difficult to access, and there are few sources of equity capital. Other than banks, there are few institutions, such as insurance companies or credit-rating organizations, which can offer other important financial services to small business..

Finally, the business support network is weak. Entrepreneurs are reluctant to organize into private sector lobbying groups because they have traditionally avoided the government and do not fully appreciate the concept of lobbying to achieve mutual goals. The relatively few outlets that do exist for entrepreneurs to seek general business advice have not worked cooperatively on previous initiatives. Furthermore, those resources that are devoted to support organizations are largely targeted at start-up and microenterprises, leaving little room for the specific needs of medium-sized enterprises.

In addition, the fact that the GOP has given private sector development a low priority has exacerbated many of the existing constraints. The institutions responsible for SME and entrepreneurship promotion remain weak, information flow between the GOP and the private sector is limited, and the lobbying efforts of the business community are uncoordinated. The GOP must develop a more comprehensive approach to adequately address the macroeconomic, financial, legal and social constraints that inhibit SME development.

CASE STUDIES

GEMINI conducted several industry-specific research programs to identify policy actions for targeted sectors. This section highlights the findings from that research, much of which has been instrumental to the work of the G-24 task force.

Case Study I: Financial Sector Reform

The Financial System in Poland

Until Poland embarked on its economic transition, there were no market-oriented structures in its financial system. In 1989, however, new legislation created or altered those institutions that did exist, radically affecting the whole economy. The major features of the post-1989 system are outlined below.

- **The Banking Sector.** The National Bank of Poland (NBP), the country's central bank, has been independent of the Ministry of Finance since 1989. After the appointment of a permanent president in March 1992, the NBP embarked on a banking reform program to create a generally favorable environment for the banking system as a whole, as well as for the institutional development of nine state-owned commercial banks. These banks were previously branches of the NBP, but the Treasury is gradually selling its controlling interest to foreign and domestic investors. Other private banks include approximately 61 banks with no foreign ownership established between 1989 and early 1994, 2 recently privatized Treasury banks, several institutions partially or fully owned by foreign banks, and a 1,600-strong cooperative banking system. Activities of the 26 operational credit unions have become increasingly important since 1989. The unions provide members with consumer loans and, to a lesser extent, microenterprise loans.

Finally, several other banks with specific mandates — such as the Polish Development Bank (PDB), a refinancing apex bank, the Polish Investment Bank (PIB), and the Bank for Socio-Economic Initiatives (BISE) — are well situated to stimulate structural changes in the Polish economy through appropriate credit and investment policies, and should become active sources of medium- and long-term credit.

- **The Capital Market.** The 1991 Act on Public Trading in Securities and Trust Funds established new rules and regulations concerning securities trading. Although significantly increasing the number and type of permissible activities, the Act's impact on the SME sector has been negligible.

- **International Assistance to the Financial Sector.** The international community has provided substantial assistance in the form of grants and long-term loans to help restructure the Polish financial and business sectors.

In 1991, Poland negotiated an agreement with the International Monetary Fund for an Extended Fund Facility, a three-year adjustment plan that gives Poland access to $2.5 billion. Poland has agreed to improve its performance in certain economic areas — the budget deficit, the level of foreign reserves, net domestic assets, government loans, and foreign loans granted or guaranteed by the government — to maintain access to these funds.

Multilateral institutions such as the World Bank, the European Economic Community (now the European Union), the European Bank for Reconstruction and Development (EBRD), and the United Nations Development Programme (UNDP), as well as several bilateral agencies, have granted lines of credit directed at private enterprise development, loans for industrial and banking sector reform and debt management, and various forms of technical assistance. Bilateral assistance has come from a number of sources including the U.S. Agency for International Development, Britain's Overseas Development Administration (ODA), and Germany's Gesellschaft für Technische Zusammenarbeit. Although foreign aid agencies have made significant funds for lending and technical assistance available, only a small percentage of those funds has reached the SME community in the form of credit. Although there are myriad reasons for this exclusion, it is likely that few foreign credit facilities exist for borrowers seeking loans of less than $100,000.

Financial Sector Constraints to SME Development

The primary concern of the SME sector is the limited access to bank credit. As in other transitioning economies, entrepreneurs maintain that the collateral requirements of traditional banks are excessive, interest rates are too high, and the financial information requested is intrusive and overly complicated. Yet bankers face their own constraints, related both to perception and to the still underdeveloped nature of the financial system, which compel them to focus their lending activities on larger companies with established credit experience, accurate financial statements, and professional business plans.

- **Bankers look at SMEs as unreliable borrowers.** When central government restrictions on lending were lifted in 1990, banks embarked on a lending spree. But because of the limited technical expertise available, these activities led to substantial losses in both the public and private sectors. Since then, banks have made little effort to introduce efficiencies in lending techniques that could reduce transaction costs. Similarly, **banks are hesitant to reduce interest rates on SME loans** — even though they are generally perceived to be too high for the market to bear — because maximum income is seen as a hedge against existing and potential losses in the bank's loan portfolio.

- **The Polish financial market remains critically short of investment capital.** Effectively prohibited from further lending until other sources of capital became available, newly licensed banks have turned to other sources of income, including short-term time or inter-bank deposits for greater risk-free returns.

- **The banking system thus far has offered only limited services to serve the particular needs of the SME sector.** Many of the more sophisticated services available in most Western countries such as export letters of credit (L/C), asset-based lending, or leasing options, are available either solely to a bank's most creditworthy clients, or do not yet exist. Making such financing mechanisms more accessible could boost the competitive position of Polish SMEs in the international market.

- **The banking system remains underdeveloped particularly in licensing, monitoring, and enforcement.** Fraudulent activities and insider lending has caused several technical insolvencies thus far, yet the NBP lacks the technical expertise among its staff to improve its supervisory capacity. **Bank clients must also contend with rudimentary management information and other automated systems.** Delays in these systems create cash flow problems for entrepreneurs, as well as opportunities for fraud.

- As mentioned above, **current bank requirements on collateral, often for nearly 200 percent coverage, are difficult for small enterprise entrepreneurs to meet.** Even in cases where collateral is used, banks have difficulty taking possession of it.

- **Foreign assistance credit facilities remain inaccessible to most of the SME sector.** Foreign agencies safeguard their investments by using Western loan standards and procedures that preclude lending to the small business entrepreneur.

Government Policy and SME Development

Changes in commercial, banking, civil, trade, and other laws directly affect the financial and private sector, yet, in many cases, the lack of legal precedence allows for a broad interpretation of existing laws, which impedes the development of the SME sector.

- As mentioned above, **current collateral law tends to favor the lender.** Yet discrepancies related to real property, mortgages, and the rights of the lending institutions to collect make the current system too costly for banks to conduct business based on secured transactions.
- **Major reforms are required in bankruptcy law.** Entrepreneurs can easily claim bankruptcy to avoid repayment of debt under the current regulations.

- The seven Treasury-owned banks are provided with deposit insurance by the Treasury and have special privileges with respect to the collection of bad debts. **Banking laws** such as these **increase**

the competitive position of the Treasury-owned banks over that of the newly established private banks.

- **The GOP has not adequately used tax policy to stimulate the SME sector.** The Ministry of Finance structured its tax policy to meet short-term budgetary goals without considering the long-term fiscal benefits created by an environment conducive to business growth.

- **Prolonged grey market activity inhibits the growth of a free market economy.** Registered SMEs are required to pay fees and taxes to the government, yet must compete with low-cost, unregistered businesses. In this way, the official economy is subsidizing the unregistered business sector.

- **The methods used to privatize SOEs could have an important impact on the overall development of the private sector.** On the one hand, the conversion of nonessential SOEs can create new SMEs through the sale of ancillary assets not necessary for SOE investors. The new businesses could alleviate some of the unemployment created by the breakup of the enterprise. On the other hand, the government continues to focus its efforts on privatization, which often distracts it from assisting SMEs. Substantial funds that might otherwise be made available to private sector entrepreneurs are being used to purchase GOP treasury bills to fund a deficit that has grown, in part, because of privatization efforts.

Case Study II: The Construction Industry

The Importance of Construction to the Polish Private Sector

The construction industry is of critical importance to the Polish economy as a source of employment, housing, commercial and industrial space, and infrastructure — all of which are in short supply in Poland. As the Polish economy evolves, the construction industry is playing an increasingly crucial role, and small, private firms are instrumental to that role. The vast majority (76 percent) of the 18,222 trading companies involved in construction are small firms (with less than 50 employees) plus there are more than 140,000 sole proprietorships. Between the end of 1990 and mid-1991, the number of small businesses in the construction industry is estimated to have grown nearly 100 percent.

The potential for small business development in the construction and building industries is great. More and more public sector enterprises are being sold, privatized, or downsized — paving the way for new forms of competition and allowing former public sector workers the opportunity to form their own businesses. Yet growth in the industry itself is severely hampered by the current policy and regulatory environment which, in its current form, disrupts the critical linkages between land resources, building technology, and finance.

The assessment conducted by GEMINI/Poland examined the environment for SMEs in the construction sector, revealing simultaneously how weaknesses in basic governance can retard private sector initiative. Included among the major problems for SME development in construction are certain characteristics of the industry, existing policies on land-use, limited access to technology, and a lack of financing options.

Industry characteristics

- Staffing problems exist throughout the industry. SMEs have particular difficulties hiring skilled laborers who, in general, choose to work for SOEs or foreign companies abroad where higher wages are available.

- **Expense-saving technological advances are not readily available to small firms.** Most building activity employs local, traditional technology involving brick, block, and cement. Entrepreneurs have not been properly exposed to the high-quality, kiln-dried, wood products common in Western construction. They similarly have difficulty identifying profitable market niches and tend not to specialize.

- **Many SME firms suffer from lack of consumer demand.** Consumers' real income has fallen due both to frozen formal-sector wages and to inflation. As a result, construction products and services are prohibitively expensive for the average Polish consumer. **Competition in the construction industry is also affected by the disproportionate market share captured by large SOEs.** Thus, little of the existing demand accrues to firms in the MSE sector.

- **The concept of competition is not yet fully understood by most business owners.** Most orders are obtained through personal contacts, tend to be local, and reward the SOEs. Little effort is made to access information about other areas, contracts or firms.

- **Lack of affordable credit requires most firms to operate on a cash basis.** Personal savings or borrowing from the family have been the most common source of start-up finance.

Policy Issues

The type of housing that the construction industry can now provide does not meet the current demand for housing in Poland.

- **Land use policy problems prevent the private sector from taking advantage of publicly owned large land tracts suitable for multi-dwelling or industrial commercial development.** Control over state-owned lands has been transferred to local authorities, yet land use decisions must still adhere to Master Plans drawn up during central planning. The local authority (*gmina*) do not have the proper skills or resources to survey or catalogue their holdings, nor do they understand what they are allowed to do with the land that they do own. *Gmina* staff are likely to disrupt the tendering process with last minute changes or to favor SOEs in awarding contracts. **Entrepreneurs and financiers are hesitant to enter into any long-term leasing arrangements** because of such unnecessary complications. Lands with high development potential are thus left to languish.

Technological Innovation

Dissemination of more efficient technology is crucial to produce the lower-cost, lower-maintenance buildings required by the markets. Improvements in technology transfer could significantly benefit newly formed SMEs, which have not yet made substantial investments in the old technology.

- **The current system for awarding building permits discourages innovation.** *Gmina* staff often do not understand existing building laws, and are hesitant to approve projects involving new materials or designs.

- **Current customs and tax provisions favor importing firms over local producers.** This threatens to eliminate Poland's comparative advantage as a raw material source, and penalizes entrepreneurs who invest in the local economy.

- **The absence of trade licensing requirements retards improvement of skills and quality.** Firms continue to award small contract and subcontract work on the basis of personal contacts rather than some industry standard.

Finance and Investment

SMEs are most likely to suffer from current fiscal policies that discourage long-term investment necessary for construction.

- As of early 1993, nothing had yet been developed to take the place of the old cooperative housing finance system, yet **the lack of affordable credit continues to paralyze the housing market.**

- **Developers have only limited options for financing new projects.** There are no laws in place to ensure the safety of collateral use, restrictions exist on foreign investment in land, and it is difficult for foreign and local banks to cooperate.

- **The existing tax and tariff collection system penalizes local capital investment.**

Structural Limitations of the Government

At the time the report was written, no government body had yet been established to play an advocacy role on behalf of SMEs in the construction or other industries.

Case Study III: The Agroindustrial Sector

The Importance of Agribusiness to the Polish Private Sector

Like the construction industry, the agroindustrial sector makes a significant contribution to Poland's economy. In 1990, the sector provided nearly 18 percent of the gross national product and created employment for some 30 percent of the population (although neither figure reflects the agroindustrial activity in the informal sector). Domestic agricultural production accounts for almost 90 percent of food consumption. Now, with the elimination of SOEs, the agroindustrial sector presents a significant opportunity for the growth of small- and medium-sized businesses, particularly in the areas of food processing, handling and storage, distribution and trade.

Major Constraints to SME Development in Agriculture

The agroindustrial sector has experienced major upheavals during Poland's transition. Before 1989, agriculture was characterized by strong intervention by the government. Active marketing boards assured a steady source of revenue for the agricultural sector. State-owned processing and marketing companies provided linkages among private and state farms, cooperatives, and the consumer. As several thousand SOEs are likely to be transferred simultaneously to private ownership, the private sector will struggle with its new role in agriculture. Clearly, it will need the full support of the GOP, which is now in the position of formulating policies to create an enabling legislative and administrative environment.

The current GOP structure has not effectively transformed the state-dominated environment into a private one and has not addressed SME development or expansion directly.

- **The existing regulatory and financing entities tend to compete with the private sector or favor SOEs over newly established private businesses.** The Agency for Agricultural Markets (ARR), which controls levels of domestic agricultural surplus and provides loan guarantees to SOEs and private companies, competes directly with the private sector in the procurement, exportation, importation, and storage of agricultural commodities.

- **The process of privatizing SOEs has progressed more slowly than anticipated.** The regional offices of the agency responsible for valuating the assets of state farming enterprises are seriously overburdened. Several of the procedures involved contradict one another and are confusing for staff. Workers in the large enterprises are not fully aware of the implications of privatization or how to go about preparing for it. Finally, farms operate on a day-to-day basis, without long-term financial planning.

- **Cooperatives are unable to play a constructive role in the new economy.** A proposed revision of the cooperative law — not yet passed at the time of the GEMINI assessment — left both banks and cooperatives unclear about how ownership issues would be treated in the future. At the same time, managers of cooperatives lack the necessary skills to operate in a profit-driven system.

PRIORITY ACTIONS

The conclusions of these case studies and the subsequent work of the task force have been instrumental in helping to formulate recommendations for further reform. Because of the GOP's approach thus far, the task force has stressed the need to develop a coherent policy and improve communication between the respective parties.

In general, **the GOP should adopt a comprehensive policy in support of the SME sector.** This includes the creation of a legal and regulatory framework, the development of appropriate institutions and mechanisms to keep the market working smoothly, and more extensive exchange between private individuals and private companies. Without such a policy, no framework exists within which to establish initiatives needed to remove the constraints to further SME development.

But while government activity should focus on removing the constraints subject to its control, **the private sector must be persuaded to adopt more appropriate management and business practices.** Furthermore, the private sector should take an active role in educating the public about new economic realities.

Specifically, the task force recommended that action be taken in the following areas:

General Environment

- **The GOP should create an institution designed to support SME development.** Such an advocacy unit will establish the necessary infrastructure to confront the constraints that impede SME development and create a proactive SME advocacy and promotion process in collaboration with SME organizations, governmental entities, and the foreign assistance community. This unit should receive extensive and ongoing technical assistance.

- **Direct assistance to *gminas* can help build capacity at the local level.** The donor community can direct its assistance initially at a few regions to create sound examples of public-private partnerships in land development and other areas.

- **An SME regulatory reform task force should be established.** Such a force could push for passage of legislation, such as a proposed Collateral Law, to improve recognition of lease assets. It could also develop a new bankruptcy law and provide information on current tax obligations and the implications for SMEs of VAT and other new regulations.

Construction

- **Alternative means of financing developers and contractors should be developed.**

- **Rapid implementation of the World Bank Housing Finance Project should be encouraged.**

- **New legislation should be proposed to mandate SME participation in public land development.** A certain percentage of the value of public land development projects for firms with less than 50 employees should be set aside to encourage subcontracting by the larger SOEs, which will in turn stimulate privatization. Building codes must also be revised.

- **Task forces on land development should be established** at both the regional and national levels to improve the participation of SMEs in land-use decisions.

Agroindustry

- **The role and functions of government bodies must be more precisely defined.** The ARR should remove itself from economic trading and procurement activities to allow the market to indicate prices for commodities. The Ministry of Agriculture should rationalize its agricultural development services in conjunction with other agencies.

- **Government policy should focus on economic development rather than food self-sufficiency.** Continuous subsidization of agricultural inputs for very small farms will not permit economies of scale in production.

- **The role of SME advisory centers should be expanded.** Private voluntary and nongovernmental organizations should coordinate efforts to streamline advisory services, while the GOP should remove itself from such activities. The advisory centers should work together with local and regional cooperative banks and private sector agribusiness organizations to develop creative financing mechanisms for the sector.

- **Investment in agribusiness formation should be encouraged.** A necessary shift from debt financing to equity financing can be accommodated by foreign capital and foreign financial institutions. Capital formation can also come from joint ventures between members of the domestic private sector.

- **The promotion of agribusiness can be stimulated through certain, targeted interventions, particularly for the development of export markets.** The oilseed industry represents a viable opportunity, for example, for the intervention of a procurement and marketing company that could provide the necessary inputs, credit, technical assistance, and marketing linkages to the export market.

GEMINI PUBLICATION SERIES

GEMINI Working Papers:

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

3. "Prospects for Enhancing the Performance of Micro- and Small-Scale Nonfarm Enterprises in Niger." Donald C. Mead, Thomas Dichter, Yacob Fisseha, and Steven Haggblade. GEMINI Working Paper No. 3. February 1990. $6.00

4. "Agenda Paper: Seminar on the Private Sector in the Sahel, Abidjan, July 1990." William Grant. GEMINI Working Paper No. 4. August 1990. $3.00

*5. "Gender and the Growth and Dynamics of Microenterprises." Jeanne Downing. GEMINI Working Paper No. 5. October 1990. $10.50

6. "Banking on the Rural Poor in Malaysia: Project Ikhtiar." David Lucock. GEMINI Working Paper No. 6. October 1990. $3.30

7. "Options for Updating AskARIES." Larry Reed. GEMINI Working Paper No. 7. October 1990. $3.50

*8. "Technology — The Key to Increasing the Productivity of Microenterprises." Andy Jeans, Eric Hyman, and Mike O'Donnell. GEMINI Working Paper No. 8. November 1990. $3.60

9. "Lesotho Small and Microenterprise Strategy — Phase II: Subsector Analysis." Bill Grant. GEMINI Working Paper No. 9. November 1990. $15.50

*10. "A Subsector Approach to Small Enterprise Promotion and Research." James J. Boomgard, Stephen P. Davies, Steven J. Haggblade, and Donald C. Mead. GEMINI Working Paper No. 10. January 1991. $3.10

11. "Data Collection Strategies for Small-Scale Industry Surveys." Carl Liedholm. GEMINI Working Paper No. 11. January 1991. $1.30

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*Publications of general interest

*28. "Apex Study of the Asociación de Grupos Solidarios de Colombia." Arelis Gomez Alfonso, with Nan Borton and Carlos Castello. GEMINI Working Paper No. 28. April 1992. $4.60. [See Technical Reports No. 36 and No. 39 for apex studies in Senegal and Thailand.]

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