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UNCLASSIFIED

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

DOMINICAN REPUBLIC

PROJECT PAPER

SMALL INDUSTRY DEVELOPMENT

AID/LAC/P-112

Project Number:517-0150
Loan Number:517-T-040
Loan Number:517-W-041

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A = Add, C = Change, D = Delete

Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Dominican Republic

3. PROJECT NUMBER: 517-0150

4. BUREAU/OFFICE: Latin America and the Caribbean LAC — 05

5. PROJECT TITLE (maximum 40 characters): Small Industry Development

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 27 YY 87

7. ESTIMATED DATE OF OBLIGATION (Under 'B:' below, enter 1, 2, 3, or 4)

A. Initial FY 82 B. Quarter 4 C. Final FY 83

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 83 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(155)	(140)	(295)	(235)	(615)	(850)
(Loan)	( )	(834)	(834)	( )	(5,000)	(5,000)
Other U.S. 1.						
Other U.S. 2.						
Host Country					2,000	2,000
Other Donor(s)						
TOTALS	155	975	1,129	235	7,615	7,850

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) FN	270	110	110	0	0	595	3,500	595	3,500
(2) ST	700					255	1,500	255	1,500
(3)									
(4)									
TOTALS						850	5,000	850	5,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 150 | 840

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

The purpose is to: establish an institutional mechanism, capable of providing a continuous source of credit, technical assistance and training to small entrepreneurs in the Dominican Republic.

14. SCHEDULED EVALUATIONS

Interim MM 09 YY 83 | MM 09 YY 84 | Final MM 09 YY 87

15. SOURCE/ORIGIN OF GOODS AND SERVICES

[X] 000 [X] 941 [X] Local [X] Other (Specify) 899

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY

Signature: Philip R. Schwab

Title: Director, USAID/Dominican Republic

Date Signed: MM 09 DD 30 YY 82

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (8-79)

U. S. AID MISSION TO DOMINICAN REPUBLIC
AMERICAN EMBASSY, P. O. Box 867
SANTO DOMINGO, DOMINICAN REPUBLIC

PROJECT AUTHORIZATION

FOR U. S. CORRESPONDENTS:
U. S. AID MISSION
APO MIAMI 34041

Name of Country	:	Dominican Republic
Name of Project	:	Small Industry Development
Number of Project	:	517-0150
Number of Loan	:	517-T-040 517-W-041

1. Pursuant to Sections 103 and 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Small Industry Development project for the Dominican Republic (the "Cooperating Country") involving planned obligations of not to exceed Five Million United States Dollars ($5,000,000) in loan funds ("Loan") and Eight Hundred Fifty Thousand United States Dollars ($850,000) in grant funds ("Grant") over a two (2) year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project.

2. The project ("Project") consists of a program to establish an institutional mechanism, capable of providing a continuous source of credit, technical assistance and training to small entrepreneurs in the Dominican Republic.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Interest Rate and Terms of Repayment

The Cooperating Country shall repay the Loan to A.I.D. in U.S. Dollars within twenty-five (25) years from the date of first disbursement of the Loan, including a grace period of not to exceed ten (10) years. The Cooperating Country shall pay to A.I.D. in U.S. Dollars interest from the date of first disbursement of the Loan at the rate of (i) two percent (2%) per annum during the first ten (10) years; and (ii) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

b. Source and Origin of Goods and Services (Loan)

Goods and services, except for ocean shipping, financed by A.I.D. under the Loan shall have their source and origin in the Cooperating Country or in countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Loan shall be financed only on flag vessels of the Cooperating Country or countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing.

c. Source and Origin of Goods and Services (Grant)

Goods and services, except for ocean shipping, financed by A.I.D. under the Grant shall have their source and origin in the Cooperating Country or in the United States, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Grant shall be financed only on flag vessels of the United States, except as A.I.D. may otherwise agree in writing.

d. Conditions Precedent to Loan Disbursements

i. First Disbursement. Prior to the first disbursement under the Loan, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Cooperating Country, will, except as A.I.D. may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

(a) An opinion of the legal advisor to the Cooperating Country that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, the Cooperating Country, and that it constitutes a valid and legally binding obligation of the Cooperating Country in accordance with all of its terms;

(b) A statement of the name of the person who will represent the Cooperating Country and of any additional representatives, together with a specimen signature of each person specified in such statement;

(c) The name of the Cooperating Country's project coordinator who will be able to contribute adequate time and effort for the successful implementation of the project;

(d) Evidence of the establishment of (1) a project office within the Central Bank and the assignment of adequate staff to support activities planned under the project, and (2) a Small Industry Development Credit Fund within the Borrower to support activities planned under the project;

(e) A detailed operational plan for sublending for the first sublending period of the project;

(f) Evidence of the establishment of a coordinated program of technical assistance and credit between the Central Bank and local small industry assistance organizations including detailed policies, procedures and eligibility criteria to be followed under that program.

ii. Disbursement for Each Program Sublending Year. Prior to any disbursement, or the issuance of any commitment documents under the Loan in each program sublending year, beginning with the year October 1, 1983 to September 30, 1984, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D. a detailed report which (a) sets forth sublending activities planned for the next program sublending year, (b) evaluates the effectiveness of the credit resources and sublending policies, procedures and eligibility criteria used during the previous sublending periods and (c) evaluates the effectiveness of the technical assistance resources provided to small industries and the effectiveness of the policies, procedures and eligibility criteria used to manage these resources during the previous sublending periods.

e. Conditions Precedent to Grant Disbursements

i. First Disbursement. Prior to the first disbursement under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Cooperating Country will, except as the Parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

(a) An opinion of the Legal Advisor to the Cooperating Country that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, the Cooperating Country, and that it constitutes a valid and legally binding obligation of the Cooperating Country in accordance with all of its terms;

(b) A statement of the name of the person who will represent the Cooperating Country and of any additional representatives, together with a specimen signature of each person specified in such statement; and

(c) The name of the project coordinator for the project together with evidence that the coordinator will contribute adequate time and effort for the successful implementation of the project.

ii. Disbursement for Technical Assistance System Component. Prior to any disbursement under the Grant, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made to support the activities include under the Technical Assistance System project component, the Cooperating Country will, except as the parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

(a) Evidence of the establishment of a coordinated program of technical assistance and credit between the Central Bank and local small industry assistance organizations including the detailed policies, procedures and eligibility criteria to be followed under that program;

(b) Evidence of the establishment of a Central Assistance Facility (CAF) within the Central Bank with the necessary supporting staff, equipment and other resources to administer the CAF activity;

(c) A detailed operational plan for the technical assistance center activities for the first project year (approximately September 1982 to September 1983).

iii. Disbursement in Each Project Year. Prior to any disbursement or the issuance of any commitment document under the grant in each project year, beginning with the year October 1, 1983 to September 30, 1984, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(a) A detailed report on the technical assistance activities planned for the next project year; and

(b) a detailed evaluation report on the effectiveness of the technical assistance resources provided to small industries and the effectiveness of the policies, procedures, and eligibility criteria used to manage these resources during the previous project years.

f. Special Covenants for Loan

i. Project Evaluation. The Cooperating Country shall establish an evaluation program as part of the Project. Except as A.I.D. may otherwise agree in writing, the program will include annual evaluations during the implementation of the Project and at least one more at the project conclusion. The evaluation will include, but not be limited to: (a) evaluation of progress toward attainment of the objectives of the Project; (b) identification and evaluation of problem areas or constraints which may inhibit such attainment; (c) assessment of how such information may be used to help overcome such problems; and (d) evaluation, to the degree feasible, of the overall development impact of the Project.

ii. Evaluation Plan. Except as A.I.D. may otherwise agree in writing, the Cooperating Country will prepare and submit to A.I.D. within 12 months of the signing of this Agreement a time phased plan for evaluation.

iii. Use of Loan Funds. Except as A.I.D. may otherwise agree in writing, the Cooperating Country agrees to (a) deposit all subloan reflows of principal generated under this project in the Small Industry Credit Fund and use such funds in accordance with the policies and critéria of the Fund; and (b) make available effective sublending interest rates and risk reduction incentives, used under this project for sublending to small business with other than program resources.

g. Waiver

i. Motorcycles financed by AID under the project and having a total value of not to exceed $25,000 may have their source and origin in countries included in AID Geographic Code 899. Exclusion of procurement from Free World Countries other than the cooperating country and countries included in Code 941 would seriously impede attainment of U.S. foreign policy objectives and objectives of the foreign assistance program.

Philip R. Schwab, Director
USAID Dominican Republic

September 30, 1982
Date

Drafted by: RALTCarter:cmk:9-24-82

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PROJECT PAPER

SMALL INDUSTRY DEVELOPMENT - DOMINICAN REPUBLIC

TABLE OF CONTENTS

ANNEXES:

Glossary of Acronyms

CEPESA	-	Centro de Asistencia Técnica de la Pequeña Empresa
CFI	-	Corporación de Fomento Industrial (Corp. for Industrial Promotion)
CONADEPI	-	Corporación Nacional para el Desarrollo de Pequeñas Industrias
DDF	-	Fundación Dominicana de Desarrollo (Dominican Development Foundation)
FIDE	-	Fondo de Inversiones para el Desarrollo Económico (Investment Fund for Economic Development)
IDB	-	Inter-American Development Bank
IESC	-	International Executive Service Corp.
ILO	-	International Labor Organization
INDESUR	-	Instituto Para el Desarrollo del Suroeste
INFOTEP	-	Instituto Nacional de Formación Técnico Profesional
INTEC	-	Instituto Tecnológico (Technological Institute)
ISA	-	Instituto Superior de Agricultura (Higher Agricultural Institute)
INDOTEC	-	Instituto Dominicano de Tecnología (Dominican Institute of Technology)
PFI	-	Private Financial Institution
PROAPE	-	Programa de Asistencia a la Pequeña Empresa
TAC	-	Technical Assistance Center
UCMM	-	Universidad Católica Madre y Maestra
UNIDO	-	UN Industrial Development Organization

I. SUMMARY AND RECOMMENDATIONS

A. Face Sheet

B. Recommendations

The Project Committee recommends that the Director, USAID/Santo Domingo, approve the following loan/grant to finance the Small Industry Development Project.

• <u>AID Loan</u>	$5,000,000
Terms: 25 years, 2% interest during a ten year grace period, 3% interest during remaining 15 years. $3.5 million of the AID loan will be used for sublending activities in rural areas.	
• <u>Counterpart Contribution</u>	$2,000,000
Counterpart contribution, will be in local currency resources. Disbursement will be over a three year period, with the intention that AID and counterpart funds will be disbursed simultaneously.	
• <u>AID Grant</u>	$ 850,000
U.S. dollars will finance technical assistance, evaluation, and training. Local currency, will finance TAC operating costs, local training, technical assistance and commodities.	
• <u>Project Total</u> (including counterpart)	$7,850,000
• <u>Disbursement Period</u> (for revolving fund)	Three Years
• <u>Implementation Period</u> (for technical assistance)	Five Years

C. <u>Summary Project Description</u>

1. <u>Borrower/Grantee</u>

The Borrower for loan funds and the Grantee will be the Government of the Dominican Republic. The Central Bank will be the primary executing agency, acting through the Fund for Economic Development (FIDE).

2. Project Summary

The Dominican Republic is a country with a substantial entrepreneurial potential. Large numbers of undercapitalized small and poorly managed industries struggle for survival and growth in many lines of business in all parts of the country. These enterprises are labor intensive and typically link significantly to agricultural production and to larger industrial, construction, tourism and commercial enterprises. Most small industries face a severe shortage of working capital and lack access to institutional credit of any kind. It is estimated that 80% of the credit available to firms is provided by private lenders at interest rates often double those charged by institutions. Entrepreneurs typically are plagued by deficiencies in business administration and technical knowledge, effective access to markets, and inefficient production technology. The fact that so many of these enterprises do survive under these conditions suggests that with technical assistance and access to credit at reasonable rates, very significant increases in productivity, employment, and production can be achieved.

The Goal of the Project is to increase the per capita income and employment in the Dominican Republic, by improving the performance of the private sector. The Purpose of the Project is to establish an institutional mechanism, capable of providing a continuous source of credit, TA, and training to small entrepreneurs in the Dominican Republic. Accordingly, the project includes:

a. Credit

A $7 million Small Industry Revolving Credit Fund will be established in the Central Bank, under the general management of FIDE. The credit will be made available to small entrepreneurs through participating financial institutions (PFI), qualified to do business with FIDE. PFIs will have final approval for subloans and will certify that the loan meets eligibility criteria of the program. The PFI will make the initial disbursement, whenever possible, directly to the supplier of goods and services. The PFI will then submit the loan documentation and a reimbursement request to FIDE which will reimburse the PFI within 24 hours.

Subloans will not exceed $50,000 nor be less than $2,000. Cooperatives and Group Associations will be eligible for subloans, the total amount of which may not exceed $100,000. Funds will be available for the purchase of capital goods, working capital, inventory financing and any other purpose deemed necessary to assure the viability of the enterprise. Loans for the acquisition of capital goods and production credit will be for a period of not more than 6 years including a one year grace period; loans for working capital will be made for a period of up to 3 years with a 6 month grace period.

b. Technical Assistance

The technical assistance component is designed to provide a self-sustaining network to service the business development needs of small entrepreneurs. Two mechanisms will be provided: (1) Technical Assistance Centers (TAC) will provide the small industry borrowers with needed assistance in loan analysis and document preparation and in basic management and operational techniques; (2) a Central Assistance Facility (CAF), located in FIDE, will provide TACs with technical assistance during the start-up phase and, upon request, specialized assistance needed by TAC clients.

3. Summary Findings

The Project Committee has reviewed the project for its institutional, financial, economic and social soundness. The Committee believes that the Project, as developed, can help to alleviate the constraints to successful small industrial development in the Dominican Republic by opening up formal institutional credit mechanisms to small enterprise participation and providing sound and timely assistance in business administration and management.

D. Participants in the Preparation of the Project Paper

Mission Project Committee

Ronald F. Venezia, Assistant Director
Tim Hammann, CRD
Aaron Benjamin, UDD, Project Manager
Debra De Witt, CRD
Benito Henríquez, CRD
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Consultants

Onofre Torres, Interamerican Management Consulting Corp.
Peter Fraser, Private Consultant

II. BACKGROUND

A. Role and Characteristics of Small Business in the Economy

Small business plays an important role in the Dominican economy. Although the exact number of small businesses is not known, there are at least 5,000 small businesses registered with the Secretariat of Industry and Commerce and it is estimated, at least 8,000 unregistered businesses in the Dominican Republic. According to results obtained in 1981 from a study on Dominican industry conducted by the United Nations Organization for Industrial Development (UNIDO), approximately 45 percent of the manufacturing labor force (or 26,000 persons) is employed by small business. In 1981, small business contributed approximately 56 percent of the total manufacturing output (excluding sugar) or $365 million to the economy.

Small businesses in the Dominican Republic are defined as having between RD$10,000 and RD$250,000 in assets, with highly variable levels of sales. A small business employs an average of twenty workers, although manufacturing firms with RD$10,000 to RD$50,000 in assets, employ on the average between five and ten workers. These enterprises are particularly active in the food processing, light manufacturing (e.g., furniture, shoemaking, metalworking, etc.), handicraft, service, and commercial/trading industries.

B. The Problems and Needs of Small Business

The recently completed INTEC study of small businesses in the Dominican Republic; the 1980 AITEC/DDF micro-enterprise survey; the UNIDO study; the CONADEPI survey; and extensive discussions with people with knowledge of this sector, have enabled a picture of the needs and constraints of Dominican small business to emerge. In particular there are five areas which are identified for attention in this Project Paper: credit, management, production, marketing, and the policy/legal environment. (See Section C.2 and D.1 for details on studies cited.)

1. A Reliable and Economic Source of Credit

Since most private finance companies find that loans to small businesses are too risky, and too costly per dollar lent, they rarely extend credit to small enterprises. As a result, the small entrepreneur must seek loans from private lenders and non-formal sources. Since these loans are usually very short term, they generally are only used for short term working capital needs. In most cases, terms are very unfavorable at more than twice the formal market rate, well beyond those permitted by statute.

Without credit or access to credit, small industry is unable to invest. In many cases, modest needs such as short-term working capital to assure steady production have not been satisfied through the formal financial market. The recent INTEC study indicated that 72.4% of all small businesses surveyed had an urgent need for credit to finance both working and fixed capital investment. Similarly, 93.1% of respondents in the AITEC/DDF study identified lack of credit as the primary obstacle to business expansion.

The "why" of the credit constraint, revealed in these studies, is also of considerable interest. In both manufacturing and non-manufacturing sectors and particularly in the lower end of the business scale, the absence of experience and inability to conform with formal banking institution requirements - e.g. lack of understanding of application procedures, lack of audited statements, inability to demonstrate positive cash flows and repayment capability, etc. - were the limiting factors. In fact, these reasons were cited more frequently even than collateral or guarantee deficiencies for not obtaining credit.

2. Administrative Knowledge

Knowledge of business administration is rare and commonly learned by hard experience. Based on information from the INTEC study and from a recent survey of its members by CONADEPI (a national small business association), it is known that accounting and record-keeping systems are irregularly maintained. Therefore, a businessman may have little knowledge of his actual assets and liabilities, his costs of production or his profit margin. As the small entrepreneur has numerous responsibilities and typically, a limited formal education, his chances of learning enough about administration and management before losses are suffered are relatively slim. Worse, the small entrepreneur often "does not know that he does not know." For example, despite the recognition of the entrepreneurs' inability to conform with banking requirements (see above), only 35% of small manufacturers and 20% of small non-manufacturers surveyed responded that they had ever sought technical assistance. The main reason for not seeking technical assistance, cited by 94% of the respondents, was that they "didn't think it was necessary."

Beyond simple loan-packaging services, Dominican small businesses have a need for direct technical assistance which will increase the entrepreneur's awareness of the utility of administrative controls and procedures, and provide rudimentary training in these areas. Perhaps the greatest need of small business is for accounting and record-keeping systems. In order to plan for growth and expansion, the entrepreneur must first know where his money is going. Only in this way, and with an eye toward the future, can he make rational decisions on procurement, production, sales, etc., with which to maximize his chances of survival, not to mention profit.

3. Production Knowledge

Systems of production used by small businesses often underutilize both labor and capital. Equipment is often outdated and unreliable. Typically, there are production techniques and equipment available which would increase production efficiency, of which the entrepreneur is unaware. Also, unskilled workers may be trained to raise their level of productivity thereby increasing the output of the business. Technical assistance, working directly with the enterprise, can uncover these shortcomings and make recommendations for improvement as well as provide guidance for implementation of recommended improvements. Amongst small manufacturers surveyed by INTEC who responded that they had sought technical assistance, around fifty percent claimed to have been interested in receiving production-oriented TA, such as for new machinery and its installation, and for quality control.

4. Marketing Knowledge

Many, if not most, small entrepreneurs do not have the resources to buy supplies in large quantities and at reduced rates nor do they have the marketing knowledge to get the best price for his product. The result often is that the small entrepreneur must buy high and sell low in smaller quantities than is optimal. A broader, understanding of raw material sources, retail channels, and marketing information will provide the entrepreneur with several choices from which he may improve his purchasing, bargaining and marketing power.

There are few enterprises anywhere that could not benefit considerably from better marketing practices. Enterprises poised at the brink of survival - as many Dominican small enterprises are - can least afford foregoing market opportunities and advantages that may be open to them, whether local or export-oriented. Recognition of this reality was revealed by the INTEC survey, wherein "marketing" and "publicity" were accorded high priority among TA categories, particularly by service and commercial enterprise respondents. All of the loan packaging, managerial and production assistance in the world is worthless if the final product cannot be sold profitably.

5. Major Policy and Legal Constraints

There are many laws and regulations now on the books that were intended either to provide incentives or to regulate business. Each government administration has had its own policy in promoting and/or regulating the private sector. As a result, the entrepreneur faces a legal environment in which laws are complex, full of loopholes, and often inconsistent, or contradictory. Laws affecting small business are often not effectively implemented. A few of the important laws affecting small businesses and their constraints are presented in Annex G-1.

The GODR is becoming aware of these constraints. Some laws, in effect, benefit the larger enterprises and those with the most political influence (usually not the small businessman), making significant change very difficult. Dealing effectively with these constraints and reforming the existing laws and regulations affecting small business is a long term process involving much analytical and political effort. Private sector organizations are addressing many of these issues with the new government.

C. Government and other Donor Response to Small Business Problems

1. GODR Response to the Problem

The GODR has recognized that small business is an important source of employment. However, GODR interest in promoting small business has been focused largely on the Dominican Industrial Promotion Corporation (CFI), a government entity, rather than promotion through private sector mechanisms. President Salvador Jorge Blanco has indicated a strong preference for labor intensive, small industry and economic decentralization, placing emphasis on the creation of new jobs in construction and agro industry, principally in the rural areas and secondary cities, thereby reducing migration to the capital and improving income distribution. This project reflects the growing recognition on the part of the GODR that small business promotion is best handled by the private sector with the support of the government rather than directly by government agencies. The following section reflects GODR participation in the business sector.

Small Industry Promotion and Job Creation

The Corporación de Fomento Industrial (CFI) is the only public institution providing credit for small industry. When created in May 1962, CFI was the institution responsible for managing the government enterprises which were obtained from the Trujillo family. Law 288 of June 1966 modified the principal functions of CFI and assigned to this institution the following major responsibilities: (1) promotion of industrial development in the country by stimulating productive sectors; (2) assisting in the rehabilitation of economic activities by promoting new industries and the development of those already existing; (3) granting credits to the industrial sector; and (4) development of research and investment projects to stimulate industrial development.

In 1979, with a $6 million credit from FIDE, CFI launched a large scale lending program designed to finance and assist the development of small industry. During the first year CFI made 319 loans for a total of RD$13.6 million, primarily with funds from FIDE. With approximately 40-50 percent of its small industry loans directed to small industries in the interior region, the Corporation continued its high rate of loan disbursement until mid 1981 by making 635 loans for a total of RD$15,000,000. Of this total, 449 (70%) were for loans of less than RD$25,000; 125 (19.7%) were for loans between RD$25,000 and 50,000; and 61 (9.6%) were for loans from RD$50-100,000. However, by mid 1981, CFI's rapid lending rate was greatly reduced reflecting, among other things, serious reservations about the soundness of CFI lending practices. Since November of 1981, CFI has been without any funding from FIDE and has virtually not made any loans.

CFI has not been successful in collecting loan repayments and has provided relatively little technical assistance. A recent institutional analysis of CFI by AID indicated that of the total outstanding loan portfolio of RD$17 million of which 90 percent consists of loans to small industries, only 50-60 percent is considered to be collectable under the best of circumstances, that is to say that at least 40 percent is not recoverable through regular collection procedures. Although the analysis recommends against channeling financial assistance directly to CFI at this time, it recognizes the pressing need for capital and technical assistance to the small industry subsector at this time.

2. Other Donor Activities

Most of the international assistance to small industries (in addition to AID contributions) has come from three multilateral donors: 1) the United Nations (UNIDO and ILO); 2) the World Bank; and 3) the Inter-American Development Bank (IDB).

The United Nations Industrial Development Organization (UNIDO) is conducting a study of small and medium-sized industries, in conjunction with the Secretariat of Industry and Commerce, which will result in: 1) a definition and characterization of small and medium industries; 2) the design of a system for development and assistance to small industries; 3) recommendations for the organization of a small and medium industry unit in the Secretariat of Industry and Commerce; 4) identification of projects and activities for that unit; and 5) collaboration in acquisition of technical experts.

Beginning in 1980, a joint effort by the World Bank (which provided financing) and the International Labor Organization (ILO) (which provided technical assistance) was initiated to develop the National Institute for Technical and Professional Formation (INFOTEP). This Institute is responsible for: conducting studies to determine training needs; providing technical support to institutions involved in worker training; offering technical assistance to private enterprises; and organizing training centers for workers in industry, commerce, and agriculture and training of blue collar workers. It is anticipated that the resources of INFOTEP will be tapped by the TACs working in conjunction with this project.

In September 1981, the Inter-American Development Bank (IDB) made a $7.5 million loan to the Investment Fund for Economic Development (FIDE) to aid industrial establishments which were damaged by the 1979 hurricanes. Credit is directed towards construction and reconstruction of industrial plants, as well as acquisition of machinery, equipment, and technical assistance. Credit is not available under this operation for working capital. The loan has not disbursed rapidly because of the limitation on the purposes for which it is available as well as perceived obstacles in FIDE mechanisms which, under the proposed project, will be subject to modification.

On June 6, 1980, the IDB approved a $.5 million loan for Small Projects for the Development Association of the Province of Espaillat (Moca). Agriculture was the primary focus of this loan, however, 35% or $175,000, was to be used for loans to micro industries (maximum of 10 workers). Sub loans did not exceed $5,000. The loan fund is completely disbursed.

The IDB is in the process of negotiating a $.5 million loan with the Development Association of Santiago. The money will be used to finance subloans for micro and small industries. The proposed eligibility criteria include sub-borrowers whose businesses have annual sales of not more than $25,000; assets of not more than $15,000; an investment/employment ratio of not more than $3,000; and at least two years experience. Subloans will be for not more than $5,000 at an interest rate of 12% plus 1% commission. The interest rate for loans can be revised if permitted by law or corresponding authority.

The activities proposed under the Small Business Development Project will not conflict with these other donor activities; on the contrary, they will serve to reinforce these efforts.

D. AID's Activity in Small Business Sector

There have been several attempts by AID in the past to promote small industry in the Dominican Republic through lending programs. These attempts met with mixed and often disappointing results. In 1978 AID funded an employment policy study. (A summary of these activities is included in Annex G-2).

1. Promoting Small Business to Generate Employment

Recently AID has financed studies on the characteristics and needs of small business in the Dominican Republic. Much of the analysis and direction of this project is a result of these studies.

a. Dominican Development Foundation Micro-Industry Sector Assessment

AID provided a small grant to the Dominican Development Foundation (DDF) - a non-profit Dominican organization - to undertake an assessment of the micro-industry sector in the Capital and six secondary cities. Completed in October 1980, involving interviews with 322 micro-enterprises, the study compiled data on micro-level business and industry including physical location, principal characteristics, problems and needs. (For purposes of this study, a micro-business or industry is defined as having a fixed capital investment of $10,000 or less, and six employees or less.)

As a result of the study's findings, in FY-1981, AID approved an OPG to the DDF in the amount of $498,810, for a three-year program of institutional development including loans and technical assistance in management to micro-enterprises. This amount is being matched by a local counterpart contribution of $597,029, for a total program value of $1,095,839. The program will provide 250 loans to individual borrowers (micro empresarios) and 310 loans to small groups (solidarios). It is anticipated that 500 new jobs will be created and will reinforce 1,860 existing jobs. DDF has also obtained a $1 million line of credit from FIDE to support this program.

b. Santo Domingo Technical Institute (INTEC) Small Industry Sector Analysis

In September of 1980, a small industry sub-sector analysis managed by the Santo Domingo Technical Institute (INTEC) was initiated with joint financing by AID and the Association of Industries.

Its purpose is to develop a strategy and program to increase employment opportunities in small enterprises. The project supports the establishment of a comprehensive and cooperative GODR/private sector effort to develop small industry. This effort begins with a nationwide assessment which is studying and analyzing capital/employment ratios of selected companies; their installed capacity; production and supply of raw material; laws and regulations that govern industrial operations. Also, being examined is public sector industrial policy; industrial interrelationships; existing business promotion assistance programs; energy constraints; and the economic and social impact on employment and foreign exchange of various problems facing Dominican business.

The assessment which will be completed in September 1982, will develop recommendations for increasing employment and will include a strategy or action plan for the public and private sectors to promote economic growth and employment for the poor by providing capital and technical assistance to small business through both public and private financing institutions. New initiatives for public and private sector cooperation will be developed as a result of this analysis.

III. PROJECT DESCRIPTION

A. Introduction

The Small Business Project will provide credit and technical assistance and training to approximately 1,000 small firms. The project will establish two coordinated institutional mechanisms to service the business development needs of small entrepreneurs, through a credit component and a self sustaining technical assistance network. A Small Industry Credit Fund will be established in a division of the Central Bank, the primary executing agency. The credit will be channeled to small businesses through a number of qualified participating banks and financieras. Technical assistance and training will be provided through a network which will include three existing technical assistance organizations and may include two more organizations during project implementation. This TA network will also include a Central Assistance Facility (CAF) located in FIDE to provide TACs and end borrowers with assistance during the project.

B. Borrower/Grantee/Terms/Conditions

The borrower of the $5 million loan will be the Government of the Dominican Republic (GODR). The Central Bank will be the primary executing agency acting through FIDE, a division of the Bank. Terms of the loan will be 2 percent during the ten year grace period and 3% interest during the remaining 15 years of the 25 year term. A five year implementation period is contemplated. The borrower will provide $2 million in counterpart contribution. The borrower will pass the loan and counterpart funds to FIDE to be used as the basis for a permanent revolving credit fund. The borrower will also agree to deposit all reflows generated under the program in the Small Industry Credit Fund and will make the sublending incentives available to PFI's who wish to lend to small businesses with new project funds. All AID loan funds will be disbursed within three years.

A grant of $850,000 will also be provided through the GODR to FIDE to assist in technical assistance operations.

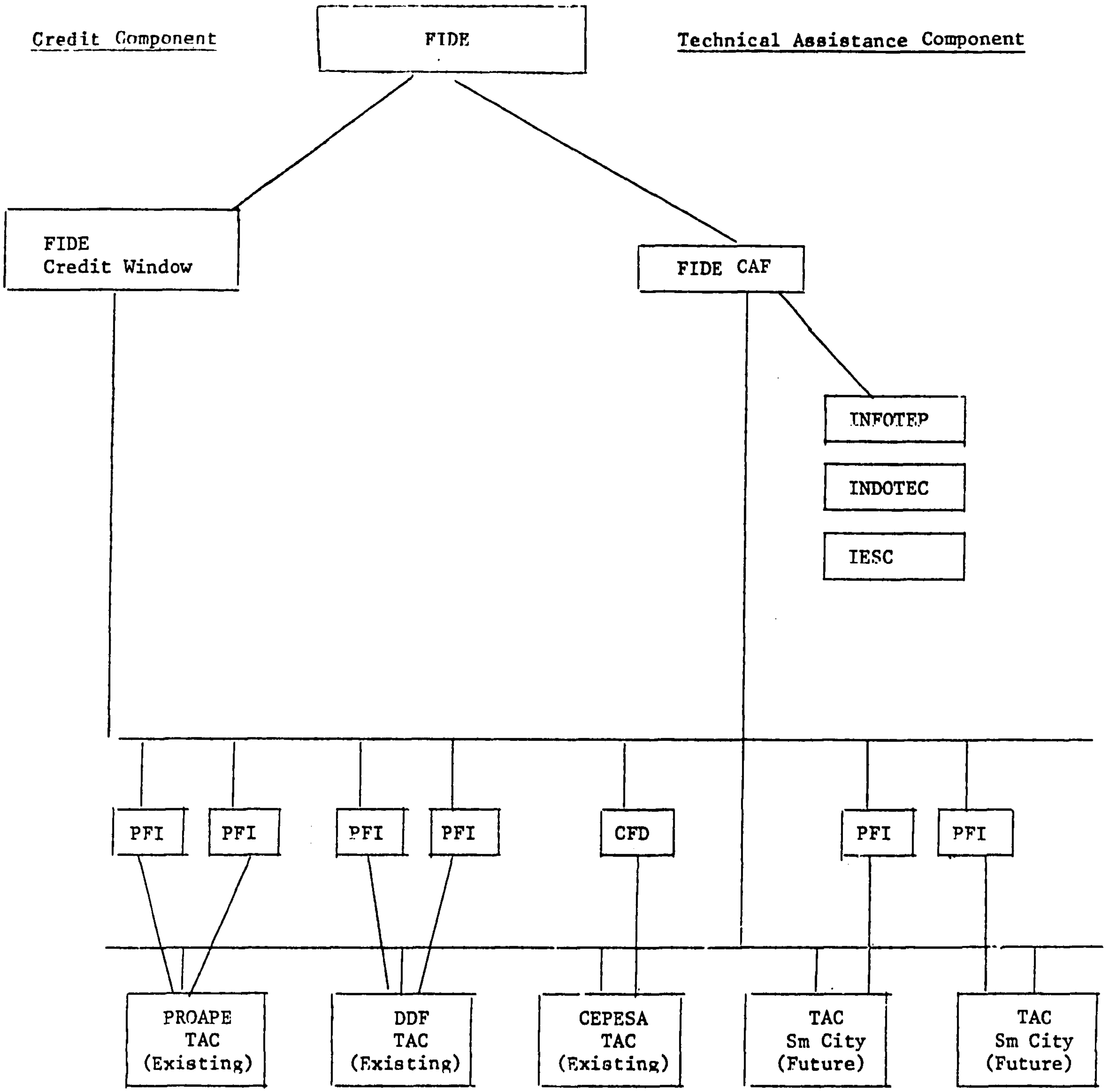
C. Goal/Purpose/Outputs/Inputs

The goal is to increase the per capita income and employment in the Dominican Republic, by improving the performance of the private sector.

The purpose is to establish an institutional mechanism, capable of providing a continuous source of credit, TA, and training to small entrepreneurs in the Dominican Republic.

Outputs will be: significant changes in small business interest rates, guarantee levels and other incentives; loans to small entrepreneurs by PFI's; strengthened existing small business technical

SCHEMATIC DIAGRAM: CREDIT AND TECHNICAL ASSISTANCE COMPONENTS



assistance centers (TAC's); and creation of new small business technical assistance centers in various Dominican cities.

Inputs will include small business credit; technical assistance; salaries and other operating costs of the technical assistance centers; and a small amount of commodities including motorcycles, office equipment and furniture.

D. Project Activities

1. Credit Component (AID Loan - $5 Million; GODR - $2 Million

a. General

Under this project activity, a $7 million Small Industry Revolving Credit Fund will be established in the Central Bank. General management of the fund will be by the "Fondo de Inversiones para el Desarrollo Económico" (FIDE), a division of the Central Bank of the Dominican Republic. The credit will flow through participating financial institutions (PFI), banks and finance companies, normally qualified to do business with FIDE. As a special incentive to PFI participation, FIDE has agreed to raise the level of guarantee from 50% to 75%. $3.5 million of the AID loan funds will be used for sublending activities outside Santo Domingo.

b. Promotion, Application, Approval and Disbursement of Credit

FIDE will undertake the initial promotion of the program. An Operations Manual will be prepared by FIDE. This manual will clearly state the purpose of the loan, eligibility criteria for sub-borrowers; rules and regulations on types and terms of loans, operating procedures and types and operations of technical assistance. The Manual will be made available to eligible PFIs, TACs, Business Associations, and the media. In addition, the following actions are considered prerequisites to assure successful implementation of the loan:

1) Introductory sessions for the personnel of the PFI and TACs. These would serve to explain criteria, terms and conditions and mechanisms of operation. They would also assist in developing uniform criteria for review of loan applications, emphasize the innovative elements of the credit policies and provide a forum for discussions of operating problems which would be of common interest to personnel of the FIDE, PFIs and TACs. These would be conducted by technical consultants as required and personnel from FIDE.

2) Promotional sessions with potential sub-borrowers groups, trade associations, church leaders, Peace Corps Volunteers, GODR Agencies, Area Development Agencies and the media. These sessions will provide the broad informational base necessary to

reach all potential sub-borrowers, provide for effective coordination at the local level and assure that all potential sub-borrowers become familiar with the loan objectives. These sessions would be directed by the technical and managerial staff of FIDE and TACs.

Potential borrowers may either be channeled through the TACs to the financieras or they apply directly to the PFI. Technical assistance, provided through TACs, is an important element of project design although it is not a prerequisite to participation in the lending program. In the first year of project implementation, 85% of all sub-lending funds will be channeled to projects using the technical assistance services of the TACs. (Based upon the results of the first year project evaluation, this allocation may be revised.) It is estimated that 75% of the loans channeled through the TACs will require technical assistance.

The TAC will conduct an initial evaluation of the business to determine if technical assistance is required. If required, the TAC will develop a business development plan in collaboration with the entrepreneur. The TAC will estimate the required TA needs of the client and prepare a TA budget based on cost guidelines which are to be established by FIDE. Technical assistance will often begin before disbursement of credit for working capital or equipment in order to assure that basic control systems are in place.

Both the loan package and the TA budget will be presented to the financiera for final approval. The financiera will review the loan proposal and the proposed TA budget and if satisfied, approve a loan for the total amount of the credit requirements plus the amount indicated on the TA budget. The financiera will approve a loan based on the business development plan, and the feasibility study if appropriate.

Upon approval of a subloan, the PFI will make the initial disbursement to the sub-borrower or whenever possible, directly to the supplier of goods and services. The PFI will then submit the loan package, promissory note, duly endorsed, the repayment schedule, and a reimbursement request to FIDE. Within 24 hours of receiving the request the PFI will be reimbursed the initial disbursement. At the time of the initial disbursement the PFI will make a payment of 3% of the total loan package to the TAC for loan packaging and for any technical assistance services delivered to the sub-borrower.

FIDE's audit process will ensure PFI adherence to established eligibility criteria and will take place after funds have automatically been reimbursed to the PFI. If the borrower is found not to meet the eligibility criteria, then FIDE may debit the PFI's account and withdraw its funding, whereupon the PFI would, if it chooses, fund the loan with its own sources.

FIDE will automatically debit the account of the PFI for payments due under the loan repayment schedules thereby capturing the reflow into the fund. In the event of uncollectibility of the loan, the PFI will liquidate its collateral, if any, and submit a claim to the FIDE loan guarantee program for up to 75% reimbursement of the PFI's losses of principal and legal expenses.

c. Sublending Terms and Criteria

Subloans will not exceed $50,000 or be less than $2,000. Subloans will be made available to cooperatives and Group Associations which are essentially associations of micro-businesses and will be restricted to a total loan of up to $100,000. Sublending funds will be available for purchase of capital goods, working capital, inventory financing and any other purposes deemed necessary to assure the viability of the enterprise. Loans for capital goods and production credit will be made for a period of up to 6 years including a one year grace period. For working capital, loans will be made for a period of up to 3 years with a 6-month grace period. Of the total loan Fund it is estimated that 70% will be for working capital and 30% for production and expansion. For new companies or start up projects, or new equipment for existing businesses, the PFI may not finance more than 80% of the total investment requirements. Eligible subloans made subsequent to the signing of the Project Authorization may be financed under this project.

Those classes of loans to businesses that would have a significant adverse effect on the environment will be specifically excluded from funding under the terms of the loan agreement. These include loans for the manufacture, importation, distribution or application of pesticides, loans for mining coral reefs, and loans which would contribute to the exploitation of endangered species. In addition, funding will not be made for activities normally ineligible for AID financing, such as gambling. These activities are detailed in Handbook 1B, Chapter 4 and will be transmitted to the borrower by Implementation Letter. FIDE will also not approve credit for those activities which are considered of low priority by the GODR, e.g., plastic firms. Also ineligible under the provisions of this loan are subloans for commercial credit, the cultivation and harvesting of crops, the purchase or lease of land, the refinancing of debts, the construction of houses and the construction of social centers or offices for cooperatives or other group associations.

Notwithstanding the general definition of a small industry included in the Background Section, only firms with less than $100,000 in fixed assets (equipment and machinery) can participate, including firms involved in agro-industry and the exportation of goods and services. Firms must also be owned and operated by the sub-borrower. The estimated job investment ratio will be approximately $10,000 or less per job created.

Funds will be made available, on the average, at a nominal interest rate of 16% (which is equal to an effective interest rate of 18%, assuming a six month grace period). This nominal interest rate includes a technical assistance fee of 2%* on the outstanding balance of the loan, and 2% for the guarantee fund. The remaining 12% collected by the PFI is divided in the following way: 1) a 4% margin to the PFI on subloans made in Santo Domingo and Santiago, and a 6% spread on those loans outside of the Capital; 2) an 8% cost to the PFI on the use of FIDE project funds for loans in Santo Domingo and Santiago, and 6% for loans made outside of the Capital.

The GODR has agreed to keep the program sublending rates as high as the law will permit. Thus, when increases in the overall sublending rates are permitted, the program sublending will also be increased in the same amount. FIDE has agreed that the sublending rates and guarantee incentives made available under this program will be available to all financial intermediaries for small business lending outside of this project. As a result of these incentives for lending to small businesses, the project anticipates that PFIs will become more interested to tap this new market using their own funds. This demonstration effort will ease the way to greater private fund lending as the risk has been greatly reduced.

Any bank or private financing company currently licensed for business in the Dominican Republic and which is subject to regulation by the Superintendent of Banks may participate in the program.

d. Inputs

AID will provide $5 million and the GODR will provide $2 million to finance the Small Industry Credit Fund. The sublending funds will, to the extent possible, be disbursed simultaneously.

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* Initially, all sub-borrowers will be charged a 3% fee for loan packaging and closing costs which will be paid for, in advance, to the TAC as part of the principal of the loan.

2. Technical Assistance Component (AID Grant - $850,000)

The Technical Assistance Component will include: Technical Assistance Centers (TAC) to provide the small industry borrowers with needed assistances in loan analysis and document preparation and in basic management and operational techniques; and a Central Assistance Facility (CAF) located in FIDE to provide TAC with technical assistance during the startup phase and, upon request by the TAC, specialized assistance needed by TAC clients.

a. Technical Assistance Centers (TAC) (AID $430,000);

Basic Design

The TAC will be a bridge between the financial institution and the entrepreneur and in many senses an advocate for small businesses. Each TAC will work closely with the local PFIs and with the local business and development association. The TAC will help the small industry client solve problems of access to credit, and provide technical assistance in administration, marketing, production technology and procurement.

TAC clients will be selected through:

- Self identification (firms that come to the Center for help).
- References by the Secretary of Industry and Commerce, the CFI, various small industry associations.
- Participating financial institutions.

Services to be Provided

The TAC will conduct an initial evaluation of the candidate firm. If the applicant is suitable, the TAC will prepare a business development plan and recommend an integrated package of technical assistance, financing and training for the client. On the basis of this plan, the client would be directed to a PFI. The TAC would normally proceed with a technical assistance program in coordination with the PFI. If the TAC cannot resolve any particular technical problems of the firm, it may seek specialized help from other organizations such as INDOTEC, ISA, IESC, UCMM, INTEC or INFOTEP paid for by CAF.

Direct technical assistance to the clients will be complemented by a series of courses and seminars in business administration, accounting, production technology, personnel administration, distribution and marketing. The TAC will collaborate with INFOTEP, UCMM and INDOTEC in these activities either directly or through the FIDE Central Technical Assistance Facility.

In sum, each TAC will:

- Provide consultation and technical assistance directly to the small entrepreneur, on organization, administration, accounting, finance, marketing, production, appropriate technology, and plant layout.
- Give short courses and seminars in business management.
- Obtain or, if necessary, prepare training materials covering technical and administrative issues affecting small industries.
- Prepare business development plans and feasibility studies.
- Work with advocacy groups to identify small business development opportunities in their regions.

TAC Operations and Structure

Payments for assistance will be made on the basis of charges to the clients directly or through an arrangement with the financiera to include the charge in the total loan amount, as discussed previously. The financiera will have the right of review of the technical assistance budget presented (if it will be added to the loan) and can negotiate what it feels would be most needed. In this way, it is expected that bidding up the cost of assistance when not essential will be avoided.

The size of the TAC will vary from region to region depending on the nature and size of the market. On the average, however, it is expected that the TAC supervisor would have at least a bachelor's degree in business administration or the equivalent and at least 5 years experience in private industry. Each TAC will probably have at least one promoter and one secretary. Staff members should be well versed in the fields of administration, accounting, production, marketing, and general business development.

Initially three TAC models will be used: the Dominican Development Foundation (DDF) in Santo Domingo; the Center for Small Business Assistance (CEPESA) in Santo Domingo; and the Program for Small Business Assistance (PROAPE) in Santiago. During the second and third year of the project it is anticipated that two additional TAC's will be included in the program. Possible TAC models will be studied further by FIDE with the assistance of off-shore TA advisors. The final selection of the additional TACs will depend upon the results of the first project evaluation of the TAC models and upon a detailed analysis of the proposed TAC's institutional objectives and structures.

With assistance provided by the CAF, the TAC will prepare a detailed plan for developing and providing its institutional services to its small business clients. These plans will be submitted to FIDE and AID for review and approval. In addition, the TACs will submit to FIDE and AID their detailed operational procedures to be used under the program. The effectiveness of these procedures will be reviewed by project funded TA advisors.

The rate of which the TAC network can be developed nationwide is largely dependent upon how successful the project supported TAC are at becoming self-sufficient. Self-sustaining technical assistance services based on user charges is a highly desirable goal, but one which may not be easily attained. Accordingly, the project will help finance the start-up costs and support of operating costs for that period of time until optimal efficiency is achieved. AID will guarantee full funding for the first year of TAC operations based on a 12 month budget. It is also anticipated that TACs will seek financing from other sources. TAC progress in achieving self-sufficiency will be a key element in the annual evaluation of the project. Subsequent disbursement of grant funds to TACs will be contingent upon demonstration of adequate progress in this area.

b. <u>Central Technical Assistance Facility (AID $420,000)</u>

A Central Technical Assistance Facility (CAF) will be established in FIDE. It will provide technical assistance to the TACs during the course of operation, and especially during the start-up phase. The CAF will act as a special implementation unit for project activities. It will be the recipient of requests for assistance by the TACs either for themselves or for their clients. The CAF will provide assistance to the TAC in TAC program design and management. The CAF will conduct the annual evaluation of the TACs to assess their progress. The CAF will provide training to TAC staff in areas affecting program development and internal management. This could be supported by off-shore technical assistance including, for example, the International Executive Service Corps, which has permanent offices in the Dominican Republic and has already been working with various entrepreneurs. The Central Facility would also have access to the facilities of INFOTEP, INDOTEC and other national TA and advocacy organizations interested in this field.

It is expected that the CAF Office will have a staff of two or three local employees paid by FIDE to coordinate TAC requests for assistance. They will also assist in the year-end evaluation of the TACs. It is also expected that 12 person-months of long term TA and 3 months of short term TA (spread over the life of the project) in the area of small business promotion and systems development, will be necessary to support the TACs and FIDE in the development of the TAC/CAF network. These advisors will provide key assistance to the TACs in: training for the technical/managerial assistance function, and training on internal planning, control, and evaluation. In addition these advisors will assist the TAC's in developing effective operating procedures, in developing more cost effective methodologies, and in developing systems for accessing local small business entrepreneural talents. (See Annex G-3.)

FIDE has agreed to pay for all of its own administrative costs through the revenues generated by the sublending spread. This office would have no responsibility with regard to review of specific loan applications or supervision of the individual loans.

Procedures, controls and criteria for technical assistance, which are linked to lending criteria, are subject to discussion and will be developed and tested by FIDE with the assistance of project funded consultants. These procedures will be submitted to AID for review and approval prior to disbursement of funds to the TAC's.

c. Inputs

AID will finance the estimated TAC operating costs in excess of revenues, motorcycles for TAC promoters, office equipment, the cost of an off-shore technical assistance and the costs of project evaluation. Also included in the A.I.D. funding to the CAF are amounts for training visits, in-country short courses, local TA through INFOTEP, and contingency funds. The GODR will finance the costs of the operation of the CAF with the revenues generated from the sublending spread.

IV. PROJECT ANALYSES

A. Institutional Analysis

1. Methodology

In examining the institutional feasibility of the project, a substantial amount of analysis was carried out. An important part of this analysis included identifying the principle obstacles to small business to financial resource utilization and small business credit access. Michael Lofstrom, LAC/DR, analyzed the institutional capability of FIDE. Peter Fraser, a private consultant on small business development, analyzed the proposed sublending and technical assistance mechanism. During this analysis numerous interviews were conducted with many of the bankers in the Dominican financial system. Additionally, meetings were held with Dominican research institutions, advocacy and technical assistance groups to obtain a broader perspective on the financial environment and the problems of small businesses. Research was also done in cooperation with the TACs to develop preliminary budgets and cost estimates. Finally, a series of discussions were held with FIDE at the Central Bank and a financial model coupled with an institutional support network was developed. (The detailed project reports prepared by these consultants are available in the Mission files).

2. The Institutional Design

a. General

From the outset of the development of this project a basic objective has been to develop an institutional design which could effectively deal with the credit and technical assistance constraints facing small businesses in the Dominican Republic. During the intensive review of the project, the Mission explored various alternative designs to deal with these two major constraints. As previously indicated, one alternative which was examined was to channel the credit and technical assistance through CFI directly to the small businesses. The institutional and financial analysis of CFI, however, indicated that this approach was not feasible at this time. Another approach examined was to establish a direct lending and technical assistance operation with one Dominican finance company. This approach proved not to be feasible for lack of maintenance of value guaranty, lack of government repayment guaranty, and the desirability of having a wider participation in its financial community. Finally, it was decided that the basic institutional design which offered the most promise was that of using FIDE to channel the project inputs through the private financial intermediaries and technical assistance organizations providing services to the small businesses. Using this basic design, it is believed that the needed credit and technical assistance can be effectively provided to small businesses through a system which is market oriented and can eventually become self-sufficient. The system can also provide a vast additional market for the private banking system. The proposed institutional design reflects this orientation at each level of project structure.

b. Fondo de Inversiones para el Desarrollo Económico (FIDE)

At the top level of the institutional structure will be FIDE which will manage the overall program. It will lend to the finance companies, who will, in turn, lend directly to the small businesses. FIDE will also manage the grant funded technical assistance program. The purpose of the TA is to help both the TACs and the sub borrower.

FIDE was established within the Central Bank in 1966 for the purpose of channeling resources, through intermediary lending institutions, to the key productive sectors of the economy: agriculture, livestock and industry. FIDE funds are provided both from GODR (Central Bank) resources and from foreign private and public financial institutions. Since 1966, FIDE has made loans totaling over $406 million. Its lending level in 1981 was about $64.2 million. These funds are apportioned, about equally, among agricultural production, livestock production and industrial activity.

FIDE has demonstrated a high level of competence in project analysis and loan recuperation. As pointed out in the detailed institutional analysis report prepared by the consultants, FIDE's staff of technicians, who number 42 at present, is viewed by the recipient financial intermediaries as efficient and fully qualified. In support of the proposed project, FIDE has also agreed to provide a staff of four to five full time assistants for the managing of the project credit activities and for the operation of the Central Assistance Facility. The Mission believes that there is no question as to FIDE's capability to manage the lending program contemplated under this project.

Beyond the staffing needs of the institutional structure, FIDE has agreed to modify a number of key policies and procedures to make the proposed program feasible in terms of eventual program self-sufficiency and in terms of PFI and end borrower participation (a more detailed discussion of these policy and procedural modifications is discussed in the Financial Analysis section). These include:

(1) FIDE will require that the end borrower pay the highest effective interest rate (to include commissions and fees) allowed under the law.

(2) The project loan fund will provide for increased pecuniary incentives to the PFIs through increases in the spreads available to the PFI participants in the program;

(3) The project loan fund will operate in a manner which minimizes the daily decision making requirements in the management of the fund at FIDE, thereby maximizing the efficiency of the fund's operation and providing for some reduction in transactions costs;

(4) In order to further reduce the risk on the part of the PFIs, FIDE will increase the guarantee coverage of the subloans under the program from 50 % to 75 %.

(5) Finally, to reduce the risk associated with small business lending, the project will provide for technical assistance to the small business borrower through the use of Technical Assistance Centers (TACs). At the central level, FIDE will play a key role in the operation of this TAC system. FIDE will establish a Central Assistance Facility (CAF) to monitor and evaluate the progress of the system and to provide technical assistance to the TACs during the course of operation, and especially during the start up phase. With the assistance of project funded consultants, FIDE will develop detailed operating procedures for the CAF. These include procedures for the approval and control of the technical assistance and the other inputs provided to the TACs and procedures to assure that the technical assistance received by the small business is adequate. These operating procedures will be submitted to AID as a Condition Precedent, and the project funded advisors will assist in the testing of these procedures during the annual evaluations.

c. <u>The Technical Assistance Centers (TACs)</u>

At the subborrower level, the TAC will be the key link between the small business and the private financial intermediaries. The TACs will be the conduit for potential borrowers to the PFI. They will identify clients and as discussed previously, they will provide the small industry subborrowers with needed assistance in loan analysis and document preparation and in basic management and operational techniques.

During the intensive review a number of potential TAC models were analyzed. Based upon this analysis three models were selected to be used initially under the project: the Dominican Development Foundation (DDF); the Center for Small Business Assistance (CEPESA); and the Program for Small Business Assistance (PROAPE). It is believed that the number of TAC's should be limited to these three TACs during the early part of the program to maximize the opportunities for the TACs to generate sufficient income, thus helping to assure early achievement of self-sufficiency.

The rationale for the selection of these models includes many factors. First, they are all existing models which have demonstrated genuine interest in small business groups. Second, they have the capability for developing into a self-sufficient model to provide continued assistance to small business. Third, each model will serve a different small business market, thus avoiding duplication of effort. Fourth each TAC model already has close ties to the banking community with whom they will work. (The TAC either is controlled by a financiera or has strong banking community representation on its board). Thus, credit support of TAC clients by the financiera should generally be good. Finally, each TAC model offers real potential for replication.

While the final selection of the additional TACs has not been made, much preliminary identification work has been completed and a number of real possibilities appear to exist. Some of the possibilities are: the Development Association for Moca; the Institute for the Development of the Southwest, INDESUR, in Azua; and the Development Association for San Francisco de Macorís. These possibilities will be studied further by FIDE with the assistance of off-shore TA advisors. Using the same basic rationale for selection of the initial TACs the final selection of the additional TACs will depend upon the results of the first project evaluation of the TAC models and on a detailed analysis of the proposed TAC's institutional objectives and structure.

The following are the designs of the three TAC models to be included intially under the project:

(1) DDF: The Dominican Development Foundation was founded in 1966. The DDF is a private non-profit community development organization to assist the rural poor to form associations for economic and social self-improvement. The DDF TAC model is largely a result of an AID OPG for $498,000 approved in January 1981 for the purpose of developing a mechanism to provide technical assistance and financing to micro level businessmen in Santo Domingo and in a number of secondary cities. DDF will provide technical assistance in management administration, and accounting to those clients receiving credit through DDF under the project. DDF will work with the very small businesses using a methodology which includes very heavy pre-loan managerial

assistance. The DDF will also provide direct loan financing through a line of credit with a financiera(s). The DDF staff in the TA portion of this project will consist of a Manager, 1 Chief of Division, a secretary, and four promoters.

The majority of DDF's loans (60-70 %) will be for working capital. Maximum total fixed assets will be RD$30,000. Average loan size will be on the order of RD$3,000-8,000. DDF is planning to assist 110 entrepreneurs during the first year of operation. While DDF's operating costs per client are higher than the other models, development of more cost effective methodologies with the assistance of project funded TA could permit adequate cost reductions over time. (See Annex H-3).

(2) PROAPE: PROAPE was founded in June 1981 and it provides administrative and financial assistance to small businesses located in Santiago and the surrounding communities. PROAPE is well acquainted with the Fundación Carvajal project in Cali and has designed their model around the methodology used there. PROAPE's current program includes accounting, administrative management, and assistance in obtaining financing. A basic objective of the PROAPE program is to improve administrative capability through short courses. Under the PROAPE model initial promotion, business identification, a very simple analysis, a short course in accounting (approximately 2 hours an evening for 5 sessions) and loan packaging will be provided before the loan is disbursed. After the loan is made, PROAPE will assume no loan management function. PROAPE has developed a relationship with Financiera Dominicana and another finance company in Santiago to channel the loans. PROAPE has made a concerted effort to organize carefully its job schedule and is becoming increasingly confident as it gets more experience. It is attempting to be more aggressive in its promotion activities and wishes to expand its offerings beyond strictly accounting to marketing and production. Staff for this project will consist of a Director, one Division Chief, one promoter and a secretary.

The average loan size is expected to be $8-9,500 with 40 loans during the first year of the project increasing to 126 new loans per year by Year 5. (See Annex H-3.)

(3) CEPESA: CEPESA, a creation of the Corporacion Financiera Dominicana (CFD). CEPESA is located in Santo Domingo and is just beginning its operations. It has no staff officially hired as of now but has been preparing for start-up. The objective of CEPESA will be to help small industries solve their problems of technology, finance and administration; thereby increasing efficiency, increasing production and improving the quality of the products and services of small industries.

CEPESA will provide technical assistance directly to the small industrialists. It will also prepare and present short courses and seminars in business management organization and administration. It will probably begin using a methodology similar to that of PROAPE and will operate primarily in Santo Domingo. Services will probably be more intensive due to the large and more complex businesses in its target clientele. It will only do promotion and TA and will not assume loan administration tasks. CEPESA, because of its affiliation to CFD will initially work with this PFI.

As CEPESA is a new organization, the first months of project implementation will be directed towards organizational and staff development. Therefore, only 30 loan clients are projected to be served during the first year. Loans will be larger than the DDF and PROAPE models, the average loan being approximately $25,000.

CEPESA seems to have a clear sense of what must be done to eventually be self-sufficient. CEPESA staff will consist of a Director, a manager, 3 promoters, and one secretary. (See Annex H-3.)

The three initial TACs all seem to have a good relationship among each other. They seem to recognize that each will have its limitations and special abilities and that collaboration would be in the best interests of all concerned. Based on preliminary discussions with the three TACs it appears that adequate inter-TAC collaboration should occur (i.e., there may be a case where DDF identifies a client which really needs CEPESA's services or visa versa). In sum, the proposed TAC models seem to be realistic and feasible.

3. Conclusions

The basic institutional design of the project has been discussed extensively with the leaders of the participating financial institutions and the TACs. During meetings, which included high level representatives from all these organizations, it was agreed that the basic institutional design presented herein provides adequate incentives and provisions for a successful small business program. The operating procedures for the institutional systems will be developed by FIDE with the assistance of project funded consultants and will be reviewed and tested periodically by these technical advisors and based upon the results of these tests, revised accordingly. Thus, it is concluded that the proposed institutional design is feasible.

B. SOCIAL SOUNDNESS ANALYSIS

1. Methodology

For this analysis, several methods were used. First there was a general review of the literature which included materials provided by the DDF, PROAPE, Interamerican Foundation, and the PISCES STUDY. Second, materials from the CONADEPI survey and the Financiera Dominicana case studies were analyzed. Third, a limited number of interviews and field visits were conducted.

2. Survey of Small Industries

The National Corporation for Development of Small Industries (CONADEPI) recently conducted a study of its members, totaling 159. (Table 1). Although the sample cannot be considered necessarily to be representative of small industries for the whole republic, it can serve here as an illustrative sample of potential beneficiaries. For example, to become a member of the CONADEPI, applicants must have at least $10,000 in fixed capital investments (although these were a few isolated cases in this study where the amount of capital invested was actually less than that). Although there is no capital "ceiling" *per se*, there were only 4 cases in which assets exceeded $150,000.

a. Characteristics of the Small Industries Surveyed

The industries surveyed have been divided into eleven groups, (Table I and II) characterized by industry activity. The industries with the largest representation are: furniture and carpentry (69); machine shops and foundries (32); concrete blocks and construction materials (18); and bakeries and confectionaries (13). The remaining categories with less than 5% of the sample should not be considered representative of the whole industry, but will be used here for illustrative purposes.

All of the industries, with the exception of dairy and food processing, had at least one enterprise located in the capital. In addition, all of the enterprises represented from San Juan (located in the central-west) were involved in furniture production. This is also the predominant activity in Hato Mayor and a significant activity in San Pedro de Macorís, (which are located in the eastern D.R.). It should be noted that the Cibao area was not represented in the survey.

Approximately one fifth (20.7%) of those surveyed claimed to have an established accounting system. Although there is not a strong correlation indicated, the general trend was that the larger the business (measured by the amount of capital invested) the more likely the company is to have an accounting system.

TABLE I - SUMMARY OF CONADEPI STUDY

TYPE OF INDUSTRY	Bakeries and Confectionaries	Laundries	Machine shops & Foundries	Blocks & Construction Materials	Furniture & Carpentry	Garment Makers & Taylors	Electrical Products & Repairs	Chemical Products	Auto Repairs	Dairy & Food Processing	Housing Accessories Production & Installation	TOTAL
1. Number Surveyed	13	7	32	18	69	4	3	7	1	3	2	159
a. Per Cent	8.1	4.4	20.1	11.3	43.4	2.5	1.9	4.4	.6	1.9	1.3	100
2. Location												
a. Santo Domingo	8	7	26	11	25	3	1	7	1	0	2	91
b. San Juan	0	0	0	0	28	0	0	0	0	0	0	28
c. Hato Mayor	5	0	1	0	11	1	0	0	0	3	0	21
d. San Pedro de Macorís	0	0	5	7	5	0	2	0	0	0	0	19
3. With Accounting System (%)	30.8	28.6	31.3	22.2	17.4	0	0	14.3	0	33.3	50	20.7
4. Number of Employees												
a. Total	106	40	193	177	297	9	11	48	4	18	11	914
b. Average	8.1	5.7	5.3	9.8	4.3	2.2	3.6	6.8	4	6	5.5	5.7
5. Capital Invested												
a. Average (in RD$000)	27.8	13.0	51.5	61.8	21.2	15.7	11.6	56.1	9.0	75.0	25.0	34.2
6. Capital Intensity (C/L in $000)	3.4	2.3	8.5	6.3	4.9	7.1	3.2	8.3	2.3	12.5	4.5	6.0
7. TA Requested (%) 1/	100	85.7	84.4	88.9	88.4	100	100	42.9	100	100	100	86.7
a. Production TA	46.2	28.6	21.9	16.7	31.9	0	0	42.9	0	66.7	100	28.3
b. Marketing TA	61.5	28.6	56.3	77.8	69.6	50.0	100	0	0	100	100	62.0
c. Administrative TA	61.5	42.9	71.9	77.8	65.2	75.0	100	0	100	100	100	67.9
8. Credit Requested (%) 1/	100	100	93.8	94.4	98.6	100	100	71.4	100	100	100	96.2
a. Working Capital	84.6	85.7	87.5	94.4	92.8	100	100	57.1	100	66.7	100	89.3
b. Equipment Capital	76.9	71.4	68.8	66.7	79.7	50	100	28.6	100	66.7	100	73.0
c. Expansion Capital (Construction)	53.8	57.1	68.8	38.9	43.5	25	100	14.3	100	0	50	50.3
9. Credit Requested (Average in $000)	15.1	11.9	34.7	27.5	14.9	18.9	14.0	8.8	7.0	54.0	16.0	21.0
a. Working Capital	6.2	4.7	22.5	14.1	6.3	5.6	8.6	15.0	2.0	44.5	10.0	11.1
b. Equipment Capital	9.1	7.8	11.5	16.5	6.0	5.2	5.0	6.0	4.0	36.5	3.5	8.9
c. Construction Capital	5.0	4.0	10.4	6.3	9.3	1.0	1.0	2.0	1.0	0	5.0	7.7

1/ At least one kind requested.

TABLE II

CONADEPI STUDY:
FREQUENCY DISTRIBUTION OF FIRM SIZE

TYPES OF INDUSTRY	Bakeries & Confec-tionaries	Laundries	Machine Shops & Foundries	Blocks & Construction Material	Furniture & Carpentry	Garment Makers & Taylors	Electrical Products & Repair	Chemical Products	Auto Repair	Dairy & Food Processing	Housing Acces-sories Production & Installation	TOTAL		Cumulative Total	
Fixed Assets (RD $000)												No.	%	No.	%
Less Than 10	2	2	4		15	1		2	1			27	17.0	27	17.0
10	1	1	3		5		2	1		1	1	15	9.4	42	26.4
11-20	3	4	4	1	26	3	1					43	27.0	85	53.4
21-30	2		3	8	15			1		1		29	18.2	114	71.6
31-40	2		3	1	3						1	10	6.3	124	77.9
41-50	2		2	1	1			1				7	4.4	131	82.3
51-60	1		2	2	1							6	3.8	137	86.1
61-70			1	1								2	1.3	139	87.4
71-80			4	2	2							8	5.9	147	92.5
81-90												-	-	147	92.5
91-100			2					1				3	1.9	150	94.4
101-110			1									1	.6	151	95.0
111-120												-	-	151	95.0
121-130			1									1	.6	152	95.6
131-140												-	-	152	95.6
141-150			2	1								3	1.9	155	97.5
151-160					1							1	.6	156	98.1
161-170												-	-	156	98.1
171-180												-	-	156	98.1
191-200								1		1		2	1.3	158	99.4
Over 200				1								1	.6	159	100.0
TOTAL	13	7	32	18	69	4	3	7	1	3	2	159	100	159	100.0

The number of employees per firm averages 5.7, with a relatively high number for the block industries (9.8) and a very low figure for garment makers (2.2). The amount of fixed capital invested ranges from an average of $11,600 for electrical products firms to $75,000 for dairy and food processing firms. There was an overall small industry average of $34,200 in capital investments. The degree of capital intensity is important here, since employment generation is a desired objective. The overall average is $6,000 of capital invested per person employed, which is up considerably from the micro-industry level of $1,000 or less.

This wide range in capital intensity appears to relate to the specific nature of the business. Furniture makers may require a considerable amount of machinery, but will require a relatively large number of workers to make and assemble the furniture parts. Dairies and food processors, on the other hand, have a high potential to become almost completely automated. Therefore, the degree to which employment is generated under this project may be a direct result of which industries become the beneficiaries.

b. Demand for Credit and Technical Assistance

The survey showed very high levels of demand for credit (96.2%) and for technical assistance (89.3%).

A relatively low number (28.2%) request technical assistance in production, as compared to a higher number requesting administrative TA (67.9%) and marketing TA (62.9%). Notably, the bakeries and dairies showed a significantly higher request for production TA than did their counterparts. Concerning requests for administrative TA, it appears that it made little difference if the firms already had an accounting system or not - many of those that did have one, apparently wanted to strengthen it; while some of those who did not, were perhaps unaware of the need for one. But since the demand was consistently high for both administrative and marketing TA, the project should concentrate in those two areas, and bring in industry - specific production specialists only for those industries where the demand for production TA was particularly high. The International Executive Service Corp could be used for this industry specific production assistance.

The demand for credit was extremely high, with the exception of the chemical products industry. Overall, the demand for the various types of credit showed a significant descending order, with 89.3% requesting working capital, 73.0% requesting credit for equipment, and 50.2% requesting credit for expansion (primarily construction). For working capital, only the chemical producers and the dairies fell below the 80% level, perhaps indicative that some firms in these industries currently have sources of working capital available. By comparing the demand for credit for equipment with the degree of capital intensity, an interesting trend arises - in all cases where the degree of capital intensity is above the average, the demand for equipment is below average, while in all cases (except for laundries) where the degree of capital intensity is below the average, the demand for equipment capital is above the average. This could indicate that some of the capital intensive industries already have the equipment they need. On the other hand, the less capital-intensive industries apparently perceive the purchase of more equipment (and perhaps a more capital-intensive approach) as an important source of growth. For expansion credit, the bakeries, laundries, machine shops tended to have the highest demand, while the remaining groups fell below the average.

The survey also asked how much credit was needed. The average request for credit was for \$21,000, or roughly two thirds of the average capital invested (\$34,200). There were many cases, however, where the amount of credit requested by the firm equalled or exceeded the total amount that the firm already had invested. This would appear to be unrealistic, and experience has shown that small businessmen's perceived need for credit usually exceeds the actual need.

Those industries with larger than average requests for credit were those with larger than average levels capital invested. Machine shops, block producers, chemical producers, and dairies tended to request higher levels of working capital, and for equipment credit. Machine shops and furniture producers tended to have the higher requests to cover expansion costs.

One thing appears to be clear. Although there is an obvious descending trend in the number of requests for credit for working capital, capital equipment, and expansion respectively, and although the average amount in requests for each of these types of credit tends to average around \$10,000, there is a great deal of difference in the amounts requested in each credit category from one industry to the next. Since the total amount requested was over \$3.2 million for only 153 industries, (6 did not request credit) clear criteria for the use of credit under this project will need to be established if a large number of small industries are going to benefit.

3. Case Studies

The Financiera Dominicana hired a small industry expert to determine the technical assistance and financial needs of small businessmen. The expert requested a list of "typical" businesses from the Association of Small Industries (API). Twenty eight businesses were visited, most of which would fall into the categories mentioned in the CONADEPI study. Of those studied (16), the predominant needs were as follows:

Technical Assistance:	Number of clients	Percent
1. Administrative (including accounting and control of cost of production	15	93.8
2. Marketing	11	68.8
Credit		
1. Working capital	16	100
2. Equipment	11	68.8
3. Expansion of facilities	8	50

These figures represent the opinion of an expert, as opposed to the perceived needs of the small enterprises in the CONADEPI Survey. Nonetheless the overall trend of both studies is remarkably similar. However, the expert found that in many cases where administrative know-how was lacking, the entrepreneur was either unaware or at least not fully aware of the need to maintain books. In those cases, the expert would proceed to show the entrepreneurs the need for maintaining records, and train him in rudimentary bookkeeping. No mention was made of a possible loan, until the entrepreneur illustrated a willingness to maintain such records. The process was slow, and often took up to five months (with monthly visits) before the entrepreneur would begin to fully recognize the need to control earnings and expenditure. Even when the need was fully recognized, very few of the "participating" clients actually kept adequate records during the period.

One very important factor that the case studies showed, was that the process of providing TA is a slow, gradual one. In many cases a trust between the promoter and the entrepreneur must be established. Secondly, it often takes months to convince and train the entrepreneur to implement improved administrative techniques.

Included in Annex I are three selected case studies from the group. These were three of the more responsive clients, and therefore more information was made available. Nonetheless they are representative of the problems found in many other cases.

4. Relationship of Beneficiaries to the Project

The project proposes to link credit and technical assistance, and extend them to the small businessman. The costs for accomplishing this, will be born primarily by the small businessman. To accomplish this, the beneficiary will have direct contact with both the financial intermediaries and the technical assistance centers.

a. Compatibility

There is an apparent high demand for both technical assistance (especially administrative and marketing) and for credit (especially working capital). Indications are that the perceived need for credit is over stated, but that the actual need for technical assistance is high. The need for basic administration services is most readily apparent.

The fact that the technical assistance will have a cost, will most likely result in a sharp decrease in the demand 1/ for TA, but those willing to pay for it, will more likely use it. Perhaps some no-cost up front promotional efforts by the TACs will be required, to convince the perspective borrowers that the benefits of the TA will be well worth the cost.

The promoters of this project who will be extending the TA, will need to work hard at acquiring the trust of clients. Quite often, the initial reaction to TA is that of suspicion that the TA is really a tax collector. Establishing confidence is a slow process, requiring frequent visits over extended periods of time. Only then will the client begin to respond to some of the guidance being given, such as establishing an accounting system.

Generally speaking, the small businessman studied had little to no contact with either finance companies, or with bona fide technical assistants. A desirable long term objective of this project is to establish the small business as a client of the finance company, and with the hope that they will be able to acquire formal sector loans from non-project funds.

Thus the proposed project, and the beneficiary can be compatible if a careful, patient, gradual approach is used.

b. Participation

Although there was relatively little participation of the beneficiary in the actual design of the project, some meetings were held with the small industry associations. An important source of information for the project design however, was the experts who work closely with the small businessman on a daily basis. Successful project implementation should occur, if the approaches suggested in C.1. above are utilized.

1/ Both the CONADEPI Survey and the Financiera Dominicana case studies, technical assistance was free.

c. Equity

The primary beneficiary of this project is the small entrepreneur, who will increase his income from properly implemented technical assistance and appropriately invested credit extended to him. Another important beneficiary will be the finance company, which will acquire an increased clientele previously untapped. The employees of the businessman should also benefit to the extent productivity rises, there should be an increase in income. For those industries in which expanded production requires more labor, increased employment should result. Generally speaking, the employees would be unskilled to semi-skilled, representing the poor in the urban centers and rural areas.

d. Impact

The means by which technical assistance and credit will be extended to the beneficiary, are discussed in greater detail in other sections of this paper. Basically, the Technical Assistance Centers will extend three types of TA: (1) administrative TA, which when implemented should result in more efficient use of resources; (2) marketing TA, which will, if utilized, result in an increased demand for products, and therefore sales; and (3) production TA, which when utilized, should result in increased production and/or productivity, and possibly new product lines.

Three types of credit will be extended by the finance companies: (1) working capital, which will permit the entrepreneur to buy in larger quantities at a lower price, and to be able to sell on credit for longer periods of time, (and thus have a better bargaining position) (2) equipment credit, which will result in increased productivity of the firm, and (3) credit for expansion which will free many entrepreneurs from the burden of paying rent, and provide sufficient space for a cleaner, safer, better organized operation. All these inputs point to increased production, which should translate into increased income and employment.

The project, is designed to provide both a self sustaining credit fund and a self sustaining technical assistance network. Most of the costs of doing this are passed on to the beneficiary - the small business owner. Given that small business proves to be a good risk, and has an effective demand for credit (at the proposed interest rate), and technical assistance if required is provided, the process should continue indefinitely.

5. Conclusions

The project is considered to be socially feasible at the small industry level. The existence of local TAC organizations and the technical assistance programmed under the project should result in capable organizations collaborating actively and effectively with small entrepreneurs and PFIs.

C. FINANCIAL ANALYSIS

1. Methodology

In completing the financial analysis for the project, two sets of analyses were carried out. First a study was made of the principal constraints and obstacles to financial resource mobilization and small enterprise access to credit. This analysis was completed jointly along with many key aspects of the institutional analysis, and, as mentioned previously, included a series of interviews with many of the bankers in the Dominican financial system and with research institutions and technical assistance and advocacy groups. The second set of analyses included a series of detailed studies of the financial viability of the basic project model proposed. This includes an analysis of: the cash flow of the sublending fund and of the TACs; the adequacy of sublending spread; the adequacy of the proposed guaranty fund; the adequacy of the sublending terms and procedures; and the adequacy of the demand for credit. The first set of analyses was carried out primarily by Onofre Torres, a financial consultant with Interamerican Management Consulting Corp. The second set of analyses was carried out primarily by FIDE personnel, Peter Fraser, (a private consultant in small business development), and Michael Lofstrom, LAC/DR (copies of their complete reports are available in the Mission files).

2. Major Findings

a. The Interest Rate Constraints

Over the years the monetary authorities at the Central Bank have developed a system of control of interest rates with a view to directing credit resources toward desired development objectives. This manipulation of interest rate levels, coupled with political pressure to maintain low interest rates, and given current sustained high international interest rate levels, have all combined to produce an interest rate framework that does not respond well to the forces of the market. One result is to stimulate capital flight toward international markets where interest rate levels are more attractive.

Additionally, the interest rate framework is set up in such a way that the larger, more well established business enterprises pay higher effective rates of interest and smaller companies pay a lower rate. This tiering of interest rates is based philosophically, on the notion that larger, stronger companies can more easily afford to pay a higher price for credit. However, it ignores the fact that larger loans to stronger companies inherently embody less risk of default and have a lower transaction cost per dollar lent. Therefore, a second result of the interest rate policy is that financial intermediaries (FI) prefer to lend to larger companies. Credit is thus directed away from the small business borrower.

In an effort to redirect funds back to the small business borrower, monetary authorities have created rediscount mechanisms whereby they provide subsidized resources to the financial intermediaries for on-lending to small businesses. Unfortunately, the monetary authorities concern that small business borrower ultimately pay a low (subsidized) rate of interest and that the financial intermediary not be allowed to make "excessive profits", has prevented any signficant mobilization of credit resources to the small business sector.

The chart below shows how the interest rate framework is presently established and how effective interest rate yields are directly related to size of company, thereby directing marketing efforts of financial intermediary away from small business lending (all numbers are expressed as a percentage).

	Loan Rates	Commis-sions	Collat-eral Business	Approx. Cost of Funds	Net Spreads	Over-all Effec Rate
Small Business: Only marginably served by FI	9	-	-	5	4	9
Medium Sized Business: Generally served by Finance Companies and to a lesser extent by commercial banks	12	2-4	-	10	4-6	14-16
Large Corporation: Generally served by commercial banks	12	4-6	2-3	13	5-8	18-20

(Collateral Business includes letters of credit, collections, and sale of foreign exchange. The exact net spread on large corporation loans depends upon the volume of the compensating balances.)

b. <u>High Transaction Costs as a Constraint to Small Business Lending</u>

Transaction costs per dollar of credit disbursed are necessarily higher in the case of small business loans. Because of the lack of sophistication of the borrower, in many cases the FI must provide limited forms of technical assistance to the borrower. As an example, the banker may have to invest a disproprotionate amount of time with a small borrower helping him to prepare a loan application that will make sense to the loan committee. Additionally, tighter loan administration and follow-up procedures may be required for a small borrower whereas a large, well established corporate borrower may not require such strict supervision.

Another transaction cost which has been identified is related to the level of paperwork required to process a loan disbursement through the Central Bank's FIDE program. Some finance companies perceive that these procedures simply increase their costs of lending to the small business sector.

c. Perceived Incremental Risk in Lending to Small Businesses

The lack of managerial and technical competence which often characterizes the small business borrower generally increases the risk in lending to this sector. As in most countries of the world, the small business failure rate is substantially higher than that of the larger, well-established corporations. To some extent, failures are attributable to lack of managerial, administrative and technical skills in the small business.

d. Effect of Inflation on Interest Rate Policy

Official figures for inflation indicate that the rate of increase in price levels in the Dominican Republic has been comparatively moderate relative to that of other developing countries. During the late 70's the oil price increases contributed to higher rates of inflation whereas the 1981-82 worldwide recession and the recent low commodity export prices obtained for Dominican exports have tended to produce very moderate levels of inflation for the last two years.

OFFICIAL ESTIMATES OF INFLATION
(Expressed as a percentage)
(Source: Central Bank July 29, 1982)

1978-79	9.21
1979-80	16.75
1980-81	7.54
May 1981- May 1982	8.92

Based on an estimated inflation rate of approximately 9%, and the assumption that depositors in the system would require a real rate of return of 3-4% over the inflation rate, it would appear reasonable to expect that competitive forces would establish a time deposit rate of approxiamtely 12-13% per annum.

Since the reserve requirement on Certificates of Deposit is fully 30%, the cost to the financial institutions of a time deposit would translate into a marginal cost of funds of 17-18.5%. If a bank were to operate under the above cost structure its lending rate would have to be a few percentage points higher than 17-18.5 Percent p.a. in order to cover administrative costs, reserve for bad debts and profit.

It is apparent from examining the pricing structure currently in place in the D.R. that only the commercial banks are capable of achieving the required yields to cover inflation plus costs. Financieras survive in the system largely as a result of utilizing subsidized funds made available by the Central Bank through its FIDE program.

3. Analysis of the Proposed Program to Alleviate Principal Obstacles to Small Industry Credit Mobilization

The interest rate structure in the Dominican Republic was found to be a principal factor in inhibiting credit mobilization to the small business sector and that the interest rate levels in the D.R. bear little relationship to interest rate levels which would be achieved as a result of the interaction of market forces. Consequently, the project is designed to: (a) force the rate of interest at which FIDE lends to the PFIs as high as possible given the present legal constraints (usury laws, etc.) in the system; and (b) transfer most of the costs of the loan program through to the end borrower, thus providing an effective subloan interest rate which approximates the market rate of interest.

USAID/DR and the members of the technical advisory team all agree that it is not reasonable to expect that major modifications to the overall interest rate structure in the country can be negotiated through this project. However, at the same time, negotiations are taking place on this subject between the GODR and the International Monetary Fund (IMF). It is possible, however, to modify certain specific interest rate policies as they affect the small business sector so that the price of credit to small business will correspond more closely to that which would be determined by market forces. In addition, significant modifications in the FIDE sublending procedures and in the provision of needed TA to small businesses can result in a significant alleviation of the credit constraint. The proposed project will also provide an effective mechanism for maintaining a long term meaningful dialogue on this issue, thus presenting many opportunities for demonstrating to the GODR the merits of adjusting their interest rate policy. Accordingly the project will include the following key actions:

a. Interest Rate Actions

Consistent with the idea of achieving long range self-sustainability of the program, the project will require that the end borrower pay the highest effective interest rate (to include commissions and fees) allowed under the law. Thus it is expected that future legislation to reduce interest rate restrictions will eventually permit interest rates for lending to the small business sector which approximate the market rate.

In order to deal with the perceived obstacles to credit mobilization toward small business, the project loan fund will provide for increased pecuniary incentives to the FIs through increases in the spreads available to the PFIs in the program. Under the present system FIs earn a spread of 4%, for loans made in Santo Domingo, and 5% for loans made to sub-borrowers in rural areas. PFIs in the FIDE-AID program will receive a spread of up to 6% which represents a 50% increase in profitability to the PFIs.

The following table presents a breakdown of the sublending rates to be used by FIDE and the PFIs under the project. The Central Bank will adjust its current sublending terms to small businesses to permit usage of these rates by FIDE.

Proposed Sub-lending Rates
(Expressed as a percentage)

	Santo Domingo and Santiago	Outside Santo Domingo and Santiago
Return to FIDE	8%	6%
FIDE Administrative Expenses	2%	2%
Guarantee Fund Allocation	3%	3%
Surplus to Revolving Loan Fund	3%	1%
Return to PFI	4%	6%
Administrative Expense	1%	1%
Reserve for Loans Loss	2%	2%
Profit	1%	3%
Commissions and Fees	4%	4%
Guarantee Fund Payment	2%	2%
*Technical Assistance	2%	2%
(Closing costs and packaging fee paid to TAC out of loan principal)	(3%)	(3%)
Nominal Interest Rate	16%	16%
**Effective Rate of Interest paid by Sub-borrower	18%	18%

* 2% fee for technical assistance charged only when needed

** Effective rate of interest based upon 6 month Grace Period

As the above schedule indicates: FIDE will charge the PFI 8% for subloans to businesses located in Santo Domingo and Santiago and 6% for subloans made to busineses outside these areas (i.e. rural areas) (2% for FIDE administrative expenses, 3% for FIDE's guarantee fund allocation, and a 1-3% surplus to FIDE depending upon the location of the small industry); the PFI will receive 4% for subloans to businesses located in Santo Domingo and Santiago and 6 percent for subloans made to businesses located outside the Capital (1% to cover their administration costs, a 2% reserve for possible loan loss; and 1-3% profit margin). The additional interest costs charged to the sub-borrower include a 2% payment to its Guarantee fund, and a 2% charge on the declining loan balance for technical assistance provided, when needed, by the TAC. Included in the principal payment of the loan, and paid for in advance by the sub-borrower, is a 3% TAC Fee to cover the TAC costs associated with project identification, closing, and packaging of the subloan.

It should be noted that given the average grace period of 6 months for most working capital loans, and a one year grace period granted on longer term loans for 5 or 6 year duration, most sub-loans will carry an effective interest rate of some figure above 16%. On the average it is estimated that most sub-loans will be made at an effective interest rate of 18%, which concurs with the estimated market rate of interest for small industry loans currently in the D.R.

It is anticipated that over time, with the expected future liberalization of interest rates, that FIDE's loan rate to the financial institutions will increase until it approximates a market rate of interest. At that point, self-sustainability of the project will have been achieved.

b. Reduction in Transaction Costs

The Revolving Loan Fund will operate in a manner which minimizes the daily decision making requirements in the management of the fund at FIDE, thereby maximizing the efficiency of the Fund's operation and providing for some reduction in transaction costs. A key element for the success of the operation of the fund is for FIDE to accept each PFIs assessment of credit risk and proceed to disbursement of funds automatically within 24 hours of receiving a reimbursement request from the PFI. The audit process to insure the PFIs adherence to established elibility criteria should take place after funds have automatically been advanced to the PFI. In the unlikely event that a PFI has made an incorrect disbursement, FIDE can then simply debit the PFI's account to reverse the entry (FIDE has agreed to this procedure).

c. Reduction in Risk Perceptions

To help reduce the risk associated with small business lending, the project loan fund will also provide for the delivery of managerial and technical assistance to the small business borrower through the use of Technical Assistance Centers (TACs) (the design of the TAC's is more fully described in the Institutional Analysis Section of the PP). TACs qualifying to participate in the program must be organized under the law No. 520 as non-profit organizations and must be approved by AID and FIDE as legitimate organizations capable of delivering acceptable quality technical assistance under the program.

In addition, in order to further reduce the perception of risk on the part of the PFIs, the project includes increasing the guarantee coverage of the FIDE loan program from 50 Percent to 75 Percent.

We have attempted to secure a commitment from FIDE to maintain the value of the Small Industry Credit Fund against erosion of capital due to inflation. However, FIDE has a policy against indexation of credit funds (adjusted for the rate of inflation) for maintaining the value of its loan portfolio.

Given the counterpart contribution and the availability of funds from other sources, FIDE has promised to maintain the viability of the Fund with their sources against decapitalization due to inflation. FIDE also has an excellent record in maintaining an activity level of its loan funds. The USAID is satisfied with FIDE's pronounced commitment to the project.

The project team considers that the proposed sublending incentives will also have a significant impact on overall PFI sublending patterns. The proposed incentives will represent a new Central Bank and GODR Monetary Board policy and incentives which will impact on all sublending to small businesses throughout the formal financial system. Thus PFIs can use the proposed new sublending rates with their own or other resources for sublending to small businesses. Indeed based upon discussions with PFIS, the project team expects that the demonstration of successfull sublending to small businesses through the project, PFIs will be very anxious to begin non project funded sublending in this sector.

A series of analyses were carried out to test the viability of the basic project financial model. The results of a series of cash flow analyses show that the TAC models will be for the most part self sufficient within the life of the project from the revenues generated from the proposed TAC fees (See Annex H-3). In addition, the analyses indicate that the FIDE sublending terms proposed will permit FIDE to cover all the CAF costs and permit the sublending fund to revolve within the life of the project (See Annex H-1). The detailed analysis of the guarantee fund indicates that the allowance within the spread for anticipated end borrower defaults should be adequate (See Annex H-2). The sublending procedures appear adequate to assure that project credit resources are effectively utilized and at the same time reduce unnecessary transaction costs. These procedures are essentially a modification of FIDE's current procedures and therefore should be easy for FIDE personnel to operate. Finally, the analysis of the small industry credit needs (particularly the results of the CONADEPI study) indicates that the demand for credit by this subsector is expected to be substantially greater than the size of the credit resources available under the proposed project. In addition this analysis indicates that the proposed sublending terms and criteria should result in the majority of this subsector being included as potential project participants (See Table II, Social Soundness Analysis).

4. Conclusions

The financial analysis of the project design clearly indicates that the proposed modifications in the constraints to financial resource mobilization should result in adequate PFI participation in the project and adequate small business access to credit. In addition, the analysis indicates that the project activities have a reasonable expectation of being self sustaining within the life of the project. Therefore the project committee concludes that the proposed project design is financially feasible.

D. Economic Analysis

1. Introduction

The purpose of this project is to provide credit for working capital and production expansion at a realistic interest rate to small businesses that are not served by financial institutions with existing credit facilities. It is estimated that there are approximately 13,000 small businesses throughout the Dominican Republic that need loans for expansion of production facilities but because of higher risk and higher unit loan cost, their credit demand has not been met by financial institutions. This project, therefore, is a pilot attempt to find a means of bringing together the formal financial institutions, particularly financieras, and the small business enterprises in a way that when this AID program is over, private financieras will continue serving this sub-sector with their own resources.

The economic analysis presented below is based on a cost-benefit analysis. The discounted present value of the cost stream will be compared with the discounted present value of the estimated benefit stream to obtain the economic benefit-cost ratio.

2. Economic Cost

Total cost of the project is RD$7.85 million, of which $7.0 million is designated for credit expansion and RD$0.85 million is for technical assistance, training, and expenses to establishing TACs which will assist in making small business loans acceptable to financieras. However, the economic cost is larger than the project cost due to over-valuation of the peso at the official exchange rate. The parallel market exchange rate is currently at about RD$1.5 to US$1. Since the parallel rate is a free market exchange rate, it is taken as the shadow exchange rate for the purpose of this analysis.

Table 1 shows estimated cost and benefit streams. The total project cost of RD$7.85 million will be disbursed during the first 5 years. It will increase gradually from RD$1.46 million in year 1 to RD$3.45 million in year 3 and then taper off to RD$70,000 in year 5. The economic cost will have a similar pattern of expenditures as the project cost, but at higher levels. In real terms, assuming an average inflation rate of 8 percent, the total economic cost of this project is RD$8.0 million. This figure is used in the benefit-cost calculation. Note that although the total project cost is RD$7.85 million, the amount of funds available for loans is only RD$7.0 million, RD$850,000 being earmarked for expenditures related mainly to technical assistance. The $7.0 million credit will be loaned out during the first three years as follows -- $1.2 million during the first year, $2.5 million in the second year and $3.3 million for the third year.

3. Expected Rate of Return

Since there will be hundreds of sub-project lending under this credit program, it will be impossible to estimate the rates of return for all individual loans. However, the credit program as a whole should obtain a rate of return that would be large enough to satisfy the repayment of interest and principal and an adequate return to the borrower.

Various studies indicate that small business enterprises borrow short term loans in the private curve market at about 3 percent per month, or at a compound annual rate of 43 percent. It is also reported that practically all private loans are for very short term emergency working capital. Small businesses do not borrow for production expansion at this high rate. An implication is that the rate of return for capital investment is less than the private curve market rate. In other words, the private curve market rate can be considered as the upper limit for the rate of return for production expansion.

On the other hand, the financieras make loans to medium sized businesses at an average rate of 18 percent a year, which is clearly the lower limit of the rate of return. For credit demand for capital expansion by small businesses exceeds supply by a substantial margin at 18 percent. In fact small businesses do not have access to credit at this rate.

It seems clear, therefore, that the rate of return for capital for small business enterprises lie between 18 percent and 43 percent. The actual rate probably depends on, among other factors, the type of business, credit availability and location. As a first approximation, we assume that the rate of return for credit under this project is 30 percent, which is approximately the mid point between the upper and lower limit.

4. Expected Benefit

Economic benefits can be grouped into two categories -- quantifiable and non-quantifiable benefits. Quantifiable benefits are the assumed 30 percent rate of return on credit and the expected increase in employment due to higher levels of productive activities as a result of credit made available. Over the life of the credit program, it is estimated that the small business will provide job opportunities to approximately 1,000 unskilled and semi-skilled workers. Non-quantifiable benefits to the economy are (1) the private curve market interest may decline due to less demand for its credit, thus making it less painful for borrowers, (2) human capital of small business entrepreneurs would rise due to training provided by the TACs and they may be able to obtain, in the future, necessary credits from financieras's regular funds, and (3) by providing opportunities for production expansion of small businesses and by providing jobs to unskilled poor workers, this project assist correcting the current skewed income distribution to a more equitable one.

In this analysis an attempt is made to estimate the quantifiable benefits and to calculate the benefit-cost ratio without the benefit of non-quantifiable benefits. Therefore the following benefit-cost ratio can be considered somewhat underestimated.

5. Benefit Stream

As was mentioned above, two types of quantifiable benefits are calculated. They are the direct return to the credit made available for capital expansion (both working and fixed) and the benefit resulting from the increase in employment to meet higher production. An implicit assumption for the analysis is that the aggregate demand for the product exists and there will be no saturation of the product market, either domestic or foreign.

a. Benefits from Capital Expansion

For this calculation, it is assumed that there will be a 3 year lag between the time loans are made and the time benefits accrued at the 30 percent a year rate. For the sake of simplicity, we assume that all amortization payments are reloaned out immediately so as to maintain the loan portfolio intact over the life of this loan program. In addition we assume that the size of the initial loan fund will not change (not increase) from capitalization of interest payments (note that about 2 percent of interest payments is designated for capitalization). Under these conditions, economic benefits will accrue each year at 30 percent of the loan beginning third year after the loan and there is no reason why this stream of benefits will not continue for the indefinite future.

Table 1 describes the benefit stream based on the plan that the RD$7.0 million loan fund will be disbursed in 3 years. Aggregate benefits from year 1 loans are RD$360,000 per year accruing in the 4th year of the program and continue at this rate every year thereafter. Similarly year 2 and year 3 loans produce a 30 percent rate of return each year with a 3 year lag time. However, since the benefit stream is measured in current prices, it should be expressed in year 1 prices to make a comparison possible. In Table 1, an 8 percent inflation rate is used to calculate the benefit in real terms. This stream of real benefits is discounted to year 1 to obtain the present value of the benefit assuming a real discount rate of 5 percent (Table 2). Total present value of the real benefit stream is found to be RD$10.4 million and the corresponding economic cost is RD$8.0 million. The economic benefit-cost ratio of 1.3, is quite satisfactory. If we make the assumption that the loan program will be terminated 13 years after the initial loan, the benefit-cost ratio is reduced to 0.9.

b. Benefits from Employment Expansion

As explained in the social soundness analysis, the target group operates businesses that have an average capital-labor ratio of RD$6,000 in 1981 prices. On the average, in 1983 prices, we can expect an increase of one job for every RD$7,000 capital expenditure assuming an 8 percent inflation rate. For a RD$7.0 million loan program, we therefore expect an employment increase of 1,000. They are primarily unskilled and semi-skilled jobs that pay the legal minimum wage of about RD$1,800 a year. Although unemployment is estimated at 20 to 25 percent, the shadow wage, however, is not estimated to be zero, but at about DR$80 per month or RD$960 per year. The estimated economic wage benefit per year per job is therefore RD$840. Table 3 shows the stream of economic wage benefits expected from this credit program. In the case of perpetual loan program, the present value of wage benefits is estimated to be RD$4.1 million and in the case of 13 year loan program it adds RD$2.9 million to the economic benefit.

Since the employment benefit accrues in addition to the benefit from returns to capital, the benefit-cost ratio increases to 1.8 for the perpetual loan program and 1.3 in the case of the 13 year loan program. Clearly the economic benefit of this credit program exceeds its economic cost by a substantial margin. Therefore this project should be undertaken based on economic ground.

6. A Sensitivity Analysis

The benefit-cost analysis presented above was performed based on fairly stringent assumptions. Two are of particular importance. They are the assumptions of a 30 percent rate of return and no defaults. The latter in particular may not be realistic in view of the fact that small businesses have been considered in the past as being higher risk due to high default rates. The crucial question is under what circumstances the benefit to the economy becomes less than the cost?

Table 4 provides partial answers to this question. It gives benefit-cost ratios for different rates of return with different default rates. If we make the assumption of no default, the benefit-cost ratio is larger than 1 in all cases (marginally so in the case of 20 percent return in the 13 year loan program), indicating that the economic benefit is more than the corresponding economic cost. However, if we make the assumption that yearly defaults equal 5 percent of the outstanding loan portfolio, the benefit-cost ratio exceeds only when the rate of return on loans is 30 percent (for the perpetual loan program). A 25 percent rate of return would be marginally acceptable. Similarly, a 30 percent rate of return in the 13 year loan program would be marginally acceptable. However, this project is clearly non-economical if the rate of default reaches 10 percent a year, the benefit-cost ratios being no more than 0.7 in all cases.

This simulation analysis points out the importance of minimizing the default rate if the project is going to be economically beneficial. It seems to suggest that reduction of the default rate is more important than increase in the rate of return.

Table 1
Cost and Benefit Stream *
(In RD$ Millions)

YEAR	1	2	3	4	5	6	7	8 ...
I. Project Cost	1.46	2.77	3.45	0.095	0.070			
Economic Cost	1.69	3.06	3.78	0.14	0.11			
Real Economic Cost (Assume Inflation = 8%)	1.69	2.83	3.24	0.11	0.08			
II. Loan (RD$ million)	1.2	2.6	3.2					
Benefits due to: (RD$ millions)								
Year 1 loans				0.36	0.36	0.36 ...		
Year 2 loans					0.78	0.78	0.78 ...	
Year 3 loans						0.96	0.96	0.96 ...
Benefits in real terms: (assume inflation = 8%)								
Year 1 loans				$\frac{0.36}{(1.08)^3}$	$\frac{0.36}{(1.08)^4}$	$\frac{0.36}{(1.08)^5}$ ...		
Year 2 loans					$\frac{0.78}{(1.08)^4}$	$\frac{0.78}{(1.08)^5}$	$\frac{0.78}{(1.08)^6}$ ...	
Year 3 loans						$\frac{0.96}{(1.08)^5}$	$\frac{0.96}{(1.08)^6}$	$\frac{0.96}{(1.08)^7}$

* The benefit stream is calculated on the assumption that the rate of return to capital is 30 percent and that the benefit begins to accrue in the 3rd year after the loan.

Table 2

Present Value Calculation *
(In millions of RD$)

1. Indefinite loan program
(Real discount rate = 5%)

	Benefit Stream	Economic Cost	Benefit/Cost
Year 1 loans	2.09		
Year 2 loans	3.99		
Year 3 loans	4.33		
Total	10.41	7.95	1.31

2. 13 year loan program (real discount rate = 5%)

	Benefit Stream	Economic Cost	Benefit/Cost
Year 1 loans	1.50		
Year 2 loans	2.86		
Year 3 loans	3.10		
Total	7.46	7.95	0.94

* The present value is calculated using the following formula for the indefinite loan program:

$$PV = \sum_{t=0}^{\infty} \frac{r.L}{(1+f)^{t+g}\,(1+d)^{t+g}} = \frac{rL}{[(1+f)\,(1+d)]^{g-1}} \cdot \frac{1}{(1+f)\,(1+d) - 1}$$

Where r = rate of return on loan
L = amount of loan
f = inflation rate
d = real discount rate
g = year in which begins the benefit stream less one

For the 13 year loan program the above formula reduces to:

$$PV = \frac{rL}{[(1+f)\,(1+d)]^{g-1}} \cdot \frac{1}{(1+f)\,(1+d)-1} \cdot \left(1 - \frac{1}{(1+f)^{10}\,(1+d)^{10}}\right)$$

Table 3
Employment Benefit Stream Calculation *

YEAR	1	2	3	4	5	6	7	8	...
Loan (RD$ million)	1.2	2.6	3.2						
Benefits due to: (RD$ millions)									
Year 1 loans				0.14	0.14	0.14 ...			
Year 2 loans					0.31	0.31	0.31 ...		
Year 3 loans						0.38	0.38	0.38	...
Benefits in real terms: (assume inflation = 8%)									
Year 1 loans				$\frac{0.14}{(1.08)^3}$	$\frac{0.14}{(1.08)^4}$	$\frac{0.14}{(1.08)^5}$ ...			
Year 2 loans					$\frac{0.31}{(1.08)^4}$	$\frac{0.31}{(1.08)^5}$	$\frac{0.31}{(1.08)^6}$ ...		
Year 3 loans						$\frac{0.38}{(1.08)^5}$	$\frac{0.38}{(1.08)^6}$	$\frac{0.38}{(1.08)^7}$	

Present Value

1. Indefinite loan program = RD$4.11 million
2. 13 year loan program = RD$ 2.94 million

* The wage benefit is estimated by the amount of loan divided by RD$7,000 times RD$840 (See explanation given in section 5, part b).

Table 4
Benefit-Cost Ratios * -- A Simulation **

Rate of Return	30%	25%	20%
I. Perpetual Loan Program			
No default	1.8	1.5	1.2
5% default a year beginning 2nd year	1.1	0.9	0.7
10% default a year beginning 2nd year	0.7	0.6	0.5
II. 13 Year Loan Program			
No default	1.3	1.1	0.9
5% default a year beginning 2nd year	0.9	0.75	0.6
10% default a year beginning 2nd year	0.6	0.5	0.4

* In this calculation we assume that the employment benefit shown in Table 3 declines proportionately with the benefit reduction from capital loans, as a result of loan defaults.

** Various present values are calculated based on the formula:

$$PV = \left[\frac{W}{(1+f\ (1+d)}\right]^{g} .rL \ . \sum_{t=0}^{n-1} \left[\frac{W}{(1+f)\ (1+d)}\right]^{t} .$$

where 1-W = assumed rate of default
n =   for the indefinite loan program
n = 13 for the 13 year loan programs

Meanings of other symbols are given in Table 2.

V. PROJECT IMPLEMENTATION

A. GODR Project Administration

The project will be managed and administered within the Central Bank institutional structure. As discussed in the Institutional Analyses section, FIDE, the Economic Development Investment Fund within the Central Bank, will have the responsibility for managing project activities. Within FIDE, a special project implementation unit, the Central Assistance Facility (CAF), will be established and will actually coordinate the various project activities.

To accomplish this, all plans to carry out project activities and all project disbursement requests will require prior CAF approval. The CAF will supervise and approve the development of the annual sublending and TAC operating plans. The CAF will also assure that adequate technical standards are maintained in all project documentation. The CAF will prepare projections on sublending requirements and will receive disbursement requests from participating TACs and assure that such requests are in conformance with approved overall operating plans and will then forward such requests to the Director of FIDE. The Director of FIDE will certify the appropriateness of the proposed disbursement and will forward them to A.I.D.

As provided for under the project, FIDE will be assigned additional personnel to help facilitate the development, monitoring, and flow of project related documentation. In particular FIDE will assign two full time administrative assistants to the CAF to assure the timely flow of documentation between the CAF and FIDE, and between FIDE and the A.I.D.

B. USAID Project Administration

The Project Manager will maintain close contact with appropriate officials of the Central Bank and the participating TACs. He will ensure that provisions of the Project Agreement and Implementation Letters are met. He will monitor disbursement progress through frequent visits to the CAF and TAC offices. Members of the project committee will review the annual operating plans, quarterly budget requests and evaluation reports.

Bi-monthly project status meetings will be held at the Mission to discuss progress and ensure that project activities conform to A.I.D. regulations, that sound financial control is being exercised, and that the terms and conditions of the project agreement are being met.

C. Financial Plan

1. Disbursement Procedures

The total cost of this five year loan/grant is $7.85 million, of which $5.85 million will be financed by A.I.D. and $2 million by the GODR. The GODR counterpart contribution represents 25% of the total cost of the project. The AID resources will consist of $5 million in loan funds and $850,000 in grant funds. The AID contribution will finance a total cost in dollars of $235,000 and a total cost in pesos of $5,615,000. The GODR contribution will consist entirely of local currency resources. Tables I and II show summary financial plans for the project, broken down by funding category project activity and by year.

AID funded U.S. Dollar costs under this project will be for technical assistance, training and evaluation costs. U.S. Dollar disbursements for eligible goods and services will be made using standard AID procedures, i.e., by issuing Letters of Commitment (L/COM) and making payment directly or through the use of Letters of Credit.

AID will provide RD$5,000,000 for sub-loans $3,500,000 of which will be used for sublending out of Santo Domingo (i.e., rural areas). It is the intention of the disbursement procedures that the AID loan funds and the counterpart contribution be disbursed simultaneously.

AID funded pesos will also be used for local training, technical assistance, commodities and for the operating expenses of the TACs. Disbursements in Pesos will be made monthly based upon the estimated requirements of the project for a period of 90 days. The borrower/grantee will submit to USAID reports presenting the status of the funds previously disbursed and specifying the needs for the ensuing 90 day pericd. The above described procedure will provide USAID with the information necessary to determine program requirements and make disbursements accordingly. Advance checks will be forwarded directly to the GODR National Treasury for immediate release to the implementing agency.

Disbursements to the TACs will be made by FIDE based upon the estimated requirements of the TAC for the first year. The disbursements will be made on the basis of reports submitted by the TACs presenting the status of the funds previously disbursed and specifying the needs for the ensuing period. Funding for the second and subsequent years will depend upon the results of the first year's evaluation.

2. GODR Repayment Capability of the Loan

Although the GODR currently experiences a urgent balance of payments problem, it is a short-run crisis brought about mainly by the sharp drop in world prices of its major export commodities. Traditionally the GODR maintains a low level of external public and

TABLE I

SUMMARY COST ESTIMATE AND FINANCIAL PLAN

(US $000)

SOURCE / USE	A.I.D. LOAN FC	A.I.D. LOAN LC	A.I.D. GRANT FC	A.I.D. GRANT LC	TOTAL A.I.D.	COUNTERPART LC	GRAND TOTAL
Subloans		5,000			5,000	2,000	7,000
Estimated TAC Operating Costs in Excess of Revenues:							
DDF				100	100		100
PROAPE				30	30		30
CEPESA				25	25		25
Additional TACs				225	225		225
Commodities				50	50		50
Off-shore & In-country TA			185	135	320		320
Evaluation			50		50		50
Contingency				50	50		50
Total	—	5,000	235	615	5,850	2,000	7,850

TABLE II

SUMMARY OF COSTS BY YEAR
(US $000)

	1983	1984	1985	1986	1987	TOTAL
AID						
Estimated TAC Operating Costs in Excess of Revenues:						
DDF	40	30	20	5	5	100
PROAPE	20	10	-	-	-	30
CEPESA	15	10	-	-	-	25
Additional TACs	-	75	75	50	25	225
Commodities	20	15	15	-	-	50
Off-shore & In-country TA	180	50	50	20	20	320
Evaluation	10	10	10	10	10	50
Contingency	10	10	10	10	10	50
Sublending Fund	834	1,829	2,337	-	-	5,000
GODR:						
Sublending Fund	334	731	935	-	-	2,000
Total	1,463	2,770	3,452	95	70	7,850

publicly guaranteed debt. In 1980, the ratio of public debt service payments to exports of goods and services was only 11 percent. Although this ratio is expected to rise to 19 percent in 1982 due to upcoming amortization payments on a large 1979 loan, the long term debt service burden is relatively small. We believe that the GODR should not have difficulty with the repayment of the $5 million loan under the terms of agreement out of its foreign exchange earnings.

D. Procurement

The Mission has determined that the procurement of all technical assistance will be undertaken by A.I.D. directly. The Mission bases this determination on the conclusion that use of the host country contracting made for these procurements would unnecessarily delay project implementation. In addition, direct contracting by A.I.D. would not materially increase expenditure of Mission staff time.

Under the project approximately 12 person-months of long term and 3 months of short term technical assistance is needed to help in the planning and organization of project activities. To be effective, all of this assistance is needed during the first year. FIDE's contracting capability, while good in terms of other developing countries, would probably not be able to obtain the needed assistance on schedule. Thus, serious delays in project implementation could result.

Adding to the FIDE's contracting weakness, is that contracting of the technical assistance could give rise to special difficulties in the host country/contractor relationships. The GODR in the past has been reluctant to contract advisors at salary levels that greatly exceed those of their host country counterparts. Contracting of the advisors by A.I.D. will minimize such friction by avoiding situations where FIDE officials must make salary payments to advisors, provide customs privileges, etc.

Except for motorcycles goods and services procured under the grant will have both their source and origin in the United States or the Dominican Republic. Goods and services procured under the loan will have both their source and origin in countries included in Code 941 of the Geographic Code Book or, for those materials purchased under shelf procurement regulations described in A.I.D. Handbook 11, from countries in Code 935. Procurement under subloans to small industries will be made in accordance with standard A.I.D. procedures applicable to Intermediate Credit Institution (I.C.I.) projects.

A source/origin waiver is requested in this document from Code 000 to Code 899 for the purchase with Grant funds of 20 125cc motorcycles to be used by the TAC promoters to visit the small businesses. This is necessary to carry out the Project. The motorcycles will cost approximately $25,000. The small "street-trail" motorcycles are not manufactured in the United States. Although they are available from suppliers in two of the 941 Code countries, country-wide maintenance and service from those suppliers in the Dominican Republic is considered to be inadequate for purposes of the project and therefore not available within the meaning of AID HB 1 Supp. B __5 B4 a(2). A waiver is therefore requested to Code 899 to allow for adequate maintenance and service country-wide of purchased motorcycles. The procurement will otherwise be conducted in accordance with AID's established procedures.

E. Evaluation Plan

Development of the institutional conditions necessary for replication of the project activities will require .reful evaluation of the implementation of all project activities. Information will be needed early on to make adjustments in the design of project activities in order to produce an effective model and structure within the life of the project.

A series of intensive project evaluations will be undertaken. These evaluations will take place approximately at the end of every year during the life of the project. The first evaluation will take place about September 1983. The focus of this evaluation will be on the performance and adequacy of inputs, the performance of implementing agents, and to measure progress towards outputs.

Also during the first evaluation, a special study will be made of the effectiveness of the credit and technical assistance components. A survey will be made to provide baseline information for use in future surveys. The first survey will focus on measuring small industry and PFI response to the sublending and technical assistance program. Among the topics to be examined will be: small business awareness of the program; desire of PFIs, TACs and small industries to enter the program; the adequacy of the spread to the PFI and to FIDE; the adequacy of the guarantee mechanism; the adequacy and eligibility and sublending criteria used under the program and possibility of future PFI sublending with their own funds. Specifically in relation to the TACs the first evaluation will focus on the adequacy of the TAC to set up basic business accounting and control systems; the desire of the small industries to undertake TAC recommended administrative and technical improvements; and the requirement that 85% of all sublending be channeled through the TACs. TAC progress toward self-sufficiency will be a particularly important point to be studied as future grant disbursements to TACs for operating expenses and the development of new TAC models will be based partially on this aspect.

The second evaluation will take place about September 1984. An input and output level performance review will again be undertaken. In addition, a review will be made of progress made towards achievement of purpose level targets. The first survey will be repeated and expanded to examine the effectiveness of the TA and training provided to the CAF, TAC's and small industries. The impact of project activities on alleviating the constraints to small industry development will also be studied. For the two additional TAC's entering the program, a survey will be initiated along the lines of that used in the first evaluation.

The effectiveness of the institutional structure to carry out project activities will also be examined during the second evaluation. Attention will be given to identifying obstacles and weaknesses in the institutional framework requiring adjustment in order to effectively carry out project activities.

During subsequent project evaluations, targets at each level of the logical framework will be examined. The surveys will be repeated. Questions regarding the impact of the project on employment and income will be studied. In addition, evidence of spread effects from TAC operations will be examined. A major focus of these evaluations will be an examination of the effectiveness of the sublending and technical assistance model developed under the project. Experience gained regarding small industry response, and cost effectiveness will be studied.

All evaluations will be carried out jointly by A.I.D. and FIDE. Final preparation and publication of the evaluation documents will be the responsibility of FIDE.

It is estimated that approximately $50,000 will be needed to carry out the series of evaluations. All expenses will be funded under the grant. Funds will be provided for the costs of technical assistance, local travel, per diem and materials.

F. Implementation Plan

1. Schedule of Major Events

Many project activities will require substantial time to fully develop and implement. A five year implementation period is therefore anticipated as necessary. The proposed schedule for the implementation of the major activities required during project implementation is:

(a) September 1982 - Project Authorized

(b) September 1982 - Project Agreement signed and first Implementation Letter issued.

(c) October 1982 - PIO/T for procurement of offshore TA issued.

(d) November 1982 - Project Agreement approved by Dominican Congress

(e) November 1982 - Initial Conditions Precedent for Grant met.

(f)	November 1982 -	Contract for offshore TA executed.
(g)	January 1983 -	Initial Conditions Precedent for Loan met.
(h)	September 1983 -	First evaluation completed.
(i)	October 1983 -	Conditions Precedent to Disbursement for 1983-84 project year met.
(j)	September 1984 -	Second project evaluation completed.
(k)	October 1984 -	Conditions Precedent to Disbursement for 1984-85 met.
(l)	September 1985 -	Third project evaluation completed.
(m)	October 1985 -	Conditions Precedent to Disbursement for 1985-86 project year met.
(n)	September 1986 -	Fourth project evaluation completed.
(o)	October 1986 -	Conditions Precedent to Disbursement for 1986-87 project year met.
(p)	September 1987 -	Final project evaluation completed.

G. Conditions, Covenants and Negotiation Status

1. Negotiation Status

Representatives of the Technical Secretariat of the Presidency and the Central Bank have worked closely with the Mission staff on the design of the project. The GODR will be the borrower/grantee and will pass the program fund to the executing agency, FIDE. The GODR, not FIDE, will be responsible for making the loan repayments. The project is being reviewed by the GODR Monetary Board; approval is expected within the week. There are no remaining issues which will require substantive negotiation. Once the project is authorized, the loan and grant agreements will be developed and negotiated with the GODR. The loan and grant agreements will then be reviewed and approved by the legal advisors to the President. The agreements will then be signed shortly after.

2. Conditions Precedent

a) Initial Conditions (Grant and Loan)

Initial conditions precedent to any disbursement under the project (both loan and grant) will include the usual A.I.D. legal requirements, including a statement by a recognized legal entity that the project is legally binding, and that the recipients of the loan and grant are responsible and legally bound to all requirements under the Project Agreement. In addition, the GODR will be required to name a project coordinator, acceptable to A.I.D., who can devote adequate time and effort necessary for the successful implementation of this project. Once these conditions are met, the procurement of TA may begin.

b) Initial Conditions (Grant)

Prior to disbursement of grant funds for the operation of the participating TAC s, FIDE must submit to A.I.D.: evidence that the coordinated program of technical assistance and credit between FIDE and the TAC has been set up; a manual setting forth the procedures, policies and eligibility criteria to be followed under the small industry technical assistance program; evidence that the CAF office has been set up with adequate staff; and a detailed operating plan for the technical assistance program which clearly indicates and justifies the support for the TAC's needed. Once these materials have been submitted, grant disbursement for the TAC operations may begin.

Disbursement of grant funds after the first year of project activities and for each subsequent project year will be contingent upon the completion of a detailed evaluation report on the project activities and the recommendation contained in this report. In addition, a detailed operating plan for the TAC s for each subsequent project year will need to be submitted to A.I.D.

c) Initial Conditions (Loan)

The initial conditions precedent to disbursement of loan funds will require evidence of the assignment of adequate staff in FIDE to support the sublending activities. In addition, FIDE will have to establish the CAF office with adequate staff.

Prior to any disbursement of loan funds under the project, FIDE will also be required to show evidence of the establishment of a Small Industry Credit Fund within the Central Bank to support the activities planned under the project. FIDE will be required to have separate accounts for this fund.

Also prior to the disbursement of any project funds for subloans FIDE will submit an operational plan for the first sublending period of the project (from approximately October 1982 to September 1983). This plan will describe in detail the anticipated sublending activities during this period. The plan will include the Monetary Board approval to maintain the program sublending rates at the maximum official rate allowed. This plan will include the numbers of subloans, timing and will indicate industrial areas associated with each subloan, and the arrangements for TA and training for the subborrower. In addition, this plan will describe in detail the activities anticipated to promote and support the sublending activities. Finally, prior to this first disbursement of the loan funds for sublending activities, FIDE will submit to A.I.D. a manual setting forth the sublending and technical assistance policies and procedures, and eligibility criteria to be followed under the program. Once these conditions have been met initial disbursement of loan funds can be made.

Disbursement of loan funds for sublending activities after the first year and for each subsequent project year will be contingent upon the completion of a detailed evaluation report on the sublending and technical assistance activities including a report on the effectiveness of the inputs provided. In addition a detailed operational plan outlining sublending the activities planned for each subsequent project year will need to be submitted to A.I.D.

3. <u>Covenants</u>

FIDE will covenant to use and deposit all reflows of principal generated under the loan in the Small Industry Credit Fund and to use these reflows in accordance with the policies and criteria of that program. FIDE will covenant to establish an evaluation program as part of the project and to submit an evaluation plan within six months after obligation of the project. Finally, FIDE will covenant to make available the effective sublending interest rates and risk reduction incentives to PFI's who wish to lend to small businesses with non project funds.

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AIDAC

ACTION: AID-10
INFO: AMB. DCM POL BIO ECON FCS CONS AC BMO CPU GSO PER RSO RMO NCOIC AGATT DAO MAAG USICA PC IAGS DIR AD PRG CRD CONT AGR MGT HAN EDU UDD A/RF CHRON

E.O. 12065: N/A IMMEDIATE
TAGS:
SUBJECT: SMALL INDUSTRY DEVELOPMENT

SUMMARY: LAC BUREAU REVIEW OF SUBJECT PID WAS HELD JUNE 23, 1982. THE PID IS VQPROVED AT THE LEVEL OF DOLS 5 MILLION IN LOAN FUNDS AND DOLS 850,000 IN GRANT FUNDS, SUBJECT TO SATISFACTORY RESOLUTION OF THE CONCERNS OUTLINED BELOW.

1. CONSTRAINTS AFFECTING SMALL BUSINESS:

--A. CREDIT: IN VIEW OF KEY CONSTRAINTS (E.G., LACK OF BORROWER CREDIT WORTHINESS O

DEQUATE GUARANTEES; RISK DUE TO TYPICALLY HIGH FAILURE RATES OF SMALL BUSINESS; LOW QUALITY ENTREPRENEURIAL SKILLS; AND GODR INTEREST RATE CONTROLS) WHICH AFFECT THE-AMOUNT OF CREDIT- - AVAILABLE TO SMALL BUSINESS, MISSION IS REQUESTED TO ANALYZE THE NATURE OF THE CREDIT CONSTRAINT TO ENSURE THAT PROJECT DESIGN ADDRESSES BINDING CONSTRAINTS TO SMALL BUSINESS DEVELOPMENT. AS MISSION AWARE, PPC HAS

QUESTIONED WHETHER GODR POLICY MEASURES, ESPECIALLY INTEREST RATE CONTROLS, ARE NOT A PRINCIPAL OBSTACLE TO FINANCIAL RESOURCE MOBILIZATION AND TO SMALL ENTERPRISE CREDIT ACCESS. UNLESS THIS CAN BE DEMONSTRATED NOT TO BE TRUE OR UNTIL THE GODR TAKES APPROPRIATE MEASURES TO REMOVE THE CONSTRAINT, MISSION SHOULD NOT PROCEED TO AUTHORIZATION. MISSION SHOULD ANALYZE THIS QUESTION SOONEST AND TRANSMIT RESPONSE FOR AID/W REVIEW.

--B. OTHER POLICY/REGULATORY CONSTRAINTS: IN ADDITION TO THE INTEREST RATE POLICY QUESTION DISCUSSED ABOVE, THE PID INDICATES THAT OTHER GOVERNMENT POLICIES AND REGULATIONS ARE HINDERING SMALL BUSINESS DEVELOPMENT. MISSION SHOULD CLEARLY IDENTIFY CRITICAL CONSTRAINTS IN THIS AREA AND EXPLAIN HOW THIS PROJECT OR OTHER VEHICLE (E.G., CBI OR IMF PROGRAMS) WILL ADDRESS THEM.

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--C. SMALL BUSINESS ADVOCACY: PROJECT IMPLEMENTATION AND RESUPZANT OUTPUTS ARE EXPECTED TO FACILITATE THE FLOW OF FIDE LOAN FUNDS TO PRIVATE FINANCIAL INSTITUTIONS FOR THE PURPOSE OF STIMULATING AND INCREASING THE GROWTH OF SMALL BUSINESSES, AND IMPROVE THE QUALITY OF SMALL BUSINESS THROUGH THE PROVISION OF TECHNICAL ASSISTANCE. TO HELP ACHIEVE THESE OBJECTIVES, MISSION SHOULD IDENTIFY CONSTITUENCIES OF SMALL BUSINESS DEVELOPMENT AND HOW PROJECT MIGHT SUPPORT THEM IN FOSTERING INCREASED ECONOMIC GROWTH IN SMALL BUSINESS, ATTRACTING OTHER RESOURCES, AND INFLUENCING AND IMPROVING THE REGULATORY CLPYATE FOR SMALL BUSINESS DEVELOPMENT.

2. DESIGN OF CREDIT COMPONENT:

--A. SUB-LOAN INTEREST RATES: REGARDING SUB-LOAN INTEREST RATES, MISSION SHOULD SEEK TO HAVE RATES SET AT LEVELS COMPARABLE TO THOSE THAT WOULD BE ADEQUATE IF SOURCE OF FUNDS WERE PRIVATE DEPOSITS RATHER THAN GOVERNMENTAL FUNDS, IN ORDER TO AVOID GIVING THE INCENTIVE TO FUBSTITUTE GOVERNMENT FUNDS FOR THOSE THAT COULD BE RAISED COMMERCIALLY. THIS WILL FACILITATE MAKING THE LENDING MECHANISM EVENTUALLY SELF-SUSTAINING. FURTHERMORE, IT CORRESPONDS TO A.I.D. POLICY NOT TO SUBSIDIZE INTEREST RATES. SPECIFICALLY, MISSION SHOULD SEEK TO ESTABLISH SUB-LENDING RATES TO COVER EXPECTED INFLATION, PLUS DEPOSITORS' REAL RATE OF RETURN, PLUS RESERVE FOR BAD DEBTS, PLUS ADMINISTRATIVE COSTS, PLUS RETURN TO FINANCIAL INSTITUTION TO MAKE IT FINANCIALLY SELF-SUSTAINING. IF THIS CANNOT BE ACHIEVED, PLEASE INFORM BUREAU PRIOR TO PROJECT APPROVAL.

--B. REVOLVING FUND: AS A MEANS OF PRESERVING THE REAL VALUE OF THE FIDE REVOLVING LOAN FUND AGAINST DECAPITALIZATION CAUSED BY INFLATION, MISSION SHOULD ATTEMPT TO SECURE AGREEMENT WITH FIDE SO THAT CONTRIBUTIONS WILL BE MADE BY THE CENTRAL BANK TO MAINTAIN THE REAL VALUE OF THE FIDE AND A.I.D. REVOLVING LOAN FUND THROUGHOUT THE LIFE OF THE PROJECT.

3. DESIGN OF TECHNICAL ASSISTANCE COMPONENT:

--A. MISSION SHOULD DESIGN THE PROJECT WITH A VIEW TOWARD TACS ACHIEVING SELF-FINANCING OPERATIONS BY THE END OF THE PROJECT. EFFORTS SHOULD FOCUS ON ELIMINATING AS MUCH SUBSIDY AS POSSIBLE FOR TAC OPERATIONAL EXPENSES BY MAXIMIZING PROFIT POTENTIAL FOR TACS, AND BY INITIATING THE PROJECT IN A MODEST WAY, PREFERABLY WITH EXISTING ESTABLISHED TAC CENTERS (E.G., DDF, PROAPE) AND TAC MODELS THAT ARE ALREADY GENERATING FINANCIAL SUPPORT (E.G., CEPESA). MISSION IS ENCOURAGED TO SUPPORT TAC COMPONENT IN A PRUDENT WAY, WITHOUT COMMITTING A DISPROPORTIONATE AMOUNT OF GRANT FUNDS TO ANY ONE MODEL.

. IN CONSIDERING ALTERNATIVE STRATEGIES FOR

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PROVIDING TECHNICAL ASSISTANCE TO POTENTIAL SUB-BORROWERS, MISSION SHOULD REVIEW PCGP EXPERIENCE IN PARAGUAY, LAAD CONCEPT OF UTILIZING SUCCESSFUL SMALL BUSINESS CLIENTS TO ASSIST AND ADVISE ON TECHNICAL MATTERS, AND RECENT PISCES PROJECT WHICH ANALYZED RESULTS OF SMALL INDUSTRY PROJECTS CARRIED OUT IN AFRICA, ASIA AND LATIN AMERICA. MISSION MAY ALSO WANT TO CONSIDER ESTABLISHING A ROSTER OF PRE-QUALIFIED SMALL BUSINESS TECHNICAL CONSULTANTS AS A COST-EFFECTIVE MEANS TO ASSIST IN DEVELOPING SUB-PROJECTS.

--C. ONCE TAC MODELS HAVE BEEN IDENTIFIED FOR SUPPORT UNDER PROJECT, MISSION SHOULD TRANSMIT DETAILS AND RATIONALE TO BUREAU FOR REVIEW AND COMMENT BEFORE FINALIZING AND APPROVING PROJECT.

4. ELIGIBILITY CRITERIA:

--A. WITH RESPECT TO SUB-BORROWER ELIGIBILITY CRITERIA, PROJECT PAPER SHOULD LAY OUT BROAD FRAMEWORK THAT WOULD ALLOW AN ARRAY OF SMALL BUSINESSES (MANUFACTURING AND SERVICE INDUSTRIES IN AGRICULTURE, INDUSTRY, TOURISM, TRANSPORT, REPAIR, ETC.) TO BE ELIGIBLE FOR PARTICIPATION IN THE PROJECT.

--B. FOR NEW ENTERPRISES, FIDE AND FINANCIERAS SHOULD FINANCE NO MORE THAN 80-85 PERCENT OF THE CREDIT REQUIREMENTS OF A GIVEN SMALL BUSINESS SUB-PROJECT, WITH BALANCE FINANCED BY SUB-BORROWER. FOR SUB-PROJECTS INVOLVING THE UPGRADING OR EXPANSION OF AN EXISTING ENTERPRISE, THIS RESTRICTION NEED NOT NECESSARILY APPLY.

--C. CARE SHOULD BE TAKEN THAT THE TECHNICAL ASSISTANCE REQUIRED TO QUALIFY FOR SUB-LOANS UNDER THIS PROJECT IS IN EACH CASE APPROPRIATE TO THE INDIVIDUAL FIRM. SUB-BORROWERS SHOULD NOT BE EXCLUDED FROM LOANS OR REQUIRED TO ACCEPT UN-NEEDED TECHNICAL ASSISTANCE IF THEY CAN OTHERWISE QUALIFY FOR LOANS WITH NO OR RELATIVELY MINOR TECHNICAL ASSISTANCE.

--D. MISSION SHOULD DETERMINE UNDER WHAT CIRCUMSTANCES, IF ANY, A SUB-BORROWER WOULD BE ELIGIBLE FOR FOLLOW-ON CREDIT ASSISTANCE ONCE INITIAL SUB-LOAN IS FULLY AMORTIZED.

--E. PP SHOULD INCLUDE A LIST OF THOSE TYPES OF PROJECTS THAT WILL BE EXCLUDED FROM CONSIDERATION UNDER THE PROJECT DUE TO THEIR DETRIMENTAL ENVIRONMENTAL EFFECTS OR INELIGIBILITY UNDER A.I.D. REGULATIONS (E.G., GAMBLING). IEE WILL BE AMENDED BY BUREAU'S ENVIRONMENTAL OFFICER AND TRANSMITTED SOONEST TO MISSION FOR INCLUSIONS IN PP.

5. APPROPRIATION CATEGORY: WHILE WE ANTICIPATE THAT MAJORITY OF A.I.D. FUNDS WOULD BE FROM FN ACCOUNT, MISSION WILL HAVE TO DETERMINE THE FN AND SDA SPLIT AND

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SO INDICATE IN THE PP AND CONGRESSIONAL NOTIFICATION (CN). PRESENTLY DOLS 2.5 MILLION FROM FN ACCOUNT AVAILABLE FOR PROJECT THIS FY. BUREAU IS ALSO REQUESTING AN ADDITIONAL DOLS 2.5 MILLION FROM SDA ACCOUNT FOR PROJECT, BUT AVAILABILITY OF THESE FUNDS THIS FY IS UNCERTAIN. MOREOVER, GRANT FUNDS PROPOSED FOR OBLIGATION IN FY 82 (DOLS 250,000) NOT CURRENTLY AVAILABLE. BUREAU WILL NOTIFY MISSION IF SUCH FUNDS BECOME AVAILABLE LATER IN FY. IN ANY EVENT, PLEASE TRANSMIT DRAFT ACTIVITY DATA SHEET FOR CN AS SOON AS POSSIBLE BUT NOT LATER THAN END OF AUGUST.

6. MISSION AUTHORIZATION: SUBJECT TO A.I.D. WASHINGTON CONCURRENCE WITH TAC MODELS TO BE PROPOSED FOR PROJECT SUPPORT, PER PARA 3 (C) ABOVE, AND SATISFACTORY RESOLUTION OF POLICY CONSTRAINT QUESTION OF PARA 1(A) AND SUB-LOAN INTEREST RATE QUESTION OF PARA 2(A),

MISSION DIRECTOR IS HEREBY REDELEGATED AUTHORITY TO AUTHORIZE THE SUBJECT PROJECT AT THE LEVEL OF DOLS 5,000,000 IN LOAN FUNDS AND DOLS 850,000 IN GRANT FUNDS UNDER FUNDING ACCOUNTS TO BE CONFIRMED WITH A.I.D. WASHINGTON.

7. FYI: ALL LAC MISSION PID APPROVALS ARE SUBJECT TO REVALIDATION IF POST-PID PROJECT DEVELOPMENT EXTENDS BEYOND ONE YEAR. END FYI. SHULTZ
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Department of State
INCOMING TELEGRAM
American Embassy: Santo Domingo

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E.O. 12356: N/A
TAGS:
SUBJECT: SMALL INDUSTRY DEVELOPMENT PROPOSAL

REFERENCES: (A) SANTO DOMINGO 6065; (B) SANTO DOMINGO 5699; (C) STATE 245489

1. AID/W APPRECIATES ADDITIONAL INFO PROVIDED REF (A).

2. LAC BUREAU AND PPC REVIEW INDICATES THAT PROPOSED PROJECT DESIGN FEATURES DESCRIBED IN PARAGRAPH 10 OF REF (A) APPEAR TO ADDRESS REMAINING AID/W CONCERNS. SPECIFICALLY, WE NOW UNDERSTAND THAT PARTICIPATING FINANCIAL INSTITUTIONS (PFIS) WILL BE ABLE TO "USE THE PROPOSED NEW SUBLENDING RATES WITH THEIR OWN OR OTHER RESOURCES FOR SUBLENDING TO SMALL BUSINESSES." AID/W UNDERSTANDS THAT PROPOSAL IS INTENDED TO PROVIDE A PACKAGE OF INCENTIVES TO ENCOURAGE PFIS TO LEND TO SMALL BUSINESSES; AND PACKAGE AS DESCRIBED IN REF (B) APPEARS THOROUGHLY ADEQUATE FOR THIS PURPOSE. NONETHELESS, OUR CONTINUING CONCERN HAS BEEN THAT THIS PROPOSAL, INSOME POSITIVE FASHION, IMPACT AS SOON AS POSSIBLE UPON THE PFI-SMALL BUSINESS RELATIONSHIP OUTSIDE OF THE FIDE SPONSORED PROGRAM(S), THEREBY ALLOWING OR PROVIDING FOR PFI-SMALL BUSINESS LOAN RELATIONSHIPS BASED ON REGULAR, OR NON-FIDE, SOURCES OF FUNDS. GODR WILLINGNESS TO APPLY THE PROPOSED RATES TO ALL FORMAL FINANCIAL SYSTEM SUBLENDING TO SMALL BUSINESSES IS RESPONSIVE TO THIS CONCERN.

3. IN ACCORDANCE WITH PARA 10 OF REF (A), AID/W REQUESTS THAT PROJECT PAPER (PP) AND PROJECT AGREEMENT STATE THAT THE NEW SUBLENDING FRAMEWORK OF INTEREST RATES, FEES AND COMMISSIONS WILL BE APPLICABLE TO ALL SMALL BUSINESS LENDING AT THE TIME OF INITIATION OF THE AID PROJECT, OR AS SOON AS POSSIBLE THEREAFTER. WE FURTHER REQUEST THAT PP DISCUSS BASIS FOR MISSION'S EXPECTATION, AS STATED IN PARA 10 OF REF (A), THAT QUOTE PFIS WILL BE VERY ANXIOUS TO BEGIN NON-PROJECT SUBLENDING IN THIS SECTOR UNQUOTE.

ACTION:	AID10
INFO:	
AMB	X
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RSO	
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SINCE THIS OBJECTIVE IS A PRINCIPAL AID/W CONCERN.

4. GIVEN ABOVE, AID/W CONCURS WITH MISSION'S COMPLETING INTENSIVE REVIEW EFFORTS LEADING TO PROJECT AUTHORIZATION BY USAID THIS FY.

5. BUREAU WILL NOTIFY MISSION BY SEPTEL REGARDING CN EXPIRY DATE AND FUNDING AVAILABILITIES THIS FY. SHULTZ
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Annex B

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: From FY '82 to FY 87
Total U.S. Funding $5000 Loan; $850 Grant
Date Prepared: 6/8/82

Project Title & Number: Small Industry Development 517-0150

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: (A-1) To increase the per capita income and employment in the Dominican Republic, by improving the performance of the private sector.	Measures of Goal Achievement: (A-2) Rising employment and per capita income of the Dominican Republic. An increase in overall production in the Dominican Republic	(A-3) National Income Accounts and Increase and Expenditure Survey Employment Surveys	Assumptions for achieving goal targets: (A-4) No devastating natural disasters. That the world economy will remain sufficiently stable as not to erase the improved performance of the private sector. That T.A., Credit, training, and commodities provided, will be adequate and appropriate for private sector needs.
Project Purpose: (B-1) To establish an institutional mechanism, capable of providing a continuous source of credit, TA, and training to small entrepreneurs in the Dominican Republic	Conditions that will indicate purpose has been achieved: End-of-Project status. (B-2) EOPS $7 million Revolving Credit Fund TACs providing needed TA. 1000 small industries with increased income, production, and inputs. 1000 small industries receiving TA and credit each year	(B-3) Audits of Loan Records of PFI's and FIDE Evaluation reports on TAC performance Evaluation of performance of small entrepreneurs including field visits and interviews.	Assumptions for achieving purpose: (B-4) That there is and will continue to be adequate demand in the small industry sector for T.A. and Credit. That the TA provided will improve the performance of the small entrepreneurs, and they in turn will pay back these loans.
Project Outputs: (C-1) 1. Loans to Small Entrepreneurs 2. Existing TACs strengthened and providing TA to small industries. 3. New TAC's trained, staffed, and providing TA to small entrepreneurs.	Magnitude of Outputs: (C-2) 1000 loans to small industries ($7 million total) 1000 small industries receiving TA and improving performance Annual evaluations during project and one comprehensive evaluation	(C-3) Loan records of PFI's and FIDE Records of TAC's for services provided and improved performance of clients Field checks and financial analysis of small industries for services and commodities received. Evaluation reports.	Assumptions for achieving outputs: (C-4) - Small industries will be willing to pay loans so that fund will revolve. That there is sufficient demand for training, TA, and credit, and that these inputs will result in improved performance of beneficiaries.
Project Inputs: (D-1) 1. Credit 2. Technical Assistance 3. Operating Expenses 4. Evaluation 5. Contingency	Implementation Target (Type and Quantity) (D-2) Loan / Grant / CP 5000 / - / 2000 - / 320 / - - / 430 / - - / 50 / - - / 50 / - 5000 / 850 / 2000	(D-3) 1. Bank Records 2. Arrival of T.A. 3. Records of TAC's	Assumptions for providing inputs: (D-4) 1. Counterpart funding is made available 2. Appropriate TA can be located and will be available on time according to project demands 3. Budgeted salaries are sufficient to attract qualified staff

5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable generally to projects with FAA funds and project criteria applicable to individual fund sources: Development Assistance (with a subcategory for criteria applicable only to loans); and Economic Support Fund.

IS COUNTRY CHECKLIST UP TO DATE? Yes.
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT? Yes.

A. GENERAL CRITERIA FOR PROJECT

1. Continuing Resolution Unnumbered; FAA Sec. 634(a); Sec. 653(b).

   (a) Describe how authorizing and appropriations Committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

   (a) The project was included in the FY 82 Congressional Presentation as an FY 82 project. A Congressional Notification is required.

   (b) An Advice of Program Change will be submitted for the change in funding.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,000, will there be (a) engineering, financial, other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   (a) Not Applicable.

   (b) Yes.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action needed.

4. FAA Sec. 611 (b); Continuing Resolution Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources dated October 25, 1973?	Not Applicable.
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?	Yes. See Mission Director's certification in the Project Paper.
6. FAA Sec. 209. Is project susceptible of execution as part of regional or multilateral project? If so why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	The Project cannot be executed as part of a regional project.
7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	Project will provide credit, technical assistance and training to approximately 1,000 small firms.

8. FAA Sec. 601 (b). Information and conclusion on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

It is anticipated that the technical assistance and equipment for the project will be procured from U.S. private sector sources.

9. FAA Sec. 612(b); Sec. 636(h); Continuing Resolution Sec. 508. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The loan agreement will require that counterpart contribution will be used.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

There is no excess, U.S. owned local currency available for this program.

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes.

12. Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar, or competing commodity?

This project will not directly produce any commodity for export which is produced in the U.S.

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B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b); Sec. 111; 113; 281 (a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

(d) Women's participation is promoted through equal access to sub loans by small businesses owned and operated by women.

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is Assistance being made available? (Include only applicable paragraph which corresponds to source of funds used. If more than one fund source is used for project, include relevant paragraph for each fund source.)

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; 103A if for agricultural research, full account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with programs carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value, improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration of programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic

(a) The project will directly stimulate labor intensive production and investment in rural areas through its sub lending program for rural and agricultural industries. The development of rural small businesses will increase income to both business owners and their employees.

production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under sec. 104 (b) or health under sec. 104 (c); if so, (i) extento to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems and other modes of community research.

Not Applicable.

(4) [105] for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development; and (ii) extent to which assistance provides advanced education and training of people in developing countries in such disciplines as are required for planning and implementation of public and private development activities.

Not Applicable.

(5) [106; ISDCA of 1980, Sec. 304] for energy, private voluntary organizations, and selected development activities; if so, extento to which activity is: (i) (a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; (b) facilitative of geological and geophysical survey work to locate potential oil, natural gas, and coal reserves and to encourage exploration

for potential oil, natural gas, and coal reserves; and (c) a cooperative program in energy production and conservation through research and development and use of small scale, decentralized, renewable energy sources for rural areas;

(ii) technical cooperation and development, especially with U.S. private and voluntary or regional and international development, organizations;

(iii) research into, and evaluation of, economic development process and techniques;

(iv) reconstruction after natural or manmade disaster;

(v) for special development problems, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;

(vi) for programs of urban development, especially small labor intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.

By extending credit, technical assistance and training to small firms, the project will involve the poor in development and will increase income to both business owners and their employees.

c. [107] Is appropriate effort placed on use of appropriate technology?

Not Applicable.

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or has the latter cost-sharing requirement been waived for "relatively least-developed" country)?

Yes.

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least-developed?"

Yes.

f. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The project directly recognizes and utilizes the needs, desires and capabilities of the population and of the implementing agencies.

g. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes. The project should contribute directly to the development of economic resources and to increasing the productive capacity of the Dominican Republic.

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

The Dominican Government and the Central Bank are not in default on any AID loans and appear capable to repay the proposed loan.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

Not applicable.

3. Project Criteria Solely for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of section 102?

Not applicable.

b. FAA Sec. 531 (c). Will assistance under this chapter be used for military, or paramilitary activities?

No.

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UNITED STA[illegible]S INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

82
LAC/DR-IEE-26

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	Dominican Republic
Project Title and Number	:	Small Industry Development 517-0150
Funding	:	$5,000,000 Loan; $850,000 Grant
Life of Project	:	5 years, FY-82 - FY-86
IEE Prepared by	:	Charles Blankstein, Director Capital Resources Development
Recommended Threshold Decision	:	Negative Determination
Bureau Threshold Decision	:	Concurrence with recommendation
Action	:	Copy to Philip Schwab, Director USAID/Santo Domingo
	:	Copy to Charles Blankstein USAID/Santo Domingo
	:	Copy to Barry Burnett, LAC/DR
	:	Copy to IEE file

James S. Hester Date 6/29/82

James S. Hester
Chief, Environmental Officer
Bureau for Latin America
and the Caribbean

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INITIAL ENVIRONMENTAL EXAMINATION

PROJECT LOCATION:	Dominican Republic
PROJECT TITLE:	Small Industry Development
FUNDING:	$5 Million Loan - $850 - Grant
LIFE OF PROJECT:	Five years, FY-1982/FY-1986
IEE PREPARED BY:	Charles Blankstein, Director, Capital Resources Development

Charles Blankstein — Signature
June 9, 1982 — Date

ENVIRONMENTAL ACTION RECOMMENDED: Negative Determination

CONCURRENCE: Ronald F. Venezia, Acting Director USAID/DR

Ronald F. Venezia — Signature
June 9, 1982 — Date

I. Examination of Nature, Scope and Magnitude of Environmental Impacts

Under the rules proposed in Handbook 3, for environmental procedures in Appendix 2D, Section 216.2 subparagraph (c) (2) (x), Initial Environmental Examinations are generally not required for projects that are designed as support for intermediate credit institutions except in those projects where A.I.D. has control over subproject approval or knowledge of subprojects. The proposed project is designed to establish an institutional mechanism capable of providing a continuous source of credit, technical assistance and training to small entrpreneurs in the Dominican Republic.

The project will provide a loan of $5 million to FIDE to be used for credit to small entrepreneurs through participating private institutions such as commercial banks and financieras. Technical assistance and training to the same small entrepreneurs will be provided in such areas as business administration and management practices through existing or newly established technical assistance centers. A grant of $850,000 will be provided for these activities. The project proposes to work with existing businesses in the possible areas of manufacturing, food processing and services-related industries. Those classes of loans to businesses that would have a significant adverse effect on the environment will be specifically excluded from funding under the terms of the loan and grant. These include loans for the manufacture, importation, distribution or application of pesticides, loans for mining coral reefs, and loans which would contribute to the exploitation of endangered species. No activity of the proposed project could be classified as an action normally having a significant effect on the environment as cited in subparagraph (d) of the same section.

Based on the above, this IEE finds that the project will not have a direct significant environmental impact.

II. Recommendations for Environmental Action

The proposed project will foster no change with adverse implications for the human or natural environment of the Dominican Republic. It is recommended that the Chief Environmental Officer for Latin America and the Caribbean approve a Negative Determination for this project.

ANNNEX B.

IMPACT IDENTIFICATION AND EVALUATION FORM

Impact Areas and Sub-Areas	Impact Identification and Evaluation 1/
A. LAND USE	
1. Changing the character of the land through:	
a. Increasing the population	N
b. Extracting natural resources	N
c. Land clearing	N
d. Changing soil character	N
2. Altering natural defenses	N
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
5. Other factors	
B. WATER QUALITY	
1. Physical state of water	N
2. Chemical and biological states	N
3. Ecological balance	N
4. Other factors	

1/ N - No environmental impact.
L - Little environmental impact.
M - Moderate environmental impact.
H - High environmental impact.
U - Unknown environmental impact.

C. ATMOSPHERIC

1. Air additives.................................... N
2. Air pollution.................................... N
3. Noise pollution.................................. N
4. Other factors

D. NATURAL RESOURCES

1. Diversion, altered use of water.................... N
2. Irreversible, inefficient commitments.............. N
3. Other factors

E. CULTURAL

1. Altering physical symbols.......................... N
2. Dilution of cultural traditions.................... N
3. Other factors

F. SOCIO-ECONOMIC

1. Changes in economic/employment patterns............. L
2. Changes in population................................ N
3. Changes in cultural patterns......................... N
4. Other factors

G. HEALTH

1. Changing a natural environment........................ N
2. Eliminating an ecosystem element........................ N
3. Other factors

______________________________ ________
______________________________ ________

H. GENERAL

1. International impacts............................... N
2. Controversial impacts................................ N
3. Larger program impacts................................ N
4. Other factors

______________________________ ________
______________________________ ________

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CERTIFICATION PURSUANT TO

Section 611 (e) of the

FOREIGN ASSISTANCE ACT

As Amended

I, Philip R. Schwab, the principal officer of the Agency for International Development in the Dominican Republic, do herewith certify that in my judgment, the Dominican Republic has both the financial capability and human resources to maintain and utilize effectively goods and services procured under the capital assistance project entitled Small Industry Development.

This judgment is based upon the record of implementation of AID-financed projects in the Dominican Republic and the results of the consultations undertaken during intensive review of this new project.

Philip R. Schwab
Director, USAID Dominican Republic

Date September 30, 1982

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ANNEX F

REPUBLICA DOMINICANA

RECEIVED
SEP 22 8 08 AM '82

Secretariado Técnico de la Presidencia

SANTO DOMINGO, D. N.

AID C&R

0514

20 SET. 1982

Al : Señor
Philip Schwab
Director de la Agencia Internacional
para el Desarrollo, AID

Como es de su conocimiento el Gobierno Constitucional que preside el Ciudadano Presidente Dr. Salvador Jorge Blanco, tiene la firme decisión de incrementar el desarrollo de la pequeña empresa a través de nuevas fuentes y financiamiento y asistencia técnica a dicho sector.

En tal sentido, y con el objeto de dinamizar estas actividades de la pequeña empresa, representantes, del Gobierno Dominicano el Banco Central y la Agencia Interamericana para el Desarrollo (AID) diseñaron de manera conjunta un proyecto por un monto de RD$7,850,000.00 (Siete millones ochocientos cincuenta mil), a fin de proporcionar recursos financieros y asistencia técnica a pequeños empresarios. Dichos recursos serían canalizados a través del Banco Central y las intermediarias financieras autorizadas para tales fines.

Por tal motivo, deseo presentar a nombre del Gobierno Dominicano una solicitud de préstamo por un valor de US$5.0 millones bajo las condiciones concesionales que ofrece el AID para operaciones de este tipo así como una cooperación técnica no reembolsable por un monto de US$850,000.00 la cual sería destinada a establecer mecanismos institucionales de asistencia técnica a los pequeños empresarios.

Deseo llevar a su conocimiento que el Gobierno Dominicano realizaría un aporte de RD$2.0 millones como contrapartida del referido proyecto de forma tal de permitir la completa ejecución del mismo.

Con sentimiento de consideración y estima,

Ing. Ramón Alburquerque
Secretario Técnico

ACTION: UDD
DATE DUE: 9/30/82

DIR	✓
AD	✓
PRG	
CRD	
CONT	
ACR	
MGT	
HPN	
C+R	

RA
MA/AR
cs

Legal Constraints to Small Business Participation

Law 299, the Industrial Protection and Incentives Law, passed in 1968, was intended to promote import substitution through the use of incentives and tax exemptions. However, the impact of this protection was diminished considerably when Law 79 of 1970 permitted up to 50% exoneration of profit taxes for importers providing that the amount exonerated is invested in certain domestic activities. Also, the process of qualification of benefits under these laws has proven to be too complicated and costly for many small businesses.

Law 221, Incentives for Small Industries, passed in 1971, was intended to stimulate small industries, workshops and artesany. Those who qualified could benefit from a reduced tariff in the following areas: a 5% tariff on import machinery, equipment, hardware; and a 10% tariff on imported raw materials. The greatest drawback of this law was that small industry was not defined. Those enforcing the law had no means to determine which industries qualified and which did not. Also, the small entrepreneur could not take advantage of import tax exemptions for lack of capital with which to finance the imports.

Law 69, the Promotion of Non-traditional Exports, passed in 1979, would grant additional tax exemptions and use of parallel market foreign exchange by the exporters of non-traditional agro-industries. Again, small industry lacked the capital with which to avail themselves of the benefits under this law.

ANNEX G-1

Use of Governmental Incentives and Exonerations, by enterprise size category *

Enterprise Size Category	Law 299	Law 221	Law 69
Small	31.9	7.8	3.4
Medium	66.7	5.9	15.7
Large	74.4	1.2	26.7

Source: INTEC surveys, 1982

*Definitions:

- Small : Assets between RD$10,000 and RD$250,000
- Medium: Assets between RD$250,000 and RD$1 million
- Large : Assets over RD$1 million

AID Experience in Small Business Sector 1966-1970

Banco Popular - Fondo para Artesanía y Pequeña Empresa

In 1966, AID established a fund of $100,000 for small business. Loans varied between $500 and $3,000. The maximum loan amount was $3,000 for a period of 36 months, and the maximum investment in the company was $10,000. Loans were made to 53 small businesses generating 208 jobs at an average cost per job of $490.

Under the terms of sub-borrower lending the only security required was a character reference of the beneficiaries, and for this reason, the Banco Popular did not investigate the payment records of the borrowers before making the loans. As a result many loans were not repaid.

Banco de Reservas

In 1969, AID established a loan fund of $300,000 to provide supervised credit, technical assistance and general management assistance to small businesses, which did not have any other access to credit. The maximum loan amount was $7,500, with a term of 72 months, and the maximum capital investment in the business was $35,000. This time, both a cosigner and a pledge were necessary. This program approved 76 loans and created jobs for 263 persons, at a cost of $1,225 per job. In 1970, the program was suspended by the bank because of a low recuperation rate.

Comité de Ciudadanos

This organization was formed in 1967 as an agency for community development. In 1970, it organized groups in the barrios of Santo Domingo, which tried to create small business production units and provided small loans for machinery, equipment and capital. AID made $35,000 available which was matched by $115,000 from the Office of Community Development (ODC) and the Corporación de Fomento Industrial (CFI).

The groups did not receive any technical assistance, and the majority of cases had no business experience or expertise. The program did not have adequate staff for follow-up. Eventually, the Comité was dissolved.

Lessons Learned from this Experience

i) The need to establish clear criteria regarding loan amounts, and types of eligible business;

ii) The need for a clear policy of loan recuperation. If there is a sense that the loans do not have to be repaid, they will not be repaid, and the beneficiaries will not learn the use of credit;

iii) The need to establish a guarantee. Rather than a specific mortgage, it could be backed by "group pressure" such as a Cooperative or a Solidario.

iv) The program should be limited to entrepreneurs with experience in their field;

v) Credit without technical assistance can be counterproductive.

vi) The loan/job creation ratio diminishes with the size of enterprise.

Development of Employment Policies

More recently, USAID has approached the small business sector from the perspective of the employment problem. In June 1978, USAID authorized the Employment Policy Project. The project was designed to provide technical assistance to the Dominican Republic's Office of Planning and Office of Statistics (ONAPLAN/ONE) to develop its capacity to collect and analyze data and to formulate policies. Although the project started as a survey and statistics-gathering program, in its last phase, (1980-1981) it was given more of an action orientation by the GODR to develop policies and strategies to combat unemployment and to relate labor supply to demand. The project has completed household sample surveys looking at employment questions in Santo Domingo and Santiago, secondary cities and rural areas. Final analysis in now being completed. The project has helped to gain acceptance at the highest level of government of the need for developing and implementing an employment policy in the Dominican Republic. The GODR Employment Policy Guidelines, is a direct outcome of this project.

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Technical Assistance Statement of Work

The general objective of the contractor services to be provided is to assist the Fondo de Inversiones para el Desarrollo Económico (FIDE) within the Central Bank in developing two coordinated institutional subsystems to service the business development needs of small entrpreneurs, including a credit channel and a self sustaining technical assistance network. To achieve this objective, the contractor will provide assistance to project Technical Assistance Centers (TAC's), Participating Financial Institutions (PFI's) and FIDE in the area of small business promotion and development

A. Scope of Work

The contractor will be responsible for providing technical assistance to: TAC's and PFI's participating in the project to upgrade technical and managerial functions; and to FIDE to develop and manage the overall technical assistance and sublending project subsystems. The contractor will work with FIDE, the PFI's and the TAC's and will develop criteria and procedures for the development and approval of individual small business development plans. (The development plans will include provision for needed credit and technical assistance).

The technical assistance team will utilize a multidisciplinary approach in providing the services required to TAC's and PFI's through FIDE, i.e. each advisor will coordinate his/her responsibilities as necessary to assure the success of the project effort. Assistance will include provision for both on and off shore training programs for TAC, PFI and FIDE officers. Specifically, the technical advisory team will be responsible for providing the following assistance to FIDE:

1. Prior to January 1983, assist FIDE in developing the detailed operating procedures for the project technical assistance operation. These should include procedures for the approval and control of the technical assistance and other inputs provided to the TAC's, PFI's and procedures to assure that the technical assistance received by the small businesses is adequate. Also included should be detailed procedures and criteria for the approval of small business development plans.

2. During first year, carry out an assessment of the skill needs of FIDE, participating financial institutions (PFI's) and participating TAC's. Based on this assessment, develop and implement a training program for FIDE, the PFI's and TAC personnel. (The training program could include both in-country and off-shore training activities).

3. During first year of project:

   (a) Review FIDE's sublending and technical assistance policies, procedures, and eligibility criteria and make recommendations.

(b) Assist FIDE in development of manuals' setting forth the detailed sublending and technical assistance policies, procedures and eligibility criteria to be followed under the Small Industry program.

4. Design, coordinate and manage in-service training seminars for specialized staff of PFI's and TAC's in the following areas: accounting, distribution, marketing, plant maintenance, production control, financial management, public relations, and recruiting and training of advisors. (These courses may include participation of INFOTEP, IESC, INDOTEC, UCMM, etc. and on an off shore short term TA specialist).

5. Assist TAC's in developing effective operating procedures, in developing more cost effective methodologies, and in developing systems for accessing local small business entrepreneural talents.

6. Assess institutional capabilities of TAC's proposed to participate during second year of project and make recommendations.

7. Review detailed operating procedures of all participating TAC's and make recommendations.

8. Design an evaluation system: to test effectiveness of sublending and technical assistance subsystems; to assess TAC progress towards achievement of financial self sufficiency; and to test periodically the progress of project in meeting targeted outputs, and achieving desired project purpose and goal.

B. Budget

- Small Industry Specialist	12 pm	$100,000
- Short-term TA	3 pm	30,000
- In country-courses (2 courses per year for 3 years)		60,000
	Total	$190,000

Total TA Budget

- Total from above		$190,000
- 3 Training visits (e.g. México, Colombia)		30,000
- TA from other in-country sources (e.g. INFOTEP)		100,000
	Total	$320,000

FIDE/AID Revolving Fund Projection

The FIDE/AID revolving loan fund mechanism is based upon certain assumptions which can be described in the following way:

1. All sub-loans are estimated to have an average duration of three years (1-3 years for working capital; 3-5 years for production and investment credit.)

2. The FIDE/AID Small Industry Credit Fund of RD$7 million will be fully disbursed during the first three years of the project ($1.168 million year one; $2.56 million year two; and $3.272 million year three.)

3. FIDE's estimated income from interest on loan funds is based upon an average return of 7% (8% for loans in Santo Domingo and 6% on loans outside the capital.) See sublending spread analysis.

4. The sub-borrower will make an annual payment to FIDE of 2% on the outstanding loan balance for the purpose of ensuring the PFI against 75% of the value of the loan in case of default, thus bringing the total inflow to FIDE to 9%. See Guarantee Loan Fund Analysis, Annex H-2.

The following FIDE/AID revolving loan fund projection shows that interest income accruing to FIDE from PFI small industry loans is sufficient to cover FIDE's costs and guarantee fund contributions, and at the same time generate substantial cash surpluses used to strengthen the loan capital of the revolving fund. The schedule indicates that by project completion at year end 1987, FIDE will have added to the revolving fund more than RD$450,000, thereby allowing the TACs to develop more small industry loans and achieve greater financial independence as they approach a self-sustaining level.

FIDE/AID REVOLVING LOAN FUND ANALYSIS

	1982-83	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	199[illegible]
Loan Fund Disbursements ($7 million Fund)	Beginning of the Year 1,168,000	2,560,000	3,272,000									
Average Yearly* Fund Balance	1,007,844	3,201,444	5,934,378	6,864,711	7,000,000	7,000,000	7,000,000	7,000,000	7,000,000	7,000,000	7,000,000	7,000,0[illegible]
Accumulated Surplus for Relending	-	19,956	83,741	202,899	342,838	488,226	861,588	1,253,567	1,665,090	2,097,132	2,550,707	3,02[illegible]
Total Capital Flow	1,007,844	3,221,400	6,018,119	7,067,610	7,342,838	7,488,226	7,861,588	8,253,567	8,665,090	9,097.132	9,550,707	10,026,9[illegible]
FIDE 9% Interest	90,706	289,926	541,631	636,085	660,855	673,940	707,543	742,821	779,858	818,742	859,564	902,4[illegible]
Guarantee Fund Allocation												
3% FIDE Allocation	30,296	96,835	180,905	212,452	220,726	-						
2% Sub-Borrower	20,227	64,653	120,784	141,847	143,371	150,289	157,782	165,649	173,908	182,579	191,683	201,24[illegible]
FIDE Costs												
2% Admin. Exp.	20,227	64,653	120,784	141,847	147,371	150,289	157,782	165,649	173,908	182,579	191,683	201,24[illegible]
Fund Surplus	19,956	63,785	119,158	139,939	145,388	373,362	391,979	411,523	432,042	453,584	476,198	499,94[illegible]
Accumulated Surplus	19,956	83,741	202,899	342,838	488,226	861,588	1,253,567	1,665,090	2,097,132	2,550,716	3,026,914	3,526,85[illegible]

* This line item is calculated based upon an average yearly fund balance which assumes an average monthly payment over three years with approximately 1/3 of the loan recuperated after one year. This figures also include a short lag time required for the TAC's to prepare loan projects for approval by the PFI's and FIDE throughout the life of the project.

Analysis of FIDE Guarantee Fund Mechanism

Upon initiation of the Small Industry Project, FIDE will have a balance of approximately RD$9.5 million in its Guarantee Reserve Fund for the purpose of ensuring PFI small industry loans against default of up to 75% of the loan value. Over the life of the project, FIDE will make a 3% contribution on all project loans, thereby increasing the Guarantee Fund liquidity by some RD$740,000. In addition to the FIDE contribution, the sub-borrower will pay 2% on the declining balance of small industry loans in order to strengthen the capital of the guarantee fund and broaden its usage. The 2% Guarantee Fund fee paid for by the sub-borrower will over the life of the project generate an additional RD$495,000, thus bringing the total Guarantee Fund up to RD$10.7 million by the end of 1987.

Under the assumption that all project loans made by PFIs will make full use of the Guarantee Fund, an estimated RD$5.55 million (75% of RD$7.4 million loan funds) will be maintained as a safeguard in the unlikely event that substantial loan defaults will require utilization of the funds held in reserve. Thus, FIDE will have a Guarantee Fund surplus of RD$5.18 million that will most likely be used to guarantee loans for projects, other than small industries, or be invested in short-term, highly liquid assets.

Guarantee Fund Analysis (As of July 31, 1982)

Guarantee Fund Total	$12,421,987
Less: Total Loans Guaranteed	(2,758,439)
Funds Utilized	(152,117)
Fund Balance	RD$9,511,431

Fund Balance	9,500,000
FIDE Contribution 3% (over 5 yr. life of project)	741,214
Sub-borrower Contributions 2% (over 5 yr. life of project)	494,882
Estimated Value of Fund after 5 yrs.	$10,736,096
Estimated Fund Balance if fully employed under Small Industry Project ($7.4 million x 75% = 5.25 million)	5,550,000
Projected Guarantee Fund Surplus	$5,186,096

TAC Cash Flow Projections

1. Dominican Development Foundation (DDF): In view of the institutional capacity of the DDF to develop and assist small entrepreneurs for their participation in the project, it is estimated that the Foundation will be able to generate sufficient income from fees and commissions to reduce its cash shortfall to 5,611 by year 4. Although a slightly increased deficit is projected for years 5 and 6, it is most likely that if successful the DDF would consider increasing the initial technical assistance fee which, based upon the projected number of new loans, would allow the DDF to cover all of its costs by the end of the project. In addition, the DDF has proven itself to be an effective promoter of small industry and consequently would be able to tap other resources in order to overcome short-term cash flow restrictions.

TAC DDF
PROJECTED CASH FLOW

PORTFOLIO	1	2	3	4	5	6
			- YEARS -			
# OF LOANS MADE DURING YEAR	110	110	110	160	160	160
AVERAGE SIZE OF LOAN	3000	5000	7500	7500	7500	8000
$ VALUE OF PORTFOLIO - BEG. OF YEAR	0	229680	502920	774400	1135500	1272000
$ VALUE - NEW LOANS	330000	550000	825000	1200000	1200000	1280000
$ VALUE - RECUPERATIONS	-100320	-276760	-553520	-838900	-1063500	-1224320
$ VALUE OF PORTFOLIO - END OF YEAR	229680	502920	774400	1135500	1272000	1327680
AVERAGE O/S LOAN BALANCE PER YEAR	279840	641300	1051160	1554950	1803750	1939840
INCOME						
LOAN PACKAGING FEE - 3% ALL LOANS	9900	16500	24750	36000	36000	38400
TA CHARGE - 2% (BASED ON 75% OF O/S LOAN BALANCE)	4198	9620	15767	23324	27056	29098
OTHER INCOME - COURSES	2400	2640	2904	3194	3514	3865
TOTAL OPERATING INCOME	16498	28760	43421	62519	66570	71363
EXPENSES						
SALARIES - DIRECTOR	12000	12960	13997	15117	16326	17632
- CHIEF OF DIVISION	8400	9072	9979	10977	12075	13282
- PROMOTER (4)	16800	18144	19596	21163	22856	24685
- SECRETARY	3660	3953	4348	4783	5261	5787
- X'MAS BONUS	3405	3677	4045	4450	4895	5384
- OTHER BENEFITS (15% SAL)	6128	6618	7148	7720	8337	9004
VEHICLE OPER & MTN	1200	1296	1426	1568	1725	1897
OFFICE SUPPLIES & MATERIALS	1800	1944	2138	2352	2587	2846
TOTAL OPERATING EXPENSES	53393	57664	62676	68129	74062	80518
OPERATING PROFIT/LOSS (-)	-36895	-28905	-19255	-5611	-7492	-9155
* 100% OF OPERATING DEFICIT	36895	28905	19255	5611	7492	9155
* MOTORCYCLES & OFFICE EQUIPMENT	7000	0	0	0	0	0
* TOTAL USAID FUNDING REQUIREMENT	43895	28905	19255	5611	7492	9155

Inflation factor of 8% used on Operating Expenses

2. PROAPE: On the basis of generating approximately 100 new small industry loans in year 3 of the project and with a slightly higher average loan size PROAPE is able to show a cash surplus at the end of year 3. With expanded loan portfolio in years 4 through 6 PROAPE will have a positive cash flow position throughout the remainder of the project. Even in the case of PROAPE adding another promoter to fortify its small industry development program, the TAC will still be capable of covering its costs in years 4 and 5.

TAC PROAPE
PROJECTED CASH FLOW

PORTFOLIO	1	2	3	4	5	6
			- YEARS -			
# OF LOANS MADE DURING YEAR	40	70	100	106	126	125
AVERAGE SIZE OF LOAN	8000	9000	9000	9000	9500	9500
$ VALUE OF PORTFOLIO - BEG. OF YEAR	0	222720	554960	855720	991584	1180368
$ VALUE - NEW LOANS	320000	630000	900000	954000	1197000	1187500
$ VALUE - RECUPERATIONS	-97280	-297760	-599240	-818136	-1008216	-1105660
$ VALUE OF PORTFOLIO - END OF YEAR	222720	554960	855720	991584	1180368	1262208
AVERAGE O/S LOAN BALANCE PER YEAR	271360	703840	1155340	1400652	1684476	1815038
INCOME						
LOAN PACKAGING FEE - 3% ALL LOANS	9600	18900	27000	28620	35910	35625
TA CHARGE - 2% (BASED ON 75% OF O/S LOAN BALANCE)	4070	10558	17330	21010	25267	27226
OTHER INCOME - COURSES	2400	2640	2904	3194	3514	3865
TOTAL OPERATING INCOME	16070	32098	47234	52824	64691	66716
EXPENSES						
SALARIES - DIRECTOR	12000	12960	13997	15117	16326	17632
- CHIEF OF DIVISION	8400	9072	9979	10977	12075	13282
- PROMOTER	4200	4536	4899	5291	5714	6171
- SECRETARY	3660	3953	4348	4783	5261	5787
- X'MAS BONUS	2705	2921	3214	3535	3888	4277
- OTHER BENEFITS (15% SAL)	4239	4578	4944	5340	5767	6228
VEHICLE OPER & MTN	1200	1296	1426	1568	1725	1897
OFFICE SUPPLIES & MATERIALS	1800	1944	2138	2352	2587	2846
TOTAL OPERATING EXPENSES	38204	41260	44945	48963	53344	58122
OPERATING PROFIT/LOSS (-)	-22134	-9163	2289	3862	11347	8594
* 100% OF OPERATING DEFICIT	22134	9163	0	0	0	0
* MOTORCYCLES & OFFICE EQUIPMENT	5000	0	0	0	0	0
* TOTAL USAID FUNDING REQUIREMENT	27134	9163	0	0	0	0

Inflation factor of 8% used on Operating Expenses

3. CEPESA: With CEPESA taking a more conservative approach to small industry lending in year one, it is estimated that approximately 30 loans generating RD$32,700 in revenues will cover approximately 2/3's of CEPESA's operating expenses in year one. However, CEPESA's intent of developing larger size loans of from $25-35,000 in years 4 and 5 will allow the institution the financial flexibility needed to cover its costs and establish a profit generating trend. In this respect CEPESA is operating at an advantage compared to the other TACs by focussing its program assistance on larger size, less costly, small industry loans.

TAC CEPESA
PROJECTED CASH FLOW

PORTFOLIO	1	2	3	4	5	6
			- YEARS -			
# OF LOANS MADE DURING YEAR	30	40	40	50	50	50
AVERAGE SIZE OF LOAN	12000	15000	20000	25000	35000	40000
$ VALUE OF PORTFOLIO - BEG. OF YEAR	0	250560	548640	775200	1161200	1673000
$ VALUE - NEW LOANS	360000	600000	800000	1250000	1750000	2000000
$ VALUE - RECUPERATIONS	-109440	-301920	-573440	-864000	-1238200	-1644000
$ VALUE OF PORTFOLIO - END OF YEAR	250560	548640	775200	1161200	1673000	2029000
AVERAGE O/S LOAN BALANCE PER YEAR	305280	699600	1061920	1593200	2292100	2851000
INCOME						
LOAN PACKAGING FEE - 3% ALL LOANS	10800	18000	24000	37500	52500	60000
TA CHARGE - 2% (BASED ON 75% OF O/S LOAN BALANCE)	4579	10494	15929	23898	34382	42765
OTHER INCOME - COURSES	2400	2640	2904	3194	3514	3865
- INTEREST ON ENDOWMENT	15000	15000	15000	15000	15000	15000
TOTAL OPERATING INCOME	32779	46134	57833	79592	105395	121630
EXPENSES						
SALARIES - DIRECTOR	12000	12960	13997	15117	16326	17632
- CHIEF OF DIVISION	8400	9072	9979	10977	12075	13282
- PROMOTERS (3)	12600	13608	14697	15872	17142	18514
- SECRETARY	3660	3953	4348	4783	5261	5787
- X'MAS BONUS	3055	3299	3629	3992	4392	4831
- OTHER BENEFITS (15% SAL)	5499	5939	6414	6927	7481	8080
VEHICLE OPER & MTN	1800	1944	2138	2352	2587	2846
OFFICE SUPPLIES & MATERIALS	2400	2592	2851	3136	3450	3795
TOTAL OPERATING EXPENSES	49414	53367	58054	63157	68714	74767
OPERATING PROFIT/LOSS (-)	-16635	-7233	-221	16435	36681	46863
* 100% OF OPERATING DEFICIT	16635	7233	221	0	0	0
* MOTORCYCLES & OFFICE EQUIPMENT	7000	0	0	0	0	0
* TOTAL USAID FUNDING REQUIREMENT	23635	7233	221	0	0	0

Inflation factor of 8% used on Operating Expenses

SOCIAL SOUNDNESS CASE STUDIES
CASE STUDY No. 1

DOMINICAN SHOE DIE CO.

Owner: Rafael Sánchez
Manufacturer of cutting dies for the shoe industry.
No. of employees: 6

This business has been going since 1969 but has never developed because of the lack of funds, and its inability to broaden the range of products.

Due to the lack of working capital, Mr. Sánchez cannot buy the proper material for the dies, which is a steel rule imported from the USA. Instead, he buys used car leaf springs. These are formed to shape in a homemade forge, and the cutting edge ground by hand on a grinding wheel. As a result, his manufacturing costs are excessive and his productivity per man-hour too low.

Mr. Sánchez claims he could increase his sales and also supply cutting dies to Puerto Rico if he had proper steel rule and better machinery.

Report of visit of September 8, 1981:

The questionnaire was completed and reviewed. As no financial records had been maintained, the basic accounting system was explained and set up.

Basic Problems: Present manufacturing methods are very antiquated. Manufacturing costs are too high and quality of the finished product is not satisfactory. His range of products is too limited.

Requirements:

1. A marketing study to determine where products can be sold, both in the national market and in Puerto Rico.

2. Investigate possibilities of other products to increase sales.

3. Source a US supplier for steel rule.

4. Determine machinery required, and if available in local market.

5. Determine manufacturing costs with present process.

6. Feasibility study to justify purchasing steel rule and additional machinery.

A basic accounting system was installed commencing in September and maintained month by month. The figures showed monthly sales were less than $3,000 and the net profit was so low that there was no way a loan could be repaid.

Regrettably, the conclusion was reached that a great deal of assistance would have to be given to this business in relation to the future possibilities for its growth.

COMMENTS ON CASE No. 1: THE DOMINICAN SHOE DIE Co.

This is an example of a case where the market need was seen and a product was produced to meet that market need. Lack of capital prevented Mr. Sánchez from purchasing the appropriate raw materials, so an inferior local resource (car springs) was substituted. This innovation served to get the operation off the ground, but with a relatively inferior product, the market, as well as the growth potential, was limited. This was a clear case of lack of sufficient capital for equipment and for inputs. In spite of the fact that the client was responsive to the request to install an accounting system, the financiera still could not provide a loan, simply because profits were too low. This case shows that the prudent finance companies (no matter what altruistic motives they might have), will be forced to make some hard choice under this project.

CASE STUDY NO. 2

DUARTE SANDAL COMPANY

Owner: Orlando Martínez

Lic. Orlando Martínez is an accountant who works principally in retail stores. It is probably this background which gave him the idea to start making sandals. He is not giving all his time to his business, but rather obtains orders, arranges for the purchase of raw materials, and handles collections.

He started out sometime in 1981 with 5-6 employees in a small rented building in Villa Duarte, selling approximately $3,000 per month. He qualified for a loan under the DDF's micro industry program, and this enabled him to increase his business, rent a second building, and hire 4 more employees.

His business is now at the point where he should move to a larger building and spend about $1,500 on additional machinery.

He believes he has enough contacts that he could increase monthly sales to $6,000 but he recognizes that as the shoe market is seasonal, he will have to hire a salesman to maintain this level as well as obtain orders in the secondary cities.

He has a basic accounting system in operation as well as having control of his manufacturing costs.

His financial needs are as follows:

1. Increased working capital. Normally, clients pay in 30 days but some of the competition give up to 90 days credit. He does not have the resources to permit this. By offering a lower price he is often able to obtain business with payment 30-45 days.

2. Additional machinery. Estimated costs $1,500.

3. Larger manufacturing facilities. He is presently paying $80 per month for the first building and will probably have to pay $125-175 per month with enough space to allow him to expand.

He has established that he is capable of increasing his business and the first loan from DDF has assisted him. He will, however, have to make a decision when he is prepared to devote 100% of his time to this business.

COMMENTS ON CASE No. 2: DUARTE SANDAL Co.

The Duarte Sandal Co. is an example of a micro industry which under the DDF project grew to be a "small" industry. In a visit to this factory, even the uninformed visitor can rapidly see the need for expansion capital.

In an unwindowed room approximately 4 yard by 8 yards, 10 to 12 people were working just as hard as they could. Most of them did not even look up to see the visitor. The visitor must remain outside looking in - not because he is unwelcomed (quite the contrary), but because there was no place large enough or safe enough to stand. The need to expand was apparent, but since the property was rented, there was no incentive to expand the existing facility.

This firm had an interesting (and unusual) division of management responsibilities. The shop manager was also the accountant (with some college training) while the owner was absent - presumaly out promoting or delivering sales.

The lack of working capital is indicative of the unpalatable choices that a small businessman must make - sell at an even lower profit, or extend credit for longer periods - either choice would restrict cash flow. The need for equipment capital as well as for expanded facilities, would still have to be sought in the informal sector (or in this case, possibly DDF).

This is one of the very few cases where all three types of capital (working, equipment, and expansion) could easily be injected, little or no TA would be needed.

CASE STUDY NO. 3

HERNANDEZ BAKERY

Owner: Salvador Hernández
No. of Employees: 10

Mr. Hernández is an entrepreneur who has had many years of running his own small business. This is the second bakery he has operated although he is not a baker and knows very little about the bakery business.

We have been working with him constantly since the first contact was made on September 3 and the results have been encouraging.

Following completion of the questionnaire two tasks were accomplished:

1. Setting up a basic accounting system.

2. Determining manufacturing costs. Up to this time he had no idea of what his costs were.

Sales and profits are as follows:

	Sales	Profits
September (9/12 - 9-30)	$5,625	$592
October	7,949	1,023
November	7,966	1,744
December	10,099	663
January	9,499	1,327
February	7,800	798
March	8,749	750
April	7,844	979

From our conversations it was apparent that there were two weaknesses in the way the business was being run:

1. Having no knowledge of his manufacturing costs he was not controlling the ingredients used in the bakery, nor the amount of waste. It was suggested he should spend more time in the bakery learning about want went on, as his single biggest expenditure was in raw materials.

2. He was not controlling the cash register. A change was made so that only he or his wife would handle the money.

His bakery being located at the edge of barrio Cristo Rey was adversely affected by the present economic conditions. For example, sales for September, October and November averaged $8,146 as opposed to a second quarter average of $10,664.

His original plan had been to spend $8,000 to remodel the store and add a second story to acquire more equipment at about $5,000. He was encouraged to defer these expenditures until the economy improved, and in the meantime reduce expenditures to the minimum and retain tighter control of the operation.

To assist him the use of the cash book was introduced (refer to the case study Fanadería Quirka) and this has been successfully used for the months of February, March and April.

For example:

1/3/82	Bank deposits	$4,194.79
	Cash on hand	983.72
	Employees' loans	188.35
		5,366.86
	Net Profit March 1982	750.20
1/4/82	Cash on hand	6,117.06
	Bank deposits	5,713.79
	Cash on hand	376.27
	Employees' loans	27.00
		6,117.06
	Net profit April 1982	979.07
1/5/82	Cash on hand	7,096.13
	180 day short term deposit	6,000.00
	Cash on hand	280.00
	Bank deposits	613.59
	Employees' loans	192.09
		7,096.13

As can be seen, Mr. Hernández has now invested $6,000 of this surplus in short term deposits, and monthly will be adding more. This set aside, capital will be available when he requires it in the future.

COMMENTS ON CASE No. 3: HERNANDEZ BAKERY

This is a case where simply more efficient use of resources, and more realistic planning were needed. His plans for expansion far exceeded the current economic reality, and such expansion at the present time could have resulted in the demise of the business.

Mr. Hernández, as was found in almost all cases studies, had no idea what the costs of operating his business really were. Establishment of an accounting system was a move in the right direction, but in this case not enough. The "Cusa book" approach was then established where all money was counted and recorded at the beginning and the end of each day.

Since it was found that more efficient use of current resources should result in accumulation of adequate capital, this was a case where T.A. and not capital was needed.