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Assistance to
Resource Institutions
for Enterprise Support

An Evaluation of the Malawi Rural Enterprise and Agribusiness Development Institutions (READI) Project

September 1988

Sponsored by the
U.S. Agency for International
Development
Contract DAN-1090-C-00-5124-00

Directed by
Robert R. Nathan Associates, Inc.

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AGENCY FOR INTERNATIONAL DEVELOPMENT CONTRACT DAN-1090-C-00-5124-00

PREFACE

This evaluation was undertaken by an eight-person team during July and August of 1988. I would especially like to thank our team members from Malawi -- Messrs. Richard Chilingulo, Dick Maganga, Victor Ndisale, and Isaac Kunje -- for their commitment to this effort, and also for their insights into the social and economic factors effecting small enterprise development in Malawi. Their input enriched our knowledge base, broadened our findings, and helped to focus our conclusions and recommendations within the Malawian context.

I would also like to thank Mr. Don Henry and the staff of the READI Coordinating Unit for their support to our team. We are also appreciative of the time and effort put forth by the staff of MUSCCO, DEMATT, INDEFUND, Africare, WOCCU/CUNA, SEDOM, and MEDI to discuss their project activities. I hope that our observations and suggestions put forth in this evaluation report will be helpful as they plan and implement their future SME programs in Malawi. Finally, I would like to thank Mr. John Phiri of the Ministry of Trade, Industry, and Tourism for his time and support throughout this evaluation exercise.

Russell Webster
Chief of Party
September 15, 1988

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LIST OF ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
Africare	United States PVO
AID	Agency for International Development (Washington)
BAS/TAS	Business and Technical Advisory Services
CDC	Commonwealth Development Corporation
CUNA	Credit Unions National Alliance
DEMATT	Development of Malawian Traders Trust
EEC	European Economic Community
EPD/OPC	Economic Planning Department (Office of the President and Cabinet)
FMO	Dutch Corporation for Development Finance
GOM	Government of the Republic of Malawi
GTZ	West German International Technical Assistance Agency
HRID	USAID Human Resources and Institutional Development Project
IBRD	International Bank for Reconstruction and Development (World Bank)
ITDG	Intermediate Technology Development Group (United Kingdom)
ITPAC	World Bank Industrial and Trade Policy Adjustment Credit
KfW	West German Credit Corporation for Reconstruction
MDC	Malawian Development Corporation
MEDI	Malawian Entrepreneurial Development Institute
MOF	Ministry of Finance
MTIT	Ministry of Trade, Industry and Tourism
MUSCCO	Malawian Union of Savings and Credit Cooperatives
NGO	Non-Governmental Organization
OPG	AID Operational Program Grant
PCV	Peace Corps Volunteer
PfP/I	Partnership for Productivity/International (US PVO)
PIC	Project Implementation Committee
PVO	Private Voluntary Organization
READI	Rural Enterprises and Agribusiness Development Institutions Project
RCU	READI Project Coordinating Unit
SEDOM	Small Scale Enterprise Development Organisation of Malawi
TOT	Training of Trainers
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organisation
USAID	United States Agency for International Development (Malawi Office)
VSO	Voluntary Service Overseas (United Kingdom)
WOCCU	World Council of Credit Unions

EXECUTIVE SUMMARY

Overview

The Rural Enterprise and Agribusiness Development Institutions (READI) Project is USAID/Malawi's largest project effort to date in the small- and medium-enterprise (SME) sector in Malawi. Started in 1984, READI's focus has been on strengthening key intermediary institutions that provide credit, training, and business advisory/technical advisory services (BAS/TAS) to SMEs based in rural areas. Although the rural focus has not been exclusive, most projects have been rural based, reflecting the need to identify off-farm income and employment opportunities in a primarily agrarian subsistence economy.

READI is primarily an umbrella project providing support to (1) INDEFUND, which is a development finance institute lending to the SME sector, (2) the Malawi Union of Savings and Credit Cooperatives (MUSCCO), and (3) the Development of Malawian Traders Trust (DEMATT). Assistance to INDEFUND has been primarily in terms of grant funds for on-lending (both local currency and foreign exchange) to rural enterprises. MUSCCO's assistance has been primarily operational support, technical assistance, and some funds for credit financing. DEMATT, which was brought under the READI Project Grant Agreement in early 1987, received primarily operational support and technical assistance. READI also provided technical assistance and advisory services under the auspices of the READI Coordinating Unit to strengthen the institutional planning, management, and project implementation capabilities of INDEFUND, READI, and MUSCCO.

In addition to these activities, in 1986 READI carried out the first national survey of SMEs in Malawi, providing an information base for policy and sectoral development planning. Also, in 1988, READI began a pilot effort to actively promote SME credit financing opportunities, preparing feasibility studies and project portfolios for presentation to INDEFUND, the Small Enterprise Development Organization of Malawi (SEDOM), as well as commercial banking institutions.

What perhaps sets READI apart from many other USAID SME programs worldwide is its focus on strengthening existing indigenous agencies, rather than setting up new institutions or project offices. INDEFUND, DEMATT, and MUSCCO all existed before READI began in 1984. Although READI served a managerial function in terms of centralizing and streamlining USAID/Malawi's funding commitments to these organizations, at a strategic level it also represented a conscious effort to focus on institutional development of SME service organizations as a way of building long-term institutional capacity.

Impacts

The READI Project has made a positive contribution towards the institutional development of INDEFUND, MUSCCO, and DEMATT. It has also had a less direct, yet notable, impact on other agencies working in SME development by improving the information base about SMEs and by sharing that information in a systematic way with the wider community.

MUSCCO's performance and institutional capability has been particularly impressive. Its program of mobilizing savings and organizing indigenously managed credit unions is creating numerous opportunities for expanding the incomes of Malawi's rural population. Although some strengthening of central office financial management capabilities is needed, MUSCCO's strategy and methodology is working in Malawi. The evaluation team believes its field staff presence should be expanded in order to reach more beneficiaries and to continue strengthening existing groups.

INDEFUND's level of lending has been less than expected during the READI Project. This is largely because INDEFUND's management and board of directors have had to focus on improving their existing portfolio and strengthening their internal organization and management. As these improvements are made, however, INDEFUND will have to take a more agressive approach to development financing in order to stimulate the growth of SMEs in Malawi.

DEMATT has made much progress under READI to strengthen its management and clarify its mandate of providing BAS/TAS services in Malawi. The services it offers are unique among intermediary agencies working in SME development in Malawi, and they are services which the evaluation team believs are needed in the sector. With continued support and strengthening of its institutional capability, DEMATT can become a major force in creating viable Malawian small businesses.

READI has also engaged itself constructively in the SME policy dialogue, working closely with the GOM Ministry of Trade, Industry, and Tourism to broaden its involvement with intermediary organizations working in the sector. Many people working in SME development in Malawi recognize and appreciate the coordinating role played by the READI Project in improving communication linkages between non-governmental and public sector agencies.

Impacts at the enterprise level, on beneficiaries, are more difficult to assess. In addition to its targets for institutional development, the READI Grant Agreement also contained specific employment and income targets. It is the opinion of the evaluation team that these targets were ambitious, and at the time they were determined, the READI project designers underestimated the amount of effort needed to achieve the institutional development necessary for promoting the employment and income targets.

More impact at the enterprise level might have been achieved had READI not encountered some of the managerial difficulties it did. For example, the project coordinator position was not filled until August 1985, a year after the Grant Agreement was signed. Also, there has been disagreement among the

READI participating institutions throughout the life of the project about what role Africare should take in supporting SME development under READI. Another area had to do with the operational support requirements of MUSCCO, INDEFUND, and the READI Coordinating Unit; these changed significantly during the course of the project, resulting in the issuance of several PILS and Ammendments that often were delayed by the bureaucratic processes necessary for their approval.

Future Directions

The original READI Project Grant Agreement was for a period of four years, running through July 1988. Current funding levels for READI should carry it through December of this year. In addition, USAID/Malawi has requested $2.0 million in obligations to extend the project to December 1990.

Aside from READI, USAID/Malawi has three other programs with SME development components. These are the Human Resources and Institutional Development Project (HRID), the Services to Health, Agriculture, and Rural Enterprise Project (SHARE) which will provide support through PVOs, and the Malawi Enterprise Development Sector Assistance Program (MED), which will provide US$ 35.0 million in association with the World Bank's Industry and Trade Policy Adjustment Credit (ITPAC).

Although the evaluation team agrees with the goals and objectives of these three programs, it is as yet unclear how these programs can specifically continue the institutional and sectoral development process initiated by the READI Project. HRID is still formulating its agenda and implementing the screening and approval mechanisms through which specific technical assistance and training will be provided. Because the scope of governmental, non-governmental, and private institutions targeted by HRID is so broad and cuts across so many sectors, we believe it is important now to define more clearly where HRID resources can be used to strengthen SME intermediary institutions working in Malawi.

The same issue applies to SHARE, which has not yet been implemented. Lessons learned in the READI Project show that it is of vital importance to clearly define the tasks to be undertaken by expatriate advisers. This definition process should begin now in order to meet the needs of indigenous organizations through appropriate PVO support.

During the course of this evaluation, USAID/Malawi was in the process of finalizing a PAD for providing US$ 35.0 million in association with the World Bank's Industry and Trade Policy Adjustment Credit (ITPAC). USAID's program, entitled Malawi Enterprise Development, will focus on policy reform, tax regulation reforms, and liberalization of foreign currency regulations; in addition, it contains a US$ 1.6 million project component for progress monitoring, special studies, and technical assistance activities to strengthen Malawian businesses.

In the evaluation team's opinion, MED has the potential for positively affecting the policy and regulatory environment for SMEs. What is less clear, however, is how MED will support indigenous Malawian organizations working in the SME sector, such as DEMATT and MUSCCO. Provision for credit funds to INDEFUND is contained within MED; however, no provision exists either in MED or the other programs discussed above for continuing institutional support to DEMATT or MUSCCO. Because these agencies do offer an important service to the SME sector, USAID should give some priority to formulating a more detailed program for their continued development.

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I. INTRODUCTION

This evaluation of the Rural Enterprise and Agribusiness Development Institutions (READI) Project was undertaken between July 18 and August 12, 1988. Our terms of reference were threefold: (1) to analyze READI's contribution to SME development in Malawi, particularly its impact on strengthening intermediary institutions working in the sector; (2) to review USAID/Malawi SME development assistance to date and make recommendations for future program activities; and (3) to identify salient Government of Malawi (GOM) policy issues which affect the READI Project and future USAID/Malawi program initiatives in the SME sector.

The evaluation team consisted of eight members, four provided under contract to Robert R. Nathan Associates, Inc. (RRNA) through the USAID/RRNA Project of Assistance to Resource Institutions in Enterprise Support (ARIES), and four provided by the Government of Malawi and other institutions working in the sector. The team worked in pairs concentrating on four areas of the evaluation. These areas and the respective experts were

- **Institutional Development:**
  - Richard Chilingulo, Ministry of Trade, Industry, and Tourism, GOM
  - Russell Webster, ARIES
- **Credit:**
  - Tim Mooney, ARIES
  - Victor Ndisale, Ministry of Finance, GOM

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- **Business Advisory and Technical Advisory Services:**
  - Mike Bess, ARIES
  - Richard Maganga, Development of Malawian Traders' Trust (DEMATT)
- **Training:**
  - Jim Cotter, ARIES
  - Isaac Kunja, Malawian Entrepreneurs Development Institute (MEDI)

This report is organized in five chapters. Chapter I provides an overview of the small and medium enterprise (SME) sector in Malawi and the READI Project. Chapter II presents our evaluation of READI's performance in strengthening institutional capacity; improving the delivery of business advisory services, technical advisory services (BAS/TAS), and credit to SMEs; and upgrading the skills of human resources in SME intermediary institutions. Chapter III discusses lessons learned in the READI Project to date, focusing particularly on the unique contribution made by USAID to stimulate growth in the SME sector through institutional development. Based on lessons learned by the READI Project, we discuss (1) how USAID's program portfolio can continue to support SME development initiatives in Malawi and (2) areas that we feel will need additional attention. Chapter IV looks at the broader policy issues as they effect the SME sector in Malawi and suggests actions that can be taken to ensure the GOM policy objectives are realized. Chapter V provides conclusions on the progress of the READI project to date, and makes recommendations to continue the institutional development of MUSCCO, INDEFUND, and DEMATT. It also summarizes our main recommendations for future USAID program initiatives and for GOM policy implementation requirements in the SME sector.

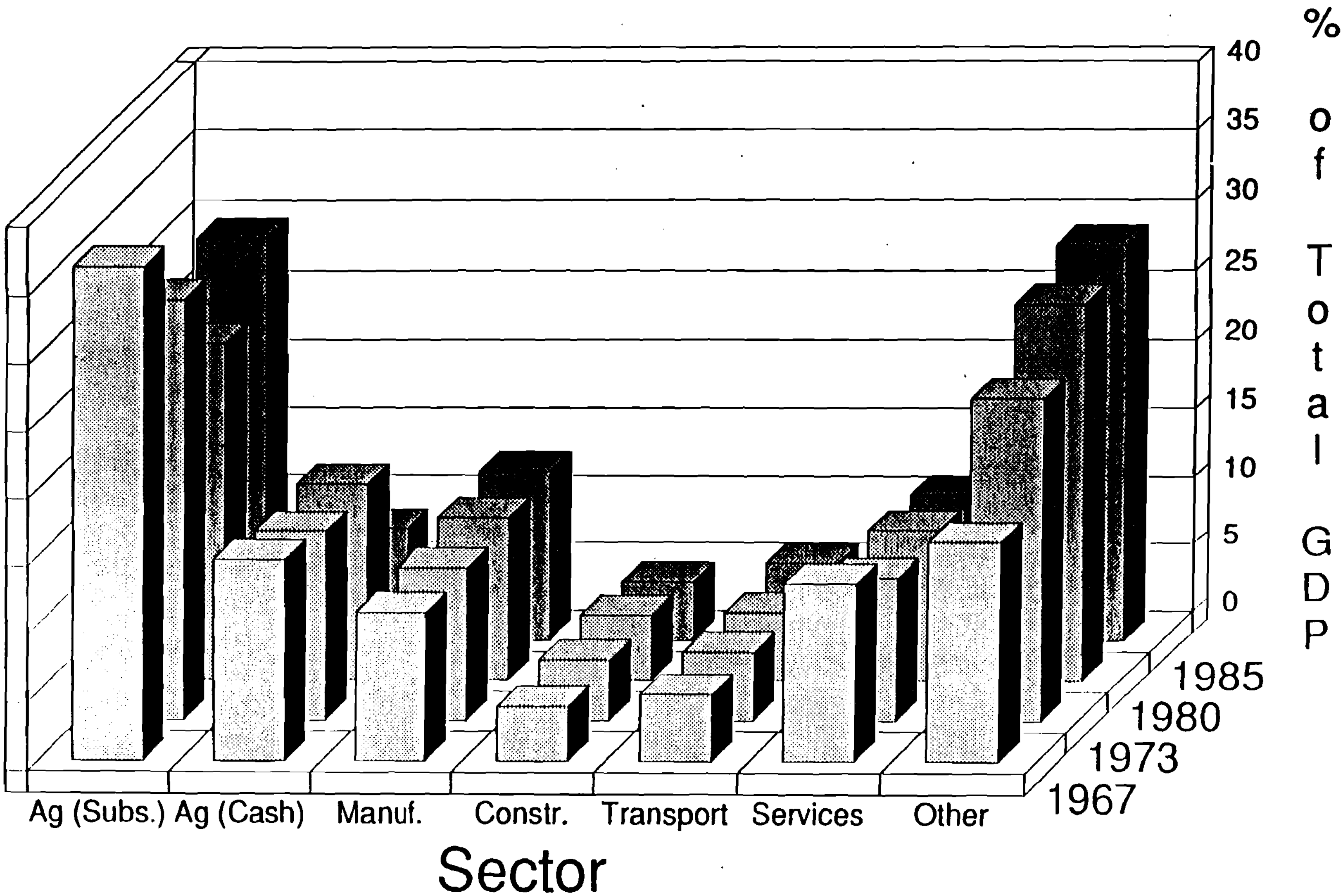
Economic Background on Malawi

Malawi is a long, narrow, land-locked country in the southern region of Africa bordered on its northern and northeastern frontiers by Tanzania, with Zambia lying to its west and Mozambique surrounding its southern region on three sides. Lake Malawi, the third largest freshwater lake in Africa, extends nearly the entire length of the country, demarcating most of the eastern border with Tanzania and Mozambique. Malawi's total area is 45,750 square miles, including 36,325 square miles of land (of which 36 percent is arable) and 9,425 square miles of water, the latter consisting of about 83 percent of Lake Malawi and several smaller lakes. Malawi's population, which is estimated to have reached 7.5 million in 1987, has an annual growth rate of 3.2 percent and is placing pressures on land use in a predominately agriculture-based economy.

Per capita income in 1987 was about US$ 174, below average for sub-Saharan Africa. Agriculture is the major economic activity, accounting for over 35 percent of GDP and providing a livelihood for about 90 percent of the population. Agriculture also accounts for about 88 percent of Malawi's export earnings, mainly from tobacco, tea, and sugar. Changes in Malawi's GDP by sector since 1967 are shown in Figure I-1. Note a significant drop in cash crops between 1980 and 1985, which can probably be attributed to falling international prices for Malawi's major export crops, combined with worsening terms of trade; these are discussed more in the following paragraphs.

From Malawi's independence in 1964 up until the late 1970s, the country was able to achieve a real per capita income growth of 3 percent per annum through relatively stable financial conditions and liberal economic policies. Since that time, however, owing to a combination of external developments and domestic factors, this pace of growth has slowed, inflationary pressures have increased, and the balance of payments position has deteriorated. The economy recovered somewhat during 1982-84, with real GDP growing at 4 percent per annum, but since 1984, performance has weakened significantly, owing primarily to a sharp downturn in the terms of trade.

Figure I - 1:
Sectoral Makeup of GDP (1967 - 1985)



In 1984, rail links to Beira and Nacala in Mozambique were closed because of Mozambique's civil war; as a result, imports and exports must be shipped via a combination of road and rail links through Zambia, Zimbabwe, and South Africa to and from the port of Durban at very high cost. This transportation crisis, combined with little growth in international prices for Malawi's major exports, has resulted in an average growth in GDP of only 2 percent per annum since 1980.

During 1987, the GOM took a number of actions to address the deterioration in Malawi's domestic and external financial position. A fiscal program to mobilize revenues and contain expenditures was introduced in August 1987; maximum bank lending interest rates were deregulated (they rose by 4 percentage points to about 26 percent) and deposit interest rates increased by 3 percentage points (raising the 12-month rate to 17.25 percent) in July 1987; in February 1987, the Malawi kwacha was devalued by 20 percent against its currency basket. Other changes included the liberalization of smallholder agricultural marketing, continued adjustments in producer prices, and further actions to improve the performance of parastatals, particularly the Agricultural Development and Marketing Corporation (ADMARC). The government has also taken steps towards a tax reform program to increase revenues and broaden the tax base. Despite these positive changes, domestic economic performance continues to be a problem: inflation rose to 25 percent, and real output fell by 0.2 percent in 1987.

Characteristics of the SME Sector in Malawi

As in many countries, information about the SME sector in Malawi is limited. This is particularly true when one includes small and micro enterprises operating more traditional, informal businesses or production activities; the GOM keeps some statistics on licensed businesses, but at present there are only 156 registered small-scale industrial establishments (defined as those with 20 or fewer workers), which employ a total of 1,370 people. Using data based on a 1984 study of small-scale industry in Malawi by Ettema, the READI Project estimates that approximately 182,000 SMEs are operating in

Malawi (Ettema, W. "Small-Scale Industry in Malawi," *The Journal of Modern African Studies*, 22, 3, 1984, pp. 487-510).

In 1987, READI completed the first nationwide survey of SMEs in Malawi, entitled *New Directions for Promoting Small and Medium Scale Enterprises in Malawi: Constraints and Prospects for Growth.* The study was based on a sampling of 1,383 businesses. The analysts on the survey team also used official statistics available from the GOM, as well as data gathered through earlier industrial sector studies, to pull together some of the first descriptive information about SMEs in Malawi. This section highlights some of the important findings from this survey.

More than 96 percent of the entrepreneurs sampled were sole owners of their businesses. The majority of businesses fell into three categories: trading (42 percent), service (26 percent), and common manufacturing (30 percent).

Three-quarters of businesses surveyed were started with less than K 1,000 (about US$ 370); fewer than 5 percent started with more than K 10,000 (about US$ 3,700). The majority of businesses were started with the entrepreneurs' own savings (91 percent); also, of the total number interviewed, only 16 percent had applied for any loans during the previous two years. This last statistic indicates the existence of a large and as yet unmet demand for financial services in Malawi. In fact, formal credit for SMEs has only been available in Malawi since 1982, with the exception of a K 500,000 program in 1978/79 operated through the Investment and Development Bank. Commercial bank participation in financing SMEs is very limited; SEDOM and INDEFUND, both development finance intermediaries, provide the largest number of loans to SMEs in Malawi.

Even with the establishment of SME development finance intermediaries, however, most of the capital formation in the SME sector has occurred through entrepreneurs' own savings or through dealings in informal credit markets. READI Project estimates of SME savings, investment, and credit are presented in Figure I-2.

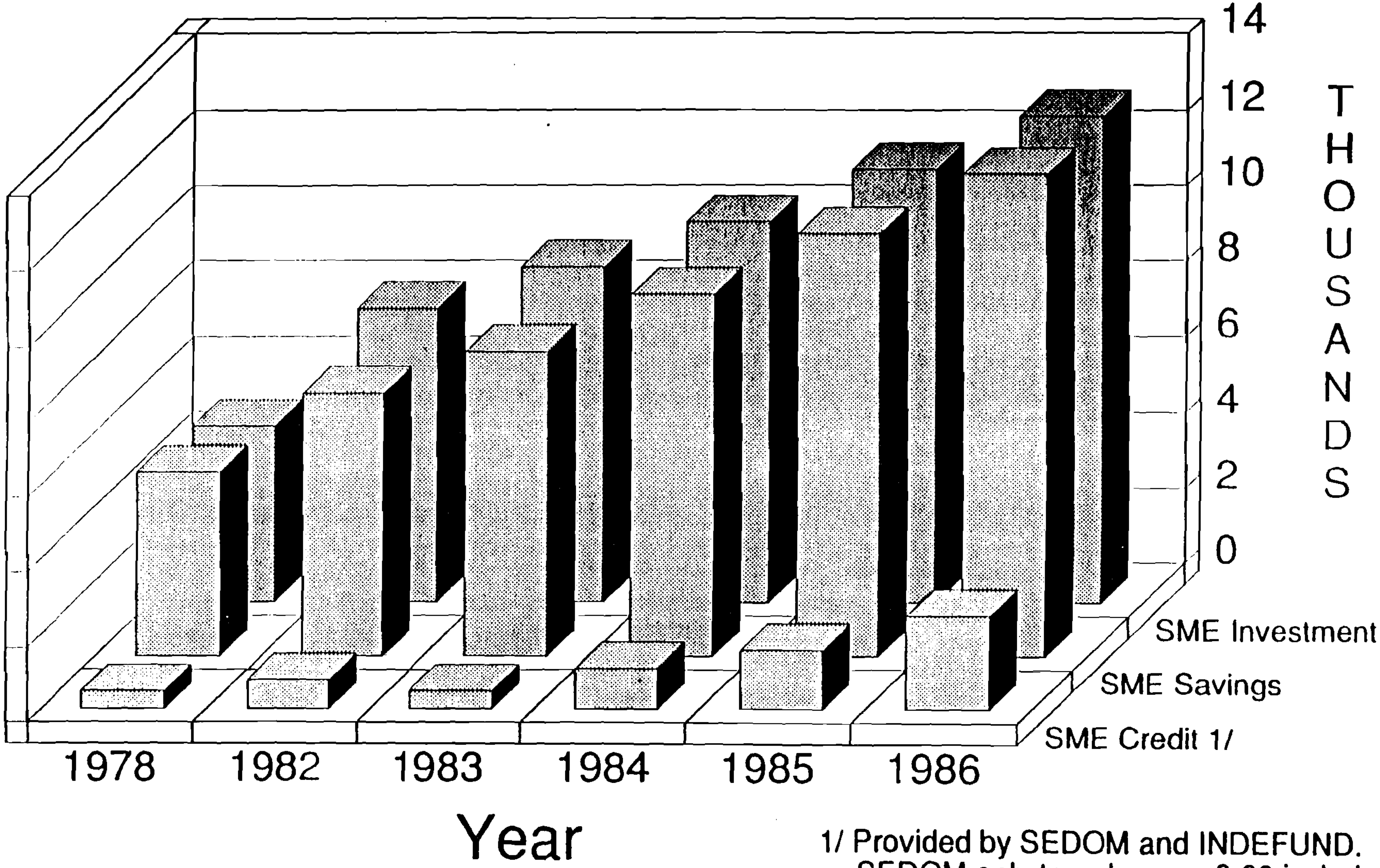
Further analysis of SME investment data generated from the survey indicated that wholesale and retail trading accounted for the majority of money invested (34 percent), with restaurants, bars, and hotels ranking second (27 percent), other manufacturing third (10 percent), and textiles/clothing, food processing, and services last (see Figure I-3).

Approximately 3,000 people were employed in the businesses surveyed, representing an average of 2.5 per enterprise. As could be expected, urban enterprises in the more economically active Southern Region had the highest average (4.6), while rural businesses in the Northern Region had the lowest (1.1). Forty-one percent of businesses interviewed were in the Southern Region, 32 percent in the Central Region, and 27 percent in the Northern Region. Figure I-4 shows the composition of the survey sample by type of business.

Gender data collected through the survey showed that women constituted only 19 percent of the total number employed in SMEs interviewed. This suggests that job opportunities at present for women in small enterprises are limited. The only SME activity in which female employment approached that of males was in the hotel, restaurant, and bar industry (see Figure I-5). In the agriculture sector, by comparison, a 1977 census carried out by Malawi's National Statistics Office showed that 94 percent of women of working age were engaged in subsistence farming, with only 2 percent self-employed; this compared with figures of 62 and 7 percent for men in the same categories.

Several constraints on SME development in Malawi were cited by the survey respondents. More than half stated that acquiring start-up capital was the biggest problem; about the same percentage cited the scarcity of capital for purchasing additional equipment and materials as a significant constraint. Other problems included attracting customers, gaining access to land, and finding a reliable source of raw materials and spare parts.

Figure I - 2:
SME Savings, Investment, and Credit
(Kw 1000's)



1/ Provided by SEDOM and INDEFUND. For SEDOM only term loans > 3,00 included.

Figure I - 3:
Capital Investment in SME Activities

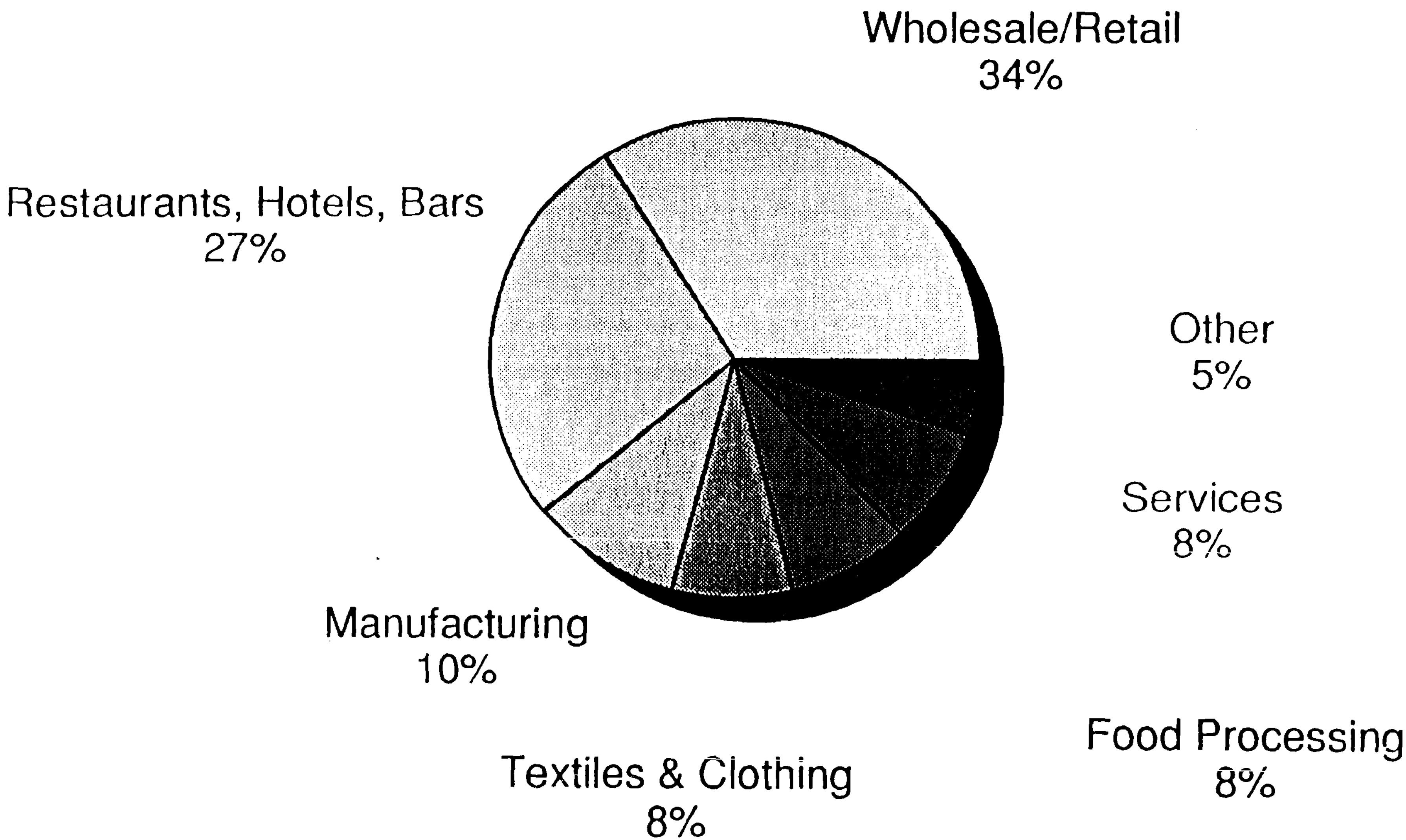


Figure I - 4:
Composition of SMEs in READI Survey

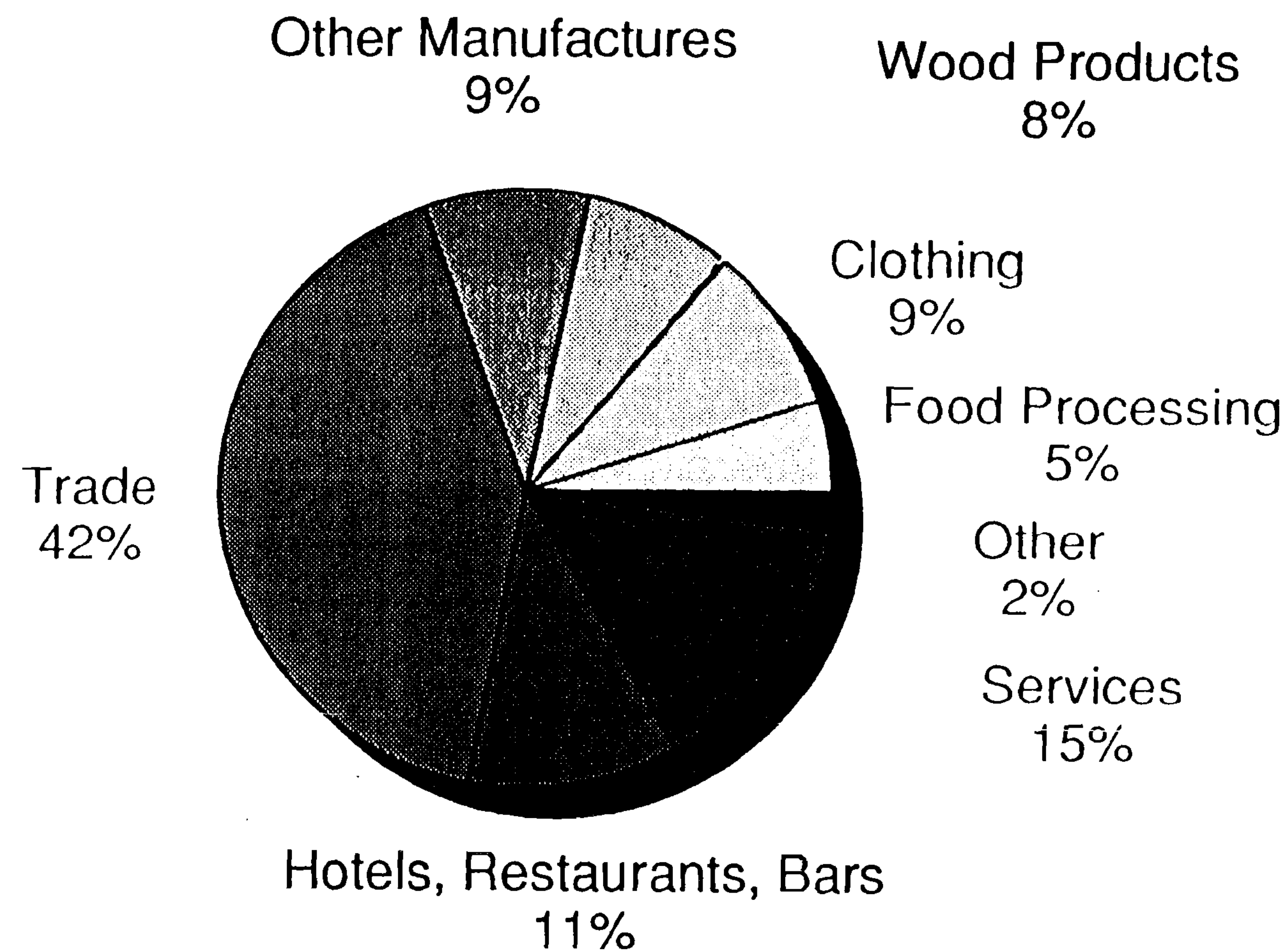
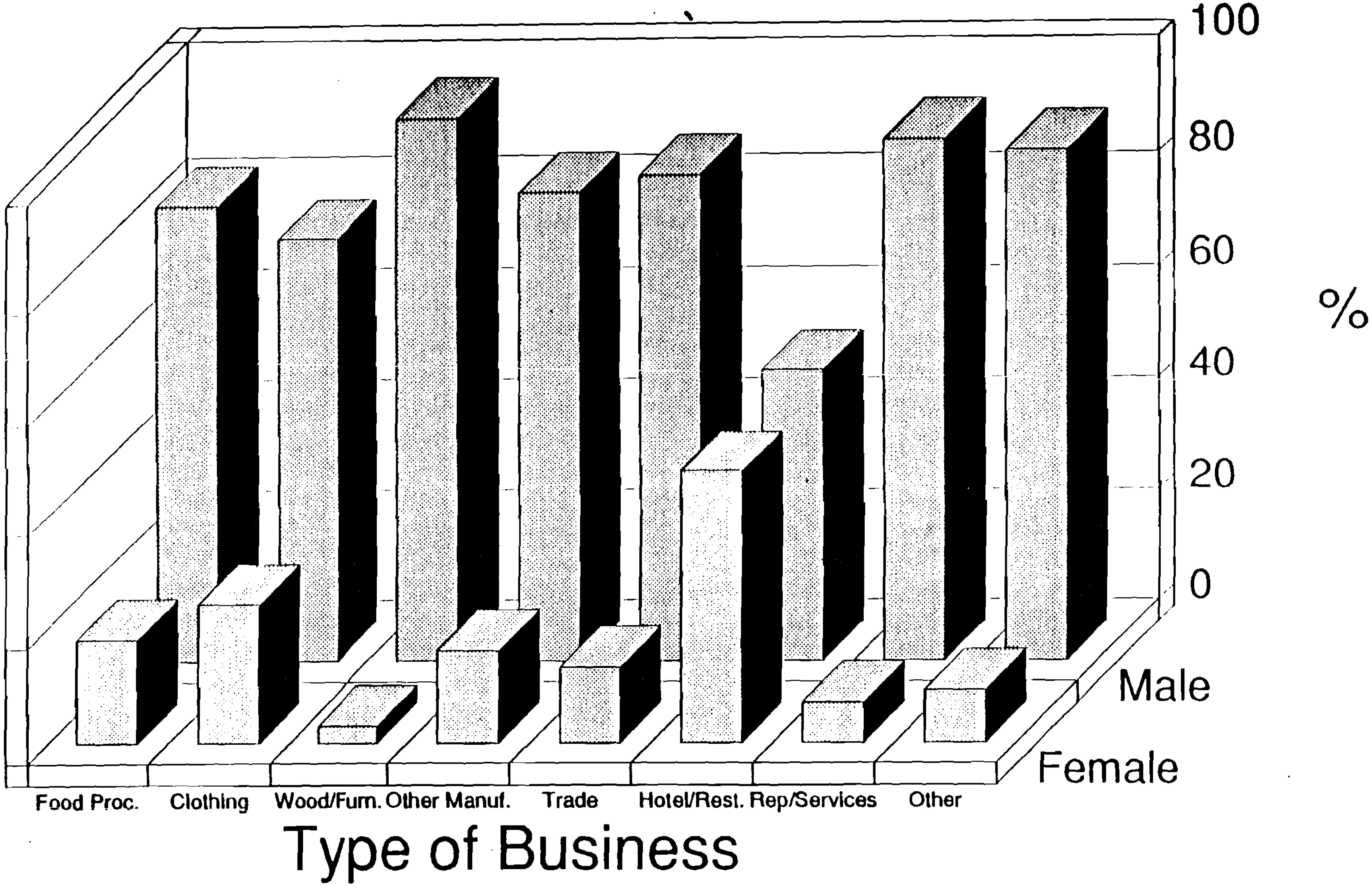


Figure I - 5:
Employment in SMEs by Gender



Although lack of money was overwhelmingly the number one problem cited by the respondents, the surveyors concluded also that there exists a great need for business and technical advisory services in the sector. Services are needed for marketing, raw material assessment, transport assessment, technology choice, training assessment, credit supply, and project planning, appraisal, and monitoring. Entrepreneurship training was also identified as important for sectoral development and growth in Malawi.

GOM Priorities and Donor Initiatives

Many more areas of SME development are analyzed in the READI survey. One of its important contributions has been to provide information which has aided the GOM in formulating an economic development agenda that includes specific policy goals and objectives for strengthening the small and medium enterprise sectors in Malawi. In addition to the GOM's recognition of the importance of SMEs for development, several major donors working in Malawi are active in SME promotion as well.

SMEs and the GOM Statement of Development Policies (DEVPOL)

The importance of SMEs for economic growth was strongly recognized in Malawi's *Statement of Development Policies: 1987-1996* (DEVPOL). This represents the first time that targeted SME development policies formed part of the DEVPOL agenda. In the language of DEVPOL, "the next decade will see a particular emphasis on support for small-scale enterprise, formal and informal." The policies and strategies to achieve this are to

- Review all regulations, rules, and practices which affect the small-scale manufacturing enterprise, with the objective of minimizing unproductive obstruction to proper enterprise

- Prepare and introduce a number of legal and administrative measures concerned with taxation, foreign exchange, credit, government procurement, and marketing which will directly stimulate the subsector

- Establish a capacity to advise the subsector on opportunities for both diversification from the more traditional small-scale manufacturing enterprise pursuits and increased complementarity with medium- and large-scale manufacturing enterprises

- In parallel with the progression of institutional capability, enhance the availability of credit, including that from the commercial banking sector, and review the resources made available to support the administration of small-scale manufacturing enterprise credit in the light of lending rates and on-lending margins

- Ensure that a high proportion of the resources of a new technical institute are devoted to research, technological development, consultancy, and training related to small-scale manufacturing activity

- Clarify and harmonize the roles and resources of the various public, parastatal, and private organizations concerned with commercial and industrial development, in particular those involved in small-scale manufacturing enterprise

To assist in formulating, implementing, and monitoring these strategies and policies, a Small-scale Industry (SSI) Unit has been established within the Ministry of Trade, Industry, and Tourism. The SSI Unit's mandate includes collaboration with other SME intermediary institutions to help strengthen credit, technical assistance, and training services to small-scale entrepreneurs in Malawi.

Donor Activities

Several donors, including USAID, are actively supporting development of the SME sector of Malawi's economy. Some of these activities are described in Table I-1 below. Donor coordination of SME development is managed by the World Bank through a Donor Coordination Sub-Group on Small-scale Enterprises. Participants include representatives from the EEC, Federal Republic of Germany, Netherlands, UNDP/ILO, World Bank, and USAID.

A review of the minutes of a recent meeting of this group (April/May 1988) shows that the issues discussed ranged from GOM policy to the impact of various intermediary institutions on the SME sector in Malawi. As could be expected, there is no consensus among members regarding all aspects of SME

Table I - 1: Summary of Donor Activities in SME Sector

Donor	Project	Period	Funding (1000's)	Description	SME Component
USAID	Rural Enterprise and Agribusiness Development Institutions	84 89	5,100	Institutional support to DEMATT, MUSCCO, and INDEFUND for strengthening financial, technical, and business advisory services to the SME sector. In addition to direct funding to these agencies, READI has provision for funding local technical assistance and training activities of the World Council of Credit Unions and Africare through OPGs channeled through Washington. READI works under the Ministry of Trade, Industry, and Tourism.	Entire Project
	Human Resources and Institutional Development	88 - 93 (?)	15,000	Technical assistance, training, and advisory services for developing human resources in both public and private sector institutions.	Training of staff working in SME support institutions, banks, etc. and some provision of technical assistance.
	Malawia Enterprise Development (in the process of being prepared at the writing of this report)	88 - 91	35,000	Two components, one direct program assistance in support of policy and institutional reform (33.4 m), and the other a project component to fund technical assistance, studies and training in support of program objectives and the policy dialogue process (1.6 m).	(a) Support to local SME intermediary institutions that are part of GOM approved development budget. (b) Improvement of policy and regulatory environment, access to foreign exchange, (c) On-budget grants to INDEFUND and SEDOM for SME equity investments, (d) SME investment promotion program through Malawi Export Promotion Council.
Peace Corps	Provision of voluntary assistance to support local organizations	Ongoing	N/A	Eight PC Volunteers presently placed in SME development organizations: DEMATT (1), INDEFUND (1), MUSCCO (3), MEDI (2), READI Promotion Unit (1)	Placement of volunteer experts to train counterparts in SME intermediary institutions.
EEC and ermany (KFW)	Small Enterprise Devopment Organization of Malawi (SEDOM)	Since 1983	Proposed 7,000 for 88 - 91 (Phase III)	SEDOM is a parastatal body that grants loans and provides business/ technical advice to small scale enterprises. It is generally recognized as the lending institution which deals with the small scale, whereas INDEFUND deals with medium scale.	See description

Table I - 1: (Continued)

Donor	Project	Period	Funding (1000's)	Description	SME Component
Germany (KFW)	INDEFUND	86 -	2,668	For SME loan funds.	See description
World Bank	Industrial and Trade Policy Adjustment Credit	2 tranches: 35 m. 1988, 35 m. 1989	70,000	To support the continuation of GOM's reform program of industrial and international trade policies. Parallel lending to be provided by USAID, Japan OECF, EEC, AfDB, UK, and the Netherlands.	Ease regulations on availability of foreign exchange, and review tax policies and regulations effecting small businesses.
UNPD/ILO	Malawian Entrepreneurs Development Institute	Since 1981	n/a	UNDP supports MEDI, which is part of the Ministry of Labour, through operational funding and the provision of an ILO technical advisor.	MEDI gives a combination of business and skill training to existing and potential Malawian entrepreneurs. Programs are held both on the MEDI campus, as well as around the country in village areas.
	Procurement support and T.A. to a new Leather Tannery	1988	600	To assist in establishing Malawi's first complete leather tannery; credit financing also to be provided by INDEFUND and SEDOM.	This is a medium-scale enterprise which is based in a rural area.
	Industrial Statistics (under review)		200	To set up a statustical unit in the Industrial Development Division of MTIT	
	Institutional Strengthening of the MTIT Small Scale Industrial Unit (under review)		425	Operational support and T.A. for institutional development and staff training.	
	Research and Development Facility for Small-scale Industries (under review)			To establish a network among existing universities and institutions for research and development of appropriate technologies, etc. for SSI's	
	Advisory Services for Women Entrepreneurs (DEMATT)	beginning 1988	660	To provide 1 technical advisor and 2 UN volunteers to DEMATT for establishing a unit to support female entrepreneurs.	
	T.A. and Credit Funds for SEDOM (under review)		600	T.A. to strengthen operations in the Northern Region; capital funds for equity investments in SME's.	
	Credit Facility for Rural Traders (feasibility study phase)				

development strategies and methodologies; however, these meetings do appear to provide a useful forum for donors to discuss and try to coordinate their SME programs.

The READI Coordinator participates regularly in these sessions to represent the interests of USAID and the institutions being served by the READI Project. In addition, READI interacts on a fairly regular basis with other SME programs operating in Malawi, including the Small Enterprise Development Organization of Malawi (SEDOM), which is funded by the EEC, and the Malawi Enterprise Development Institute (MEDI), which is receiving technical assistance from UNDP/ILO.

An Overview of the READI Project

Goals and Objectives of READI

The major goal of the READI Project stated in the Project Grant Agreement was to "increase the productivity and incomes of Malawi's rural population." In preliminary discussions with the USAID/Malawi Mission, the evaluation team learned that the Mission favors modifying this goal somewhat to include some focus on urban enterprises. Given the infrastructural constraints in Malawi and the greater opportunities in urban areas to achieve employment impacts, this modified goal is justifiable. Continued work in rural areas, however, is necessary to achieve GOM policy objectives and also to create viable employment and income-generating opportunities for a farming population that is facing constraints on the availability of arable land.

The purpose of READI, as stated in the Project Grant Agreement, has been to strengthen, diversify, and expand the economic activity of small and medium scale Malawian entrepreneurs, especially entrepreneurs involved in the following types of private sector activities:

- Agricultural production, processing, and marketing and the manufacture of agriculture-related inputs
- On- or off-farm rural employment generating activities

- Import substitution or foreign exchange earning types of light industry and manufacturing activities which can be expected to benefit rural consumers

The targets set for measuring the achievement of this purpose were stated as

- 700 new jobs created in rural areas or with agriculture-related businesses
- 150-200 smallholders with expanded or diversified incomes
- A minimum of three Malawian private sector institutions established with good prospects for long-term self-sustainability, which assist, support, and guide emergent Malawian entrepreneurs
- The parameters for small- and medium-sized entrepreneur development defined (credit needs, opportunities, support institutions) and the needed strategy emerging

Three major project outputs for READI were defined. These were stated in the Grant Agreement as

- Financial intermediaries serving small-scale entrepreneurs strengthened:
  - Improved financial sustainability
  - Client advisory services established
  - Improved internal loan review, approval, and monitoring procedures
  - Management staff more knowledgeable of priority investment areas and level of profitability for frequent types of credit requests, and such knowledge reflected in loan portfolio
  - Improved management capability for planning longer-term organizational development
- Small- and medium-scale entrepreneurial economic activities expanded:
  - 40 new businesses started in areas of economic priority
  - 75 existing businesses expanded

- ► 8-10 areas of potential investment having moderate to high levels of profitability and favorable macroeconomic impact identified

■ Better coordinated and more effective support services provided by the private sector:

- ► Study of investment potential completed and available to potential investors and financial intermediaries
- ► Investment/financing guidelines prepared for use by credit institutions in Malawi on targeted areas of economic activity:

  1. Smallholder income diversification
  2. Smallholder cash/export crop production
  3. Potential agro-processing or agro-business ventures
  4. Potential rural industries and manufacturing
  5. Rural wholesaling/retail opportunities

- ► Small- and medium-scale entrepreneurial audit needs assessment
- ► Institutional survey for the provision of credit and related services for small- to medium-scale entrepreneurs

READI Project Beneficiaries

Tables I-2 and I-3 characterize the beneficiaries of institutions funded under the READI Project by type of assistance received (e.g., technical advisory services or credit).

In addition to the long-term loans presented in Table I-3, MUSCCO made 90 short-term loans totaling K 332,000 to its member societies from the beginning of 1986 through mid-1988. As of 30 June 1988, MUSCCO's primary

Table I-2. An Overview of BAS/TAS Beneficiaries
(1986-87, Estimates)

Institution	Assistance	Number of Enterprises	Number of Employees or Members
DEMATT	BAS/TAS	545	1,254
INDEFUND	BAS	79	1,437
INDEFUND	TAS	31	514
MUSCCO	Promotion	25	120
MUSCCO/WOCCU	Training	70	14,409
Africare	BAS/TAS	125	1,005
Africare	Promotion	125	4,310
Africare	Training	19	838

Table I-3. An Overview of Credit Beneficiaries
As of 30 June 1988

	INDEFUND	MUSCCO
Long-term loans:		
Number approved	25	25
Enterprises affected	23	25
Amount approved (K)	2,014,005	93,564
Average size (K)	83,915	3,743
Disbursements	917,566	91,901
Employment impact:		
Loans approved	472	n/a
Loans disbursed	280	n/a
Women borrowers:		
Women borrowers	1	4
Average loan approved (K)	52,000	2,623
Average loan disbursed (K)	60,488	2,276

societies had K 1.5 million ($577,000 at the current exchange rate) of loans outstanding.

Budgetary Components and Participating Organizations

The READI Project Agreement was signed between USAID/Malawi and the GOM on 31 August 1984. The original grant agreement contained a total project funding of US$ 5.1 million to provide "umbrella project" support in technical assistance, credit, and training programs working in cooperation with two Malawian institutions, INDEFUND — Malawi's development finance institution for lending to medium-scale enterprises — and the Malawi Union of Savings and Credit Cooperatives (MUSCCO). The grant agreement was amended in March 1987 to include the Development of Malawian Traders Trust (DEMATT), which until late 1986 had been supported through a project agreement with Partnership for Productivity/International (PfP/I). This and other subsequent amendments have brought the total project budget to US$ 5.8 million.

The original grant agreement was for a four-year period; at current budget levels, READI has enough funds to sustain the project to December 1988; USAID/Malawi has put in a request under its FY 1989 budget for an additional US$ 2 million to extend READI through December 1989.

Line agency responsibility was initially vested in the Ministry of Finance, but was later moved to the Ministry of Trade, Industry, and Tourism. To manage the project, READI contained provision for a Coordinating Unit to be staffed through a Personal Services Contract. The purpose of this arrangement was to lessen some of the managerial burden on USAID/Malawi and also to provide the needed technical assistance in strengthening the planning, implementation, and monitoring capabilities of target institutions.

Through the use of Operational Program Grants (OPGs), Africare and WOCCU/CUNA were to provide technical assistance in strengthening participating agencies. Africare had a broadly defined role to assist INDEFUND and MUSCCO through technical assistance and training to improve their services to small- and micro-entrepreneurs; Africare's responsibilities, under the Grant Agreement, were described as private sector support.

WOCCU/CUNA had a previous OPG, which was modified in 1984 to bring them under the READI Project. Their responsibilities remained essentially the same, that is, to provide technical assistance to MUSCCO in the areas of financial management and planning, central finance administration, and strengthening of field service capabilities.

Table I-4 presents the original READI budget distributed among participating agencies and program activities. Amendments to the READI Project budget by implementing agency are presented in Table I-5.

In Chapter II, we describe in greater detail the various components of the READI Project and discuss important issues that have affected its implementation and its impact on SME development in Malawi.

Table I-4: READI Project Original Budget
(1000's $)

Recipient	Credit Amount	Credit %	T.A. Amount	T.A. %	Training Amount	Training %	Commodities Amount	Commodities %	Operations Amount	Operations %	Other Costs Amount	Other Costs %	Total Amount	Total %
INDEFUND	1,200	23.5	0		75	1.5	50	1.0	75	1.5	0		1,400	27.5
MUSCCO 1/	300	5.9			75	1.5	53	1.0	172	3.4	120	2.4	720	14.1
CU 2/			455	8.9			25	0.5	35	0.7	85	1.7	600	11.8
Africare 3/			900	17.6	60	1.2	100	2.0	175	3.4	240	4.7	1,475	28.9
WOCCU/CUNA 4/			370	7.3									370	7.3
Contingency													535	10.5
Total	1,500	29.4	1,725	33.8	210	4.1	228	4.5	457	9.0	445	8.7	5,100	100.0

1. MUSCCO Other line item of $120,000 was for construction.
2. CU other line item of $85,000 was for studies.
3. Africare other line item of $240,000 is for overhead.
4. READI Project funding increased technical assistance line item in existing WOCCU/CUNA OPG by $370,000. In addition, OPG amendment shifted $114,112 from Institutional Support for MUSCCO to training.

Source: Project Paper

Table I-5: READI Project Budget
Amendments and Changes
($'s)

Project Element	Original Budget (August 1984) Amount	%	Amendment No. 2 (March 27, 1987) Amount	P.I.L. No. 16 (July 2, 1987) Amount	Amendment No.3 (Sept 27, 1987) Amount	P.I.L. No. 33 (July 8, 1988) Amount	%
MUSCCO - credit	300,000	5.88	300,000	275,000	275,000	268,000	4.62
INDEFUND - credit	1,200,000	23.53	1,200,000	800,000	855,965	475,965	8.21
MUSCCO - institutional development	790,000	15.49	790,000	790,000	940,000	1,120,000	19.31
INDEFUND - institutional development	200,000	3.92	200,000	200,000	204,551	104,551	1.80
DEMATT - institutional development			225,000	225,000	325,000	565,000	9.74
Africare - private sector support	1,475,000	28.92	1,475,000	1,475,000	1,475,000	1,475,000	25.43
Coordinating unit/studies/ monitoring	600,000	11.76	800,000	1,185,000	1,366,328	1,596,484	27.53
DEMATT - technical assistance			110,000	150,000	358,156	195,000	3.36
Contingency and inflation	535,000	10.49					
Total	5,100,000	100.00	5,100,000	5,100,000	5,800,000	5,800,000	100.00

II. REVIEW OF READI PROJECT PERFORMANCE

As explained in Chapter I, the READI Project incorporates several institutions working at different levels in the project. At one level are the funded agencies — MUSCCO, DEMATT, and INDEFUND. At another level is the GOM, at first represented by the Ministry of Finance and later by the Ministry of Trade, Industry, and Tourism. At another level are the organizations responsible for providing technical assistance to the agencies that are funded: WOCCU/CUNA and Africare. At yet another level are other indigenous agencies working in the SME sector in Malawi. Although these indigenous agencies are not funded by READI, they interface with the project through its coordinating forums, the Project Implementation Committee (PIC) and, more recently, the Selection Committee for reviewing new projects. At yet another level is the READI Project Coordinating Unit, which has the responsibility for administering the Project and for carrying out the mandate to facilitate greater coordination among the SME players in Malawi. Another level still is the READI Project Promotion Unit, which is responsible for identifying and promoting new projects financed by INDEFUND and other lending institutions.

This preponderance of actors is important to understand for our presentation. The purpose of this chapter is to present the team's findings about the performance of the READI Project to date. We have divided the chapter along functional project lines such as (1) organization and management, (2) credit, (3) BAS/TAS, and (4) training. Some of the institutions funded by READI carry out activities in more than one area, and they are discussed in multiple sections.

Project Organization and Management

Overview of Project Design

The READI Project design is multifaceted and complex. It involves numerous agencies relating to a central management unit at different levels:

- USAID/Malawi, responsible for providing project support and serving as a liaison to the GOM on behalf of the U.S. government. Administrative responsibilities include approving project budgets, amendments, allocations, and advances.
- The Ministry of Trade, Industry, and Tourism, which is the GOM line ministry responsible for project implementation. This responsibility includes (1) approving budgets and expenditures for application to the Central Reserve Bank and USAID/Malawi and (2) chairing the PIC, which includes representatives from several GOM agencies and from nongovernmental institutions serving the sector.
- The READI Project Coordinating Unit, responsible for project administration and for facilitating coordination between project-funded institutions and other institutions working in the sector, including the Ministry of Trade, Industry, and Tourism and other GOM agencies.
- MUSCCO, INDEFUND, and DEMATT, which are recipients or funded institutions of READI funds administered by the CU.
- Africare and WOCCU/CUNA, which are responsible for providing technical assistance and which are funded from separate OPG agreements. For WOCCU/CUNA, this technical assistance goes to MUSCCO. For Africare, technical assistance and training serves entrepreneurs and other institutions working in the sector.
- Other intermediary institutions working in the sector. For example, SEDOM and the Commercial Banks review READI project proposals for possible funding, and MEDI cooperates with READI in developing the Training of Trainers subproject. These and other organizations are also represented on the READI PIC.

An understanding of these various actors is important to grasping the distinction between the READI Project, which involves a rather large group of organizations working in the sector, and the READI Coordinating Unit, the purpose of which is to facilitate both administrative and substantive aspects of the Project. "READI" and "the READI Project," therefore, refer to the project in its totality. In these references, we are speaking of an effort on the part of the GOM and USAID/Malawi to strengthen certain institutions working in the sector and to enhance coordination among a larger cast of intermediaries. When we talk about the "READI CU" or "CU," however, we are referring specifically to the Central Coordinating Unit and its functions in project support.

During its implementation, READI has encountered difficulties which, although they cannot be attributed solely to the design of the project, may have been exacerbated because of gaps in project design. The design issue is important because it establishes a framework within which the participating agencies relate to each other and to the SME sector.

One problem encountered had to do with the choice of targets and project performance criteria. According to the Project Paper, "purpose achievement indicators" were defined as

- 700 new jobs created in rural areas, or with agriculture-related businesses
- 150-200 smallholders with expanded or diversified incomes
- A minimum of three Malawian private sector institutions established with good prospects for long-term self-sustainability, which assist, support, and guide emergent Malawian entrepreneurs
- The parameters for a small and medium-size entrepreneur strategy defined (credit needs, opportunities, support institutions) and the needed strategy emerging

Project outputs were defined as

- Financial intermediaries serving small-scale entrepreneurs are strengthened:
    - Financial sustainability improved
    - Client advisory services established

- Internal loan review, approval, and monitoring procedures improved

- Management staff more knowledgeable of priority investment areas, level of profitability for frequent types of credit requests; and such knowledge reflected in the loan portfolio

- Improved management capability for planning longer term organizational development

■ Small and medium entrepreneurial activities expanded:

- Forty new businesses started in areas of economic priority

- Seventy-five existing businesses expanded

- Five to ten areas of potential investment having moderate to high levels of profitability and favorable macroeconomic impact identified

■ Better coordinated and more effective support services provided by the private sector:

- Study of investment potential completed and available to potential investors and financial intermediaries

- Investment/financing guidelines prepared for use by credit institutions in Malawi on following targeted areas of economic activity:

  - Smallholder income diversification
  - Smallholder cash/export crop production
  - Potential agro-processing or agribusiness ventures
  - Potential rural industries and manufacturing
  - Rural wholesaling/retailing opportunities

- Small- and medium-scale entrepreneurial audit needs assessment

- Institutional survey for the provision of credit and related services for the small- to medium-scale entrepreneurs

In the evaluation team's opinion, these targets and performance criteria were overly broad and ambitious for a single project activity. In particular, the institution-building targets were overgeneralized and lacked clear definitions and achievement objectives. The targets do not reflect any recognition that there were several distinct organizations with distinct needs, objectives, and resources at hand. Coordination among the various participating institutions could have been facilitated more easily by a better and more clearly defined set of achievement indicators.

Another design issue arises from the use of a Washington-based OPG Agreement for funding the Africare and WOCCU/CUNA technical assistance inputs. This has caused problems in the reconciliation and communication of budgets and funding allocations between the field and AID/Washington. In one instance, for example, the allocation of funds for WOCCU/CUNA's technical advisers was delayed for several months because of a breakdown in communication between the field and the United States. This situation might have been avoided if these funds had been administered through the USAID/Malawi office.

Another area of concern, discussed in more detail below, has to do with the accountability of Africare and WOCCU/CUNA to the Project. The terms of reference set out in the Project Paper for WOCCU/CUNA explicitly state that it will work with MUSCCO. Since MUSCCO already had a working relationship with the WOCCU network, this arrangement had some precedent and was already functioning. WOCCU/CUNA's performance criteria under the scope of READI, therefore, were fairly straightforward, requiring little guidance from the CU. (The CU, however, did guide MUSCCO in strengthening its institutional planning and development strategies.)

The terms of reference for Africare were less explicit in defining the specific institutions Africare was to support. Africare's role, according to the original grant agreement, had three main functions. They were to

- Identify and examine areas of investment potential and opportunities for small- and medium-scale Malawian entrepreneurs
- Provide technical and managerial assistance to Malawian entrepreneurs participating in the project
- Provide assistance and training to Malawian staff of participating organizations and Africare's counterpart personnel

The Grant Agreement went on to state that "[the] Africare team will work primarily with Malawian small and medium-sized enterprises either directly or in tandem with the financial intermediaries."

It is important to recognize that Africare sees its primary role as working directly with Malawian entrepreneurs. In the words of its Resident Representative, Africare's objective is to "fill the gap" between the entrepreneurs and the financial institutions. Because its primary focus has been on the entrepreneurs, it has been difficult for other institutions working in the READI Project to understand Africare's role within the project's overall institutional development context. Africare, the READI CU, and the financial intermediaries continue to disagree about how Africare should carry out its mandate, and by whom its field staff should be held accountable. To their credit, the Africare field team has done a commendable job in spite of this loose, poorly defined arrangement.

Another design issue had to do with the budget for project-funded commodities, namely the allocation for vehicles and computers. Under the original agreement, three vehicles and two computers were to go to Africare; one vehicle, two motorcycles, and no computers to the Coordinating Unit; and one vehicle, seven motorcycles, and no computers to MUSCCO. Provision was made, however, for vehicles and computers for INDEFUND, although the amount allocated apparently was insufficient to meet its needs. The lack of computers in the Coordinating Unit has caused serious constraints on administrative and technical operations. The lack of additional vehicles and computers for MUSCCO has also caused serious constraints on field operations. Furthermore, because of USAID's stringent regulations governing the reallocation of line item budgets, procurement of additional equipment and vehicles to fill this gap has been a long and frustrating process for all parties involved. The project, which is in the last months of its initial contract period, still awaits the arrival of much needed additional equipment.

Management Support

The READI Coordinating Unit

Project start-up was delayed because of the late arrival of a project coordinator for READI; the original nominee withdrew his application at the eleventh hour, thereby causing an unexpected delay until August 1985 (a year after the project agreement), when the present project coordinator took up his post.

During the course of this evaluation, the local Malawian agencies funded by READI — DEMATT, MUSCCO, and INDEFUND — all voiced appreciation for the work done by the CU in developing their ability to prepare work plans and institutional development strategy statements. In the opinion of the evaluation team, this has been a positive step toward institutional capacity building under the scope of the project.

Another effort led by the CU has been the formation of a Project Implementation Committee chaired by MTIT and composed of READI-funded institutions and other cooperating organizations. This forum has proved invaluable for information sharing and coordination among intermediary agencies working in the sector. It is the first of its kind in Malawi and has gained universal approval among its members.

The evaluation team believes it is now important to transfer this function to the MTIT and institutionalize it more fully during the extension period of the Project. This work should begin with an analysis of the organizational and managerial requirements and the preparation of an institutional development plan by the MTIT, focusing on the upgrading of the present Small Scale Industry Unit to cover the entire small-scale sector.

On the administrative side, the CU has been responsible for processing budgets and expenditure allocations. This has been a time-consuming process, partly encumbered by the turnover of project accountants in the office. This has placed the burden of accounting and reporting too heavily on the project coordinator at various times throughout the project. A qualified accountant should be posted as soon as possible in order to let the CU focus on more technical and institutional development work during the extension period.

USAID/Malawi

USAID/Malawi has played a limited role in READI Project implementation and supervision. Under the original project design, the creation of the READI Coordination Unit, among other things, was to help lighten the load on USAID/Malawi for project management. This has indeed occurred, because of the hard work and dedication of the project coordinator; however, the impression of an "understaffed and overworked" Mission came up repeatedly from several sources during the evaluation. Some of the problems mentioned earlier — budgeting, accounting, reporting — appear to have been heightened by the tight staffing situation in the Mission during the course of project implementation.

Ministry of Trade, Industry, and Tourism

The opinion of agencies interviewed was unanimously in favor of the more active role being played by MTIT in the development of the SME sector in Malawi. They believe that this role is extremely positive, and they even would like to see MTIT's coordinating role enhanced. MTIT has, in fact, taken its role a step further already through the formation of a Small Scale Industry (SSI) Unit. It is the opinion of the evaluation team that this step is a strong positive indicator of the GOM's commitment to the sector and its intention to support further development of SMEs. We suggest further steps towards broadening this role in Chapter V.

Efforts to date have been impressive. MTIT, working together with the READI Project, has assisted in getting government and the private sector to work together on the issues of SME development. The team finds this to be a unique situation, from a global perspective, as demonstrated by the following factors:

- The READI Project Implementation Committee (PIC) is chaired by the acting chief of the Industry division in MTIT.
- This same person participates regularly in the Project Committee meetings to review project proposals put forth by the READI Promotion Unit.
- A member of the MTIT staff, the current head of the SSI Unit, participated in the study tour to Kenya and Botswana and assisted in the development of policy recommendations to the GOM rising out of this READI-sponsored effort.
- The MTIT principal secretary communicates regularly with the READI CU about SME sectoral issues and progress in the READI project and is actively interested in promoting development of the sector.

Monitoring and Evaluation

The objective of the project monitoring component of the READI Project was to obtain a continuous independent assessment of the progress of the project in achieving basic project objectives and to insure adherence to mutually agreed-upon implementation plans and, finally, to provide financial management advice and guidance to the organizations participating in the project. This monitoring function has been performed by Deloitte, Haskins, and Sells (DHS) since September 1985.

These semi-annual monitoring reports contain information about the lending procedures and operations of the two financial institutions (INDEFUND and MUSCCO) and about the operations and field activities of

DEMATT. The reports were prepared from a field visit from DHS staff based in Nairobi.

The purpose of these monitoring reports has not been clear to the implementing agencies. They have also expressed frustration that they do not have the opportunity to review drafts. USAID views these reports as management audits and finds them useful for monitoring the progress and development of the READI-funded institutions. It is important to note, however, that these semi-annual reports do not cover the operations of the Coordinating Unit.

Credit Program Performance

Project Goals and Objectives

The Project Paper and Grant Agreement set forth rather specific goals and objectives for the credit component of the READI Project. The Project Paper noted that

> More credit is needed to accomplish the GOM's economic objectives for diversifying farm output, increasing production of export crops, and developing a complementary light industry sector linked to the agricultural sector which will generate rural employment.

In response to this need, the Project Plan and Grant Agreement clearly defined the focus of the project. READI was to promote enterprise development in three areas:

1. Agricultural production, processing, marketing or the manufacture of agricultural inputs
2. On- or off-farm rural employment generating activities
3. Import substitution or foreign exchange-earning types of light industry and manufacturing

As originally designed, the READI Project was to provide assistance to two credit institutions: INDEFUND and MUSCCO. The objectives of this assistance were

- To increase the long-term financial viability of institutions that provide credit to small- and medium-scale entrepreneurs who are predominantly active in rural areas

- To increase the technical and financial services provided in order to assist the clients to derive maximum benefits from credit which they wish to obtain and to ensure that the clients can repay the loans

- To increase the operational efficiency of the financial intermediaries and improve their overall effectiveness

Specifically, the original Project Paper and Grant Agreement called for INDEFUND to receive a line of credit of US$ 1.2 million to lend. MUSCCO originally was to receive US$ 300,000 in grant funds to lend through its network of primary societies to individual borrowers. As a result of slow disbursements, several revisions to the project budget have reduced these amounts. The reduction for INDEFUND is substantial. Project Implementation Letter No. 16, signed July 16, 1987, reduced INDEFUND's credit line to US$ 800,000 and MUSCCO's to US$ 275,000. Amendment Three, signed September 27, 1987, increased INDEFUND's credit line to US$ 855,965. With the signing of Project Implementation Letter No. 33 on July 8, 1988, INDEFUND's credit line now stands at US$ 475,965 and MUSCCO's at US$ 268,000. (The CU has every intention of restoring these credit lines for both institutions as soon as additional funding becomes available.)

The sections that follow analyze the performance of INDEFUND and MUSCCO in using the credit resources made available to them under the READI Project. In order to provide some comparative analysis, this section of the report also takes a brief look at the objectives and performance of other intermediate financial institutions providing credit to small and medium size enterprises.

READI-funded Institutions

The READI Project provides credit to two institutions. INDEFUND is Malawi's development finance institution for medium-scale industry and enterprises; MUSCCO, a member of the World Council of Credit Unions (WOCCU), is the apex organization of the country's savings and credit union movement.

INDEFUND

INDEFUND came into existence with the financial support of INDEBANK and FMO (the Netherlands Finance Company for Developing Countries). As an intermediate financial institution, INDEFUND's stated objective is

> to help increase the productive potential of the country by providing finance and advisory service for the start-up, expansion, and modernization of enterprises owned and controlled by indigenous Malawians.

INDEFUND's provision of finance is to be targeted. It provides financial assistance to commercially viable enterprises mostly by way of medium- and long-term loans for capital investments, including working capital. INDEFUND, however, generally makes working capital available to borrowers in conjunction with capital investments. Medium- to long-term loans fall between 2 and 12 years in length. Generally, INDEFUND makes investments of between K 30,000 and K 150,000 in the following targeted sectors: agriculture, agro-industry and fishing, manufacturing, textiles, services, construction and mining, trading, and hotels and tourism.

INDEFUND prices its loans to be competitive with market — commercial bank — rates. Currently, it is charging 16.5 percent on farming and agricultural loans, 18.5 percent on loans to manufacturing enterprises, and 20.0 percent on working capital loans not tied to capital loans. The grace period on the repayment of principal can be as long as four years, but rarely does it extend beyond two years. In addition to interest, borrowers pay an investigation fee of 2 percent of the loan amount approved which is charged and payable before disbursements begin.

INDEFUND's Credit Role in the READI Project. The READI Project Paper spelled out A.I.D.'s objectives in providing credit funds to INDEFUND. It described READI as "an experimental activity for defining appropriate and efficient modalities of providing the types of assistance needed by the Malawian private sector." The Project Paper went on to stress that INDEFUND was to manage the credit resources received from READI following its "normal lending policies and procedures."

The Project Plan called for INDEFUND to draw down its line of credit at a rate of US$ 400,000 per year. The draw-downs have been considerably slower. According to the audits for 1985, 1986, and 1987, INDEFUND drew down the equivalent of US$ 253,700 in 1985, another US$ 209,970 in 1986, and only US$ 18,239 in 1987. As of December 31, 1987, INDEFUND had drawn down a total of US$ 481,909. The slow rate of draw-downs and, as mentioned above, subsequent revisions to the project budget have temporarily cut back the credit resources READI is providing to INDEFUND from US$ 1.2 million to US$ 475,965.

The evaluation team is concerned that the READI Project budget provides less credit funds to INDEFUND than it has already drawn down to fund READI/USAID-approved loans (US$ 475,965 versus US$ 481,909). This issue is being addressed in part by a new policy agreement between READI and INDEFUND to provide credit funds on a reimbursable basis. Nonetheless, the READI-funded segment of INDEFUND's portfolio has almost K 1.1 million in projects that have been approved, but have yet to draw down. It is not clear when additional READI funds will be available to reimburse these amounts when they are in fact lent to the borrowers. When the draw-downs begin, READI will be unable to provide the required funds until USAID extension funds become available. The team has also noted that the board and management of INDEFUND are not kept fully informed about these changes, which increases the confusion about the role INDEFUND is to play under the READI Project.

The Project Paper expected that INDEFUND would be "about 90 percent financially self-sustaining" by the end of the project. This now seems to have been extremely optimistic. As Table II-1: INDEFUND Operations Summary: 1894-1987 reveals, INDEFUND's non-grant income rose 360 percent from 1984 to 1987. As a result, the amount of operating expenses covered by non-grant income (coverage) increased from 83 to 139 percent. Continued improvement is to be expected. INDEFUND's 1988 budget projects non-grant income of K 952,700 and operating expenses (including K 115,600 for client services subsidized by donors) of K 617,200. These two figures produce a coverage ratio of 154 percent.

The table also makes it clear that the costs of INDEFUND's credit operations are high. In 1987, INDEFUND spent K 0.23 in operating expenses for each kwacha of loan outstanding. This figure is slightly above the 20 percent rate USAID has observed in successful SME credit institutions; however, the 1988 budget shows this figure falling dramatically to K 0.14.

This is a significant improvement; however, as the bottom portion of Table II-1 indicates, INDEFUND's financial costs, its interest on borrowings, and its bad debt expenses remain high. Management is well aware that INDEFUND has to reduce its high debt-to-equity ratio, currently 6.5 to 1, and reduce bad debts if it is to become self-sustaining.

On the issue of INDEFUND's high financial expenses, it is of interest to note that the financial analysis section of the Project Paper refers to grant, rather than loan, financing, "to enable INDEFUND to generate sufficient cash" to pay its loans to other donors and reach self-sufficiency. Under the terms of the actual Grant Agreement, the Government of Malawi was to lend to INDEFUND the grant funding the government received under the project. Originally, the loan agreement between the GOM and INDEFUND set interest at 7 percent per annum, of which INDEFUND was to retain 3 percent and capitalize 4 percent until 1993. This original loan was to be repayable over 25 years, beginning in 1993. In 1987, the GOM lowered the interest on the loan to 3 percent with effect from the commencement of the loan.

Table II-1: INDEFUND Operations Summary: 1984 - 1987
(Kwacha)

Non-grant income	1984	1985	1986	1987
Interest on loans	116,872	168,870	268,496	372,686
Investigation fees	5,609	8,957	16,870	22,814
Interest on locally registered stocks	42,748	41,290	117,306	290,225
Bank interest	6,739	5,754	34,113	73,133
Bad debts recovered				32,183
Total	171,968	224,871	436,785	791,041
Operating Expenses				
Salaries	91,554	128,290	154,887	204,499
Traveling	29,002	34,185	29,226	54,239
Office expenses	11,731	36,436	43,582	47,940
Staff housing	29,906	45,502	41,537	78,611
Audit expense	3,279	6,185	7,000	8,100
Depreciation	13,964	22,816	35,634	54,476
Directors' fees	5,199	5,417	11,837	15,091
General expenses	22,961	38,605	46,508	105,051
Total operating expenses	207,596	317,436	370,211	568,007
Operating profit/loss	(35,628)	(92,565)	66,574	223,034
Coverage (percent) (1)	82.84	70.84	117.98	139.27
Loans outstanding	936,425	1,333,014	1,606,094	2,478,093
Operating efficiency (2)	0.22	0.24	0.23	0.23
Other Expenses				
Interest and fees	51,130	81,519	197,534	192,510
Provision for doubtful debts		72,087	105,456	67,061
Investments and bad debt written off		66,882	27,628	0
Provision for diminution in value of investments	37,648	40,296	195,870	70,866
Total other expenses	88,778	260,784	526,488	330,437
Total Expenses	296,374	578,220	896,699	898,444
Net profit/loss	(124,406)	(353,349)	(459,914)	(107,403)

1. Percentage of operating expenses met by non-grant income.
2. Kwacha of operating expense per Kwacha of loan outstanding

INDEFUND's Credit Operations. INDEFUND went through a major reorganization at the beginning of 1988. The purpose of this reorganization was to make its operations more efficient and effective. Prior to January 1988, appraisal and monitoring were separate functions undertaken by two distinct groups of INDEFUND staff. Staff responsible for appraising loan applications were not responsible for monitoring the borrower's performance once the loan was sanctioned and disbursements made. In effect, problem loans became somebody else's responsibility.

As a result of the reorganization, project officers, who are responsible for both appraisal and monitoring, are grouped into two branch operations. One branch covers the north and central part of the country, the other the south. As a result of this reorganization, a project officer who has a loan approved becomes responsible for monitoring its performance. Although INDEFUND employees who previously had only appraisal responsibilities have shown some distaste for their new monitoring role, the reorganization should help to improve the overall performance of INDEFUND's credit operations.

INDEFUND has well-established procedures to appraise, sanction, and disburse loans. As has been noted in several of the DHS monitoring reports, INDEFUND does not have an active program to seek out new lending opportunities. Rather, the loan appraisal process usually begins when a potential borrower first makes contact with the organization's Blantyre office. This initial contact might be as little as a short letter describing a potential venture.

The decision on whether or not to pursue these leads rests in the hands of one of the two branch managers. If a potential project is worthwhile, the branch manager will assign one of his project officers to follow up. The objective here is to produce a presentation that eventually will go to the Board of Directors for approval. The table below summarizes the loan processing activities of INDEFUND, by branch, for the first six months of 1988.

INDEFUND Loan Processing Activity
January-June 1988

	South	North/Central	Total
Requests received	57	83	140
Applications rejected	39	53	92
Applications pending	14	23	37
Applications approved	4	7	11

The table suggests that the number of applications is increasing from recent levels. (According to the latest DHS monitoring report, INDEFUND received only 120 applications in 1986 and 1987 and approved 11 and 20 loans respectively.) Despite the fact that project officers and branch managers do not actively seek out new lending opportunities, the table above suggests that they are busy. It is also important to note that the resources available to each branch operation to travel are limited. Each branch has a single vehicle for a staff of three or four.

The total elapsed time from initial inquiry to loan disbursement can be and often is lengthy. It is not unusual to take three months from the time of the initial receipt of an inquiry to the presentation of the Board Paper. For READI-funded projects, USAID has to give its final approval before INDEFUND can make the client an offer. Approved board papers go to the READI project coordinator, who prepares a memorandum for USAID approval. Once USAID has approved the use of READI Project funds for a project, the next step is for the INDEFUND project officer to send a letter of offer to the client. With this letter, the project officer temporarily transfers the file to the implementation officer in the Client Services Department.

It is the responsibility of the implementation officer to follow up the documentation required before disbursement can take place. INDEFUND's policy is to require collateral in the form of bills of sale, mortgages, debentures, or securities and guarantees from third parties to cover its loans.

This can often be a lengthy process. The credit team reviewed one case in which it took a borrower three months to secure a title deed for a piece of property he had bought more than two years earlier.

Once the legal documentation is in place, the loan is ready for disbursement. In most cases the borrower presents pro forma invoices and other documentation against which INDEFUND draws down approved funds. Again, in cases where a borrower requires foreign exchange, getting all the paperwork in order can be time consuming.

This delay is particularly unfortunate in the case of READI project-funded loans. According to the original grant agreement, US$ 750,000 of the original US$ 1.2 million line of credit was to be in foreign currency. The agreement was later amended to reduce this amount to US$ 600,000. A dollar bank account was to have been established in the United States, and INDEFUND was to have been able to gain access to these funds through its commercial bank. The purpose of this arrangement was to avoid the problems incurred when trying to get approval for foreign exchange through the Reserve Bank. Instead, INDEFUND goes to the Reserve Bank on behalf of its clients who wish to use their loan proceeds to import equipment and raw materials. Under the direction of the current general manager, these procedures have been improved, and the Reserve Bank is issuing confirmed letters of credit on behalf of INDEFUND and its clients.

While a loan is in disbursement, a separate file is opened in the Accounting Department. The payments file maintains all the data required to track payments that INDEFUND makes for its clients (loan disbursements). In addition, the Accounts Department opens a ledger card for each loan. Until recently, the ledger card was the principal management tool used to calculate interest due on loans and to track loan repayments. This function is now computerized. The computer-generated monthly statements of account are a more useful tool for the monitoring function.

In summary, INDEFUND uses five different files and three different numbering systems to track any one project through its system. Upon receipt of an initial request, the project receives a number and an appraisal file is opened. An approved project gets a separate number, and the project officer in charge opens a monitoring file. The implementation officer maintains a separate file for the project in his office. This one contains a copy of the loan agreement and all the legal documentation. The Accounts Department maintains the payments file as well as the ledger card for each loan. The ledger card tracks all disbursements and repayments. Under the current system, the payments file bears the same number as the monitoring and implementation files, but the ledger card has a different number, which conforms to INDEFUND's chart of accounts. Finally, the BAS/TAS function has its own file for each client.

Performance of READI-funded Portfolio. As mentioned above, the original Project Paper called for INDEFUND to receive US$ 1.2 million to on lend. As a result of slow disbursements, PIL No. 33 reduced this amount to US$ 475,965 in July of 1988. (According to the project coordinator, INDEFUND's line of credit is to be restored to its original amount with the arrival of additional project funding from USAID.) However, according to INDEFUND's 1987 audit, as of December 31, 1987, INDEFUND clients with READI-supported loans had drawn down K 867,453 (approximately US$ 481,909). Since that time, however, INDEFUND has been able to accelerate its approval of loans meeting READI Project criteria. Table II-2: INDEFUND Summary of READI Project-Funded Loans summarizes the loans funded by the project.

As the table points out, the focus of READI-funded loans has shifted dramatically over the course of the last 15 months. Whereas 6 of the first 14 enterprises to receive loans were resthouses and motels, the 9 loans approved since the current general manger assumed his post represent an assortment of agricultural and agribusiness ventures. INDEFUND's lending activities, however, remain noticeably focused in the south of the country. Table II-3: Analysis of INDEFUND's READI-Funded Projects, provides a more detailed analysis of the distribution of READI-funded loans both by region and by sector. It is encouraging to note that as of the end of June 1988, agriculture and agro-industry accounted for 58 percent of the number of loans, 74 percent of the volume of loans approved, and 48 percent of the loans disbursed under the project.

The disbursements of loans remains a problem. Less than half of the READI-funded loans have been disbursed, and only K 125,000 has been disbursed of the K 1.2 millon of loans approved in 1987 and 1988. In addition, the READI-funded portion of INDEFUND's portfolio that is in disbursement has some serious problems. INDEFUND has already made provision for bad debt on K 122,642 or 13.4 percent of the amount disbursed; however, the evaluation team believes that the actual situation is worse. Table II-4: INDEFUND Debtors Position as of June 30, 1988, summarizes the current status of READI-funded loans that are in disbursement. It presents ample evidence that the READI-funded portion of INDEFUND's portfolio is weak. Of the K 47,041 in capital repayments due in June, more than 72 percent, almost K 34,000, was 120 days or more in arrears. The situation with interest payments was equally bad. Of the K 66,359 due, more than 69 percent or almost K 46,000 was 120 days in arrears. Based on the debtors' position as of the end of June, loans with a cumulative outstanding balance of K 197,974 are 120 or more days in arrears on interest and/or capital payments. As the table below indicates, however, INDEFUND expects that its collateral will minimize any net losses:

Table II-2: INDEFUND Summary of READI Project Funded Loans

Project Number	Project Name	Approval Date (day/mo/yr)	Description	Location	Region	Amount Approved (Kwacha)	Funds Disbursed (1)	Forecast Disbursements (2)	Sex (3)	Type (4)	Employment (5)
10/84	Mtema Green Gold	20/07/84	Coffee farm	Nhkata Bay	North	41,000	41,411		Male	C	40
11/84	Malindi Fisheries	08/06/84	Fishing (6)	Mangochi	South	47,500	49,006		Male	C	5
19/84	Mulanje Motel	04/12/84	Motel, restaurant	Mulanje	South	43,300	43,120		Male	P	15
25/84	Hussen Brothers	14/09/84	Resthouse	Lilongwe	Central	47,000	45,843		Male	C	16
02/85	Asia Manufacturing	23/03/85	Wooden rulers	Liwonde	South	71,500	81,437		Male	C	5
10/85	Nu-Tread Limited	12/06/85	Tire retreading	Lilongwe	Central	54,600	57,965		Male	C	60
11/85	Zidyewe Resthouse	12/06/85	Resthouse	Kasungu	North	45,000	54,191		Male	P	14
13/85	Kang'ona Kanyika	12/06/85	Resthouse	Mzuzu	North	65,530	87,417		Male	P	7
18/85	Holiday Motel	10/09/85	Motel	Mangochi	South	52,000	60,488		Female	P	15
19/85	Andrews Motel	10/09/85	Motel	Mchinji	Central	80,000	85,020		Male	P	23
24/85	Chitekwe Wholesale	04/12/85	Wholesale shop	Thyolo	South	25,000	28,672		Male	P	3
26/85	Chifira Development	04/12/85	Fishing	Mangochi	South	26,000	32,024		Male	C	5
27/85	Zinga Farm	04/12/85	Maize mill	Mulanje	South	100,000	50,934		Male	P	15
25/85	Sekera Poultry Farm	04/12/85	Poultry farm	Lilongwe	Central	42,215	48,322		Male	P	2
11/86	Asia Manufacturing	23/09/86	Wooden rulers (7)	Liwonde	South	38,000	25,714		Male	C	0
13/87	Tiyese Maize Factory	13/05/87	Maize mill	Mulanje	South	70,000	74,889		Male	C	10
16/87	Lakeshore Ginning	13/07/87	Cotton gin	Karonga	North	250,000			Male	C	40
27/87	Phala Estate		Tobacco farm	Mzimba	North	57,000	50,113		Male	P	45
35/87	Liwonde Tannery	17/12/87	Leather tannery	Liwonde	South	268,500		80,000	Male	P	26
32/87	Tayesa Rice Milling	17/03/87	Rice mill	Chiradzalo	South	191,820		191,820	Male	P	33
14/88	Chiwa Farm	13/05/88	Vegetable farm	Lilongwe	Central	55,400		55,400	Male	P	18
18/88	Matumba Fishing	22/06/88	Fishing	Mangochi	South	58,740			Male	P	5
25/88	Grain Tobacco Estate	22/06/88	Tobacco farm	Machinga	South	150,900		150,900	Male	P	40
22/88	Mchilingano Estate	22/06/88	Tobacco farm	Salima	Central	133,000		133,000	Male	P	30
			Totals			2,014,005	916,565	611,120			472
			Averages			83,917	53,916	122,224			20

1. As of June 30, 1988.
2. July to December 1988.
3. Sex of borrower.
4. C = limited liability company; P = sole proprietorship.
5. INDEFIND staff estimates of jobs per enterprise.
6. INDEFUND records show this as two loans.
7. This is a second loan.

INDEFUND: Collateral on Potential Defaulters

Borrower	Outstanding balance (kwacha)	Collateral
Coffee farm	4,713	Land worth K 40,000 to be auctioned
Fishery	42,537	
Manufacturing	60,949	Valuable machinery and equipment
Tire re-treading	25,417	Loan repaid in full after 6/30/88
Wholesaler	17,587	Stop order: paying K 900/month
Piggery	49,105	
Poultry farm	8,239	
Total	197,687	

If INDEFUND has to make provision for another K 99,881 of loans currently 120 or more days in arrears, and for which it does not have adequate collateral, the bad debt would increase to 24.3 percent of the READI-funded portion of its portfolio.

MUSCCO

The Malawi Union of Savings and Credit Co-operatives (MUSCCO) came into existence in 1980. As defined in the 1986 Annual Report, MUSCCO's major objective is

> to develop a sound and viable Credit Union movement throughout Malawi by improving management skills of the Credit Unions and to improve financial management skills and credit worthiness of the individual members and the societies.

The Annual Report goes on to describe the unique position MUSCCO fills among financial and development institutions in Malawi. Savings and credit unions "are the only financial institutions in the rural areas that provide both a place to save and a place to borrow money."

Table II-3: Analysis of INDEFUND READI-Funded Projects

	Loans						Employment	
	No.	Percent	Volume Approved (Kwacha)	Percent	Volume Disbursed (Kwacha)	Percent	Number Employed	Percent
By Region								
North	5	20.83	458,530	22.77	233,132	25.41	146	30.93
Central	6	25.00	412,215	20.47	237,150	25.85	149	31.57
South	13	54.17	1,143,260	56.77	447,284	48.75	177	37.50
Total	24	100.00	2,014,005	100.00	917,566	100.00	472	100.00
By Sector								
Agriculture								
Coffe farm	1	4.17	41,000	2.04	41,411	4.51	40	8.47
Poultry farm	1	4.17	42,215	2.10	48,322	5.27	2	0.42
Tobacco farm	3	12.50	340,900	16.93	50,113	5.46	115	24.36
Vegetable farm	1	4.17	55,400	2.75	0	0.00	18	3.81
Total	6	25.00	479,515	23.81	139,846	15.24	175	37.08
Agro-industry and Fishing								
Cotton gin	1	4.17	250,000	12.41	0	0.00	40	8.47
Fishing	3	12.50	132,240	6.57	81,030	8.83	15	3.18
Maize mill	2	8.33	170,000	8.44	125,823	13.71	25	5.30
Rice mill	1	4.17	191,820	9.52	0	0.00	33	6.99
Tannery	1	4.17	268,500	13.33	0	0.00	26	5.51
Total	8	33.33	1,012,560	50.28	206,853	22.54	139	29.45
Manufacturing								
Tire retreading	1	4.17	54,600	2.71	57,965	6.32	60	12.71
Wooden rulers	2	8.33	109,500	5.44	108,151	11.79	5	1.06
Total	3	12.50	164,100	8.15	166,116	18.10	65	13.77
Hotels, Tourism								
Resthouses, etc.	6	25.00	332,830	16.53	376,079	40.99	90	19.07
Service and Transport								
Wholesale shop	1	4.17	25,000	1.24	28,672	3.12	3	0.64
Total	24	100	2,014,005	100	917,566	100	472	100

Table II-4: INDEFUND Debtors Position as of June 30, 1988
(Kwacha)

Description	Funds Disbursed	Repayments	Provision for Bad Debt (31/12/87)	Net Investment	Payments Due as of 06/30/88 Capital	Payments Due as of 06/30/88 Interest	Total Arrears 120 Days and Over Capital	Total Arrears 120 Days and Over Interest	Potential Additional Write Downs
Coffee farm	41,411		36,698	4,713		13,421		10,703	4,713
Fishing	49,006	6,469		42,537	9,563	3,435	8,731	3,435	42,537
Motel, restaurant	43,120	16,495		26,625	2,991	966			0
Resthouse	45,843	33,440		12,403					0
Wooden rulers	81,437		45,905	35,532		19,657		19,687	35,532
Tire retreading	57,965	43,464		14,501	14,501		14,501		14,501
Resthouse	54,191	5,069		49,122	600	711			0
Resthouse	87,417			87,417		1,977			0
Motel	60,488	3,910		56,578	1,271	1,990			0
Motel	85,020	12,625		72,395		1,043			0
Wholesale shop	28,672	11,083		17,589	5,045	246	2,655		17,589
Fishing	32,024	32,024		0					0
Maize mill	50,934	1,829		49,105	6,170	1,394	3,367		49,105
Poultry farm	48,322		40,039	8,283	6,900	11,366	4,600	8,782	8,283
Wooden rulers	25,714			25,714		10,169		10,169	25,714
Maize mill	74,889	10,300		64,589		924			
Tobacco farm	50,113			50,113					
	916,566	176,708	122,642	617,216	47,041	67,299	33,854	52,776	197,974

MUSSCO's Credit Role Under the READI Project

The original design of the READI project called for MUSCCO to receive a US$ 300,000 line of credit in the form of grant funds. The most recent changes to the project budget reduced this amount to US$ 268,000. The primary purpose of these funds was to increase the capital of MUSCCO's Central Finance Department (CFD). Basically, CFD is the credit union for Malawi's 79 primary savings and credit societies. Prior to the READI Project, CFD's resources were limited to "the amount of savings which the individual member has deposited with the credit union" (Project Paper, pp. 12-13). The Project Paper called for MUSCCO to use these funds in accordance with the "regulations, procedures, and policies established by MUSCCO for its Central Finance Fund." A.I.D., however, set a limit on the size of any one loan made to an individual member of a primary society to US$ 5,000 (K 5,250 at the time of the Project Paper).

The Project Paper sets forth specific targets for MUSCCO's growth towards financial self-sufficiency. It "projected that MUSCCO [would] increase its degree of self-sufficiency from. . . 10 percent to nearly 35 percent" by the end of the project (1988). MUSCCO has made considerable progress in recent years. From 1986 to 1987, the portion of operating expenses covered by non-grant income rose from 18.2 to 23.8 percent. Because of its relatively small volume of loans outstanding, MUSCCO's lending operations are expensive. In 1986, it incurred K 1.92 of expenses for each kwacha of loan outstanding. In 1987, the figure improved to K 1.31; however, it is important to view these numbers with some caution. MUSCCO's financial statements do not disaggregate expenses incurred for credit and non-credit operations, such as training of study groups and primary societies.

MUSCCO's Credit Operations

MUSCCO's CFD provides a supplemental source of credit for the primary societies to lend to their individual members. As of June 30, 1988, the primary societies had loans outstanding of almost K 1.5 million. This is the amount the primary societies had lent to their individual members. CFD had loans outstanding of almost K 226,000.

CFD makes three types of loans available to the primary societies. Development loans are very small, rarely exceeding several hundred kwacha, and provide stationery and other office supplies in kind to primary societies. Development loans carry a 6 percent interest rate and are repayable in two years. Under the short-term loan program, CFD lends money to primary societies for lending to members to meet their short-term needs. These needs might include the purchase of fertilizer and other inputs for farming or the financing of small enterprises. Under the short-term loan program, primary societies may borrow up to 50 percent of their share of capital. Societies pay 12 percent interest on these loans, 11 percent on amounts that exceed 30 percent of share capital. The primary societies lend these funds to their members at 18 percent. Under its third line of operation, the long-term loan program, CFD makes larger loans available to entrepreneur members of primary societies. CFD loans funds to the primary societies at 11 percent for up to five years. An individual society member, in turn, may borrow up to 10 times his or her share capital at 16 percent from the society.

MUSCCO has well-established procedures for making long-term loans. The process begins when a member brings an application letter, including a business plan, to the credit committee of his or her primary society. The credit committee evaluates the application on the following criteria:

- Member: records in society
  behavior in society and in the community
  skills and experience in the proposed project
- Proposed project/business: market for product
  availability of raw materials
- Size of loan in relation to maximum allowed by society
- If any, how borrower's contribution will be met

If approved, the potential borrower pays a K 1.50 application fee to the society and in return receives an application form, which he or she completes in duplicate. In the application, the borrower must estimate income and expenses and cash flow for the first 12 months of the project. When completed, often with assistance from DEMATT, the potential borrower submits the application to the credit committee.

If the credit committee approves, it passes the application on to its society's board of directors. If the board approves, it requests CFD funding by completing an "Application To MUSCCO For a Central Finance Loan" and paying a K 1.50 application fee. The head of CFD, assisted by an Africare adviser, is responsible for processing and evaluating long-term loan applications from the primary societies.

If CFD approves the application, it completes a MUSCCO Central Finance Promissory Note. In the promissory note, the borrowing society pledges its shares as collateral. In other words, the savings of all members of a primary society are at risk under this borrowing program. Upon receipt of the CFD promissory note, the primary society draws up a promissory note between it and the borrower. Under the heading of "Additional Provisions," this promissory note spells out the borrower's obligations. These provisions specify that a borrower may not withdraw either share capital or membership from the primary society during the period of the loan. The promissory note obligates the borrower to have proper fire and theft coverage, to open "a BANKING ACCOUNT FOR THE BUSINESS separate from [his or her] personal BANKING ACCOUNT," and to become an "active client of DEMATT and remain so until the loan is repaid in full."

At the present time, CFD's operations are manual. CFD calculates the interest due on a loan from the data that are recorded on the ledger card maintained for each loan. Apparently, CFD does not prepare a schedule of payments due each month by which to monitor payments. Nor does it invoice its borrowers. The evaluation team believes that computerizing CFD's loan records would make the loan monitoring function more efficient. Using the computer equipment that is currently available to CFD to computerize existing loan records should be a top priority.

Performance of MUSCCO's Credit Operations

The economic analysis of MUSCCO contained in the Project Paper set unrealistic goals for the credit operations the READI Project has funded. According to this analysis, the Project Paper expected that by 1988 MUSCCO would have 323 loans outstanding, worth K 342,000. As of June 30, 1988, information supplied to the evaluation team by MUSCCO shows that CFD had 65 loans totaling K 225,657.19 outstanding.

As of June 30, 1988, MUSCCO had drawn down K 485,303 of the line of credit made available by the READI Project. Unfortunately, data on the CFD's loan program from the beginning of the READI Project through 1985 are not readily available. From the beginning of 1986 through June 30, 1988, however, MUSCCO had used the Project's resources earmarked for credit to make 90 short-term loans totaling K 332,000 and 25 long-term loans totaling K 94,000. The following paragraphs summarize the analysis of the long-term loan program.

The long-term loan program got off to an inauspicious start in 1986. After the word got out that MUSCCO had funds available, it was deluged with applications. The quality of these initial applications was poor. The fact that MUSCCO approved only 15 of the 111 applications it received in 1986 is evidence enough of the problems it faced. The flow of applications has since slowed considerably. In 1987, CFD approved 10 of the 12 long-term loan applications it received, and as of mid-year 1988, it had approved none of the 10 applications received.

Table II-5: MUSCCO Long-Term Loan Summary summarizes the history of the long-term lending program. To date, the size of the average loan made under this program is small, e.g., K 3,743. It is encouraging to note that more than 98 percent of the amount approved has been disbursed. The average loan has a 44-month term. Although not highlighted in the table, women have

Table II-5: MUSCCO: Long-term Loan Summary

No.	Purpose	Location	Region	Date of Loan	Loan Amount	Term of Loan	Repayment Schedule	Amount Disbursed	Out-standing Balance	Status of Loan
1	Farming: oxen, oxcart	Madisi	C	April 86	790	36	Semi-annual	790	189	Current
2	Tailoring	Phanumic	C	May 86	5,200	36	Quarterly	5,200	2,976	Current
3	Tobacco farming	Enukweni	N	July 86	3,560	60		3,555	2,843	Current
4	Animals - piggery	Chitedze	C	July 86	3,000	36	Semi-annual	1,600	475	Current
5	Animals - poultry	Makungwa	S	August 86	8,411	60	Monthly	8,411	8,411	Delinquent
6	Brick/Tile Making	North Lukuru	N	September 86	7,500	24	Quarterly	7,500	7,500	Delinquent
	Retailing	Mulanje Teachers	S	October 86	1,500	36	Quarterly	1,500	892	Current
8	Brick/tile making	Ekwendeni	N	October 1986	3,094	36	Yearly	2,836	2,826	Delinquent
9	Tobacco farming	Lunyina	N	October 86	2,400	48	Yearly	2,400	1,200	Current
10	Tobacco farming	Lunyina	N	October 86	8,666	24		8,666	4,333	Current
11	Vegetable	Lunyina	N	October 86	1,131	48		1,131	707	Current
12	Tobacco farming	Enukweni	N	October 86	5,338	60		5,338	4,200	Current
13	Farm trans.: oxen, cart	Kachawa	C	November 86	1,480	36	Annual	1,480	921	Current
14	Retailing	Nalipili	S	December 86	5,350	60	Quarterly	5,350	4,500	Current
15	Animals - piggery	Malawi Railways	S	January 87	1,500	24	Annual	1,500	1,500	Delinquent
16	Animals - poultry	Chitedze	C	February 87	2,500	36	Quarterly	2,500	1,874	Current
	Animals - dairy	Malawi Railways	S	April 87	600	36	Quarterly	600	600	Delinquent
18	Hotelling	Ekwendeni	N	September 87	8,500	60	Quarterly	8,500	4,011	Delinquent
19	Retailing	Chinzama	S	December 87	2,144	60		2,144	1,830	Current
20	Retailing	Chimwabvi	S	December 87	5,000	60	Quarterly	5,000	4,919	Current
21	Animals - dairy	Buumbule	S	December 87	900	48		900	781	Current
22	Tobacco farming	Chitikuko (MUSCCO)	C	December 87	4,000	48	Annual	4,000	4,000	Current
23	Tobacco farming	Kachawa	C	December 87	8,500	48	Annual	8,500	8,500	Current
24	Tobacco farming	Lunyina	N	December 87	1,500	24	Semi-annual	1,500	1,500	"Current"
25	Brick/tile making	Chitukuko (MUSCCO)	C	November 87	1,000	24	Semi-annual	1,000	1,000	"Current"
				Total	93,564			91,901	72,489	
				Average	3,743	44		3,676	2,900	

Note: "Current" designates a loan which the evaluation team believes to be delinquent; see text for explanation.

received 4 of the 25 long-term loans, including K 790 for an ox cart (Loan #1), K 5,200 for a tailoring project (Loan #2), K 3,000 for a piggery (Loan #4), and K 1,500 for a retail business (Loan #7). Loans to women represent 16 percent of the number and 11.2 percent of the value of MUSCCO's long-term loans. Table II-6: Types and Number of Projects/Businesses Funded by MUSCCO Central Finance Long-Term Loan Program provides a breakdown of the portfolio by type or purpose of loan and by region.

Table II-6: Types and Number of Projects/Businesses Funded by the MUSCCO Central Finance Long-Term Loan Program

	Number	Total amount (Kwacha)
Type and purpose of loan		
Farming		
Farm transport (oxen and oxcart)	2	2,000
Tobacco	7	34,000
Vegetables	1	1,000
Animals (poultry, piggery, and dairy)	6	17,000
Brickmaking	3	12,000
Hotelling	1	9,000
Tailoring	1	5,000
Retailing	4	14,000
Total	25	94,000
Geographical Distribution of the Projects		
Northern region	9	42,000
Central region	8	27,000
Southern region	8	25,000
Total	25	94,000

Information provided to the evaluation team by MUSCCO indicates that six loans are currently in arrears. Upon further analysis, the evaluation team believes that two other loans are in arrears.

MUSCCO: Long-Term Loan Delinquencies
(as of July 24, 1988)

A. Loans MUSCCO has identified as delinquent

No.	Purpose	Location/region	Outstanding balance (kwacha)	Repayment schedule
5	Animals - poultry	Makunga S	8,411	Monthly
6	Brick/tile making	No. Lukuru N	7,500	Quarterly
8	Brick/tile making	Ekwendeni N	2,826	Yearly
15	Animals - piggery	Malawi RR S	1,500	Yearly
17	Animals - dairy	Malawi RR S	600	Quarterly
18	Hotelling	Ekwendeni N	4,011	Quarterly
	Subtotal A		24,848	

B. Additional loans evaluation team believes to be delinquent

No.	Purpose	Location/region	Outstanding balance	Repayment schedule
24	Tobacco farm	Lunyina N	1,500	Semi-Annual
25	Brick/tile making	Chitukuko C	1,000	Semi-Annual
	Subtotal B		2,500	

Explanation B:

Loan 24: MUSCCO records show that a semi-annual payment of K 258, including K 82.50 in interest and K 175.50 in principal, was due June 30, 1988.

Loan 25: A semi-annual principal payment of K 250 was due May 30, 1988. Interest on this loan is to be paid monthly according to MUSCCO records.

CFD has information on why most of the loans are in arrears. The explanations point out how difficult this type of lending can be. For example, Loan 15 is in arrears because the pigs have had diseases. Loan 17 has problems because the dairy cow purchased by the borrower apparently has reproductive problems and cannot produce milk. The borrower discovered the problem after receiving the Veterinary Service's approval to purchase the animal. Because of difficulties in acquiring packing materials, the borrower of Loan 24 has not yet been able to sell his tobacco and pay off his loan.

The six loans MUSCCO has designated delinquent account for just over 27 percent of the amount CFD has disbursed under the long-term loan program. The two additional loans that the evaluation team believes are in arrears account for an additional 2.7 percent. Together, the outstanding balance on these eight overdue loans amounts to K 327,348 or almost 30 percent of total long-term loan disbursements.

Cooperating Institutions

Cooperating institutions are defined here as those organizations that currently do, or have the potential to, provide credit to the SME sector. The first part of this section briefly describes two institutions that are directly involved in the sector: SEDOM is a development finance institution; MEDI, although primarily a training organization, also has a credit program. The second part provides a quick overview of Malawi's commercial banking and financial institutions. Prominent here are the two commercial banks, the Commercial Bank of Malawi and the National Bank of Malawi; the Malawi Development Corporation; the Leasing and Finance Corporation of Malawi; and the Finance Corporation of Malawi.

Cooperating Development Organizations

In addition to INDEFUND and MUSCCO, SEDOM and MEDI play important roles in providing credit to the SME sector. Financial assistance from the EEC and the GOM fuels SEDOM's lending activities. An EEC grant valued at more than ECU 3.4 million, including ECU 1.22 million for a revolving loan fund, plus a GOM contribution of K 396,000 financed SEDOM's Phase I activities from 1983 to 1985. A second grant of ECU 3.0 million and a special loan of ECU 1.8 million provided funding for SEDOM's operations from late 1985 to March 1988. Phase III funding plans call for an additional K 16 million in donor support.

As set forth in the organization's Trust Deed, the functions of its Loan Fund are

> Providing loans, but not grants, to Malawian entrepreneurs to enable them to set up, acquire, expand, or improve industrial ventures or premises thereof or machinery, equipment, stocks or fittings or other fixed or movable assets necessary in the particular industrial venture.
>
> The establishment and operation of schemes to facilitate the purchase or hire, by Malawian entrepreneurs engaged in the setting up or operation of industries, of machinery, equipment, materials, parts and components necessary for their enterprises.

SEDOM uses several different approaches to provide credit to its target market. Through the mini-loan program, SEDOM provides up to K 3,000 to borrowers. Mini-loans charge 18 percent interest and can be for as long as two years. Few, however, exceed 12 months. According to SEDOM's loans manager, the purpose of the mini-loans program is "to introduce people to credit."

SEDOM also makes term loans. SEDOM charges 18 percent on these loans, which can be for as much as K 75,000 and as long as 12 years. (The current portfolio has one eight-year loan, and the next longest has a six-year term.) In addition, term borrowers have to make a significant contribution to the project. For example, in the case of maize mills, SEDOM requires the borrower to put down 30 percent.

SEDOM also engages in financial leases, which require no minimum deposit and follow normal leasing requirements. And finally, SEDOM's Board of Directors has approved, in principle, equity investments. Currently, there is a ceiling of K 100,000 on the amount of equity SEDOM can commit to any one venture, and it will do so only when the client has reached the term loan ceiling of K 75,000 and no other sources of financing are available.

SEDOM has three regional offices which process loan applications. Each month the regional managers travel to Blantyre and sit on the mini-loan and term loan committees. Above K 50,000, the term loan committee defers final approval to the Board of Directors.

Statistics supplied to the evaluation team by SEDOM reveal some interesting facts about its loan program. From the beginning of operations through June 1988, SEDOM had received 4,881 applications requesting K 24.2 million in financing. It has approved 2,817 requests, 57.7 percent of the total, for K 8.5 million, an average of just over K 3,000 per loan. Disbursements to June 30, 1988 totaled K 7.367 million. SEDOM's borrowers have repaid K 2.439 million in capital as well as K 1.196 in interest. As of June 30, 1988, SEDOM reported outstanding loans of K 4.928 million and estimated that 8.3 percent of the portfolio was in arrears of 30 days or more. SEDOM's costs of doing business have declined steadily but remain high. In 1984, it incurred K 2.10 for every kwacha of loan outstanding. The 1987 READI study estimated SEDOM's costs at K 0.67 per kwacha of loan outstanding. Over the same time period, non-grant income as a percentage of operating costs has climbed from 4.5 to almost 20 percent. During Phase III, 1988/89 to 1990/91, SEDOM expects that income will increase from 37.7 to 51.8 percent of its recurrent costs, exclusive of technical assistance.

With adequate computer hardware and a full-time programmer who has designed customized software, SEDOM is able to generate an impressive amount of information on the performance of its portfolio. This information includes data on borrowers by sex and region, job creation, and investments by industry code.

Although MEDI is primarily a training organization, it also operates a unique loans program. MEDI provides loans in kind, including both equipment and materials, to its graduates. MEDI recently increased the interest it charges from 10 to 15 percent. Its loans have a five-year term.

Providing loans in kind provides a valuable service to MEDI graduates. Rather than having to go through the often time-consuming process of procuring equipment and supplies, participants in this program can get started in their businesses with little delay. After this initial stock of raw materials and supplies runs out, however, MEDI's borrowers often find themselves in the same predicament as most other small-scale entrepreneurs.

Commercial Financial Institutions

The commercial, as opposed to developmental, segment of the banking and finance industry of Malawi is well organized and capable of providing a complete array of financial services to both the public and private sectors. Following are brief descriptions of each of these institutions.

INDEBANK

The stated objective of INDEBANK, which holds 60 percent of the equity in INDEFUND, is

> to make a contribution to the advancement of productive business enterprises which in turn contribute to economic and social progress in accordance with the developmental goals set and pursued by government.

INDEBANK's shareholders include ADMARC, CDC, FMO, DEG, and the IFC. Its target size for loans falls in a range from K 150,000 to K 1.8 million. In addition, INDEBANK will make equity placements of up to 35 percent of the total in any one venture. Currently, it is charging competitive rates on its loans: 16.5 to 18 percent for most loans and 15 to 16 percent for agriculture-related undertakings.

The Commercial Banks

There are two commercial banks in Malawi: the Commercial Bank of Malawi and the National Bank of Malawi. Their lending activities concentrate on the country's two major export industries: tobacco and tea. At the

Commercial Bank, branch managers have authority to approve loans from K 2,000 to 20,000, depending on their seniority. The bank's regional offices have authority to approve loans of K 20,000 to 50,000. Currently, both commercial banks are charging 16 to 16.5 percent on agricultural loans and from 17 to 20 percent on other loans. The interest rate varies with the banks' assessments of applications. The commercial banks are currently paying depositors from 8.75 percent on short call deposits to 13.75 percent on one-year fixed deposits.

Malawi Development Corporation (MDC)

The Malawi Development Corporation (MDC) is a statutory body wholly owned by the GOM. The objectives of the corporation are to "develop the agricultural, commercial, industrial and mineral resources and the economy of Malawi using sound business principals." MDC limits its investments in any one project to 10 percent of its share capital plus reserves, K 2.5 million at current levels, not to exceed 50 percent of the total cost of any one project. MDC charges an investigation fee of 1 percent of its investment and a commitment fee of 1 percent is payable on the undrawn portion of a loan. MDC currently is charging 16 to 18 percent on loans denominated in kwacha and 10 percent on loans denominated in foreign exchange. It makes mid-term loans, generally from 5 to 8 years long, and never exceeds 10 years.

Finance Corporation of Malawi (FINCOM)

The Finance Corporation of Malawi (FINCOM) is owned by the GOM through ADMARC. Foreign interests hold a minority share. FINCOM engages in four lines of business: short-term (up to 180 days) trade financing; government procurement; transportation of essential commodities; and insurance for business and industry. FINCOM operates on strict commercial terms and is unlikely to serve SME sector clients unless they can meet requirements for audited accounts showing a strong balance sheet with sufficient net worth to secure any borrowing needs.

The Leasing and Finance Company of Malawi (LFC)

The Leasing and Finance Company of Malawi (LFC) provides medium-term, (three- to five-year) leases on capital equipment. The terms of any one agreement are determined by the average usable life of the asset under lease. LFC will arrange leases as small as K 1,000 up to K 1.5 million. It charges between 22 and 26 percent on the declining balance of the lease. In the two years it has been in operation, LFC has found a ready market for its services. Since opening, its has grown to almost K 27 million in assets, and it is currently willing to pay up to 18 percent interest on five-year fixed deposits in order to generate additional sources of funds.

BAS/TAS Services

Project Goals and Objectives

The original READI Project Grant Agreement called for technical and business advisory services (TAS/BAS) to be provided to the SME sector by two U.S. private voluntary organizations (PVOs), Africare and WOCCU/CUNA. Partnership for Productivity/International (PfP) was funded separately under an A.I.D. OPG to support DEMATT. The READI Project Paper envisaged a "cooperative" relationship between DEMATT (and PfP) and the funded institutions (this changed, of course, when PfP folded and USAID assistance to DEMATT came under the READI Project).

The READI Project's purpose is to support these institutions in developing assistance in the following areas:

- Agricultural production, processing, and marketing
- On- or off-farm rural employment
- Import substitution of foreign exchange earning activities that could benefit rural consumers

READI was to "finance a shared pool of technical assistance which [would] deal directly with the rural private sector and the agro-business [*sic*] sector as well as provide specialized assistance to the financial intermediaries" (Project Grant Agreement). Further, the READI Project was designed with a major assumption that was intended to be tested during the first half of the Project: "to influence the types of credit extended to clients by financial intermediaries by providing technical assistance to shape the demand for credit rather than restrict the supply of credit to narrowly defined types of activities" (Project Agreement).

Additionally, the project was intended to assist institutions to "identify target investment opportunities suitable for small and medium scale entrepreneurs [and mobilize] resources in order to realize identified investment potentials." The Project Paper and Grant Agreement did not specify who should take responsibility for such identification or who should provide business advisory or technical advisory services after the appraisal stage.

In a broader sense, the two U.S. PVOs (WOCCU/CUNA and Africare) were called upon to strengthen the two institutions (INDEFUND and MUSCCO) to meet the objectives cited above. Africare was awarded US$ 1.475 million for "private sector support" activities while CUNA/WOCCU was awarded US$ 370,000 to provide technical assistance to MUSCCO. In addition, the READI Project Coordinating Unit (CU) was budgeted at US$ 600,000 for coordinating and monitoring the project, as well as for studies, including a study "describing the types of support services frequently needed by small scale Malawian entrepreneurs," and a study "to assess and quantify the credit needs of small and medium sized entrepreneurs" (Project Agreement).

The Project Grant Agreement was amended in March, 1987 to include DEMATT as a participating agency within the READI Project "to support its business and technical advisory services to small and medium-scale businesses" (Project Grant Agreement, Amendment No. 2). Approximately US$ 700,000 was added to the READI Project budget to support DEMATT's operating budget and to finance the services of two expatriates.

Total institutional development support evolved as follows (all numbers in U.S. dollars):

Project elements	Original	Amendment 2	Amendment 3	Current
MUSCCO Inst. Dev.	790,000	790,000	940,000	1,120,000
INDEFUND Inst. Dev.	200,000	200,000	204,551	104,551
DEMATT Inst. Dev.	0	225,000	325,000	565,000
DEMATT T.A.	0	110,000	358,156	195,000
Africare	1,475,000	1,475,000	1,475,000	1,475,000
READI Unit	600,000	800,000	1,366,328	1,596,484
Total T.A. and support	3,065,000	3,600,000	4,669,035	4,669,035

As the figures above show, and as will be discussed below, the original budget for institutional development (including the READI Project Coordination Unit) increased by 65 percent between 1984 and the present (funding for the READI Coordinating Unit increased by a factor of two and a half).

The READI Project Implementation Committee (PIC) first met in June 1985. Technical and business advisory services were further elaborated within the PIC context, and the Energy Initiatives for Africa (EIA) Sub-Project for Malawian SMEs was brought under the READI umbrella in late 1985. Over the past three years, the PICs have continued to review and modify the Project's focus on BAS/TAS. The most noteworthy addition to the Project's BAS/TAS mandate has been the funding of a "Project Promotion Unit," through the READI Coordinating Unit, for identifying and promoting 100-200 prepared projects for funding (by INDEFUND).

MUSCCO

The Malawi Union of Savings and Credit Cooperatives Organization (MUSCCO) has received external assistance from USAID since its foundation in 1980. The World Council of Credit Unions (WOCCU) and the Credit Unions of North America (CUNA) have provided expatriate and training assistance through three Operational Program Grants (OPGs), including their current READI-funded OPG.

MUSCCO's purpose is to assist the development of the credit union movement in Malawi. The READI Project has provided funds for staff training, purchase of facilities, meeting operational expenses, providing expatriate assistance, and extending credit to member societies. MUSCCO's BAS/TAS activities have been directed primarily towards appraising member societies short- and long-term loan proposals.

READI Project Inputs. The READI Project has provided long-term expatriate assistance as a follow-on to earlier A.I.D.-supported technical assistance in building MUSCCO as a viable national institution. WOCCU/CUNA provide two long-term experts to MUSCCO: a financial management specialist, advising MUSCCO's general manager, and a training officer, assigned to the Field Services and Training Office. The major objectives of these two advisers are to provide on-the-job training to their counterparts and to help MUSCCO to expand and strengthen its activities.

The READI Project, by funding MUSCCO's short- and long-term loan programs, placed considerable importance upon the organization's new Central Finance Department (CFD). The project did not provide for the personnel, training, logistical, or technical assistance support necessary for the CFD to operate at expected levels.

During the course of the evaluation, it was apparent that the CFD, which is staffed by one Malawian (funded through Africare), was overworked and that expectations of Central Finance's actual abilities to appraise and monitor loans exceed its capabilities.[1] While the placement of an agribusiness specialist within the CFD has relieved some of the appraisal burdens on staff, it has not truly addressed MUSCCO's needs in this area (see Training, below). In addition, as a component of the READI-funded loan program, the CFD is expected to play a project promotional role. This places even more of a burden upon the department and creates tension between two essentially different functions of the department — project monitoring and project promotion (a divergence that characterizes all SME lending institutions). The team advises MUSCCO, as well as INDEFUND, to examine carefully the conflicts that may arise when the same organization promotes a particular project, appraises that project, and monitors that project. Tensions often arise between these very distinct banking functions.

MUSCCO's field staff (six field and assistant field officers, with three Peace Corps volunteers) is doing a truly commendable and remarkable job of assisting member societies (79 of them) in a variety of fields. Field officers provide everything from training to auditing assistance to primary societies. They cover large geographic areas with limited logistical support (old motorbikes and no protective clothing). It is a statement of the dedication and commitment of these staff members that so much has been achieved in the field over the past few years. To maintain this quality of work, when

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1. The term "appraise" applies to a banking function whereby a credit institution prepares a project for presentation to its board, credit or loans committee, or whatever body approves credit applications. Project "identification" refers strictly to the process of locating a potentially viable project. Project "promotion" is actively seeking out potential projects through some sort of promotional process (advertising, systematically soliciting requests for particular types of activities).

The terms "feasibility" and "prefeasibility" are essentially technical, not banking, terms and refer to preparing a document that sets out certain financial, technical, marketing, and technology issues for consideration. In this sense, the READI Project Promotional Subproject is attempting to prepare a series of feasibility documents. Should INDEFUND (or any other institution) find a project potentially feasible, it would then go through its own appraisal process before presenting the project to its board.

Loan "monitoring" refers to the standard banking practice of monitoring performance (whether the client is delinquent, whether the client requires loan rescheduling) and the process of collecting payments due on the loan.

MUSCCO, with the encouragement of the READI Project, is expanding the number of member societies and the level of services to those societies (i.e., loans), expansion will need to occur at the field level.

It is the opinion of the evaluation team, after visiting field offices and member societies in the Northern, Central, and Southern regions (both urban and rural), that the quality of MUSCCO's field work is already suffering from overextension. Distances travelled by field officers are amazing, and the average field officer spends more than 50 percent of his time on the road, away from home.

The READI Project did not include provision for much program support to MUSCCO for commodity inputs. MUSCCO has relied to a considerable extent on support from Africare. Such support has included access to Africare's agribusiness specialists' vehicle and other equipment (typewriter, computer, and so on). This reliance has been a source of tension between MUSCCO and Africare and between Africare's own advisers and Africare management. Given the considerable amount of goodwill on the part of both Africare and MUSCCO, Africare's support has proven invaluable. MUSCCO, however, should have been provided with a dedicated line item for commodity procurement to support its BAS/TAS program.

In addition, as set out above and as pointed out in various portions of this evaluation, the positions and skills of expatriate advisers have not always conformed to or fit with the true needs of the recipient/participating agencies. In MUSCCO's case, it seems apparent that an adviser with more financial management experience, attached to the CFD, would have been of more value to the institution than an agribusiness adviser (it should be noted that both Africare advisers have received consistently high marks for service and dedication from virtually all MUSCCO staff interviewed).

READI Coordinating Unit Assistance

One of the READI Project's greatest contributions to MUSCCO has been the Coordinating Unit's assistance to management in developing MUSCCO's first institutional plans. The process of planning is acknowledged by all parties interviewed as being a major step in MUSCCO's institutional development.

Another READI Coordinating Unit accomplishment with MUSCCO has been its integration into the entire project implementation process and, consequently, its increasing contacts with other SME institutions. This has been most significant in the growing realm of cooperation between MUSCCO and DEMATT. The READI-funded Club Makokola Workshop (late July 1987) provided a necessary forum for substantive discussions between DEMATT and MUSCCO. The two institutions have since signed an agreement whereby DEMATT will provide client advisory services to MUSCCO-funded members. This cooperation is obvious both in the field and at headquarters level, and must be viewed as a positive contribution to SME sector development.

DEMATT

The Development of Malawian Traders Trust was founded in 1979 and was assisted by a U.S. PVO, PfP (Partnership for Productivity/International), from 1981 until PfP's demise in late 1986. PfP provided expatriate and technical assistance, and operational support to DEMATT until PfP left the scene. CARE/International was appointed as an interim contractor to administer OPG funds until USAID placed PfP's program with DEMATT under the READI umbrella.

This proved to be a watershed in DEMATT's history. Previously, DEMATT and PfP developed several schemes to make DEMATT self-sustaining. During the year after PfP's departure, DEMATT dropped all plans for serving as a financial institution and focused its attentions on developing strong business advisory services.

DEMATT within the READI Project. DEMATT formally came under the READI Project in March 1987. PfP's technical adviser for training became senior technical adviser (to the general manager), contracted through USAID under the READI Project. An expatriate training officer was contracted and brought to DEMATT (under the READI Project) in August 1987.

From March through October 1987, DEMATT developed its first institutional plan. The process of institutional planning clarified DEMATT's goal and mission, set out who should be brought into the organization to achieve the institutional plan's objectives, brought about changes in the organization's structure, and focused DEMATT's attention on its role within the overall SME sector. The institutional plan proved to be an invaluable exercise insofar as it showed the links necessary to go from planning to operational performance.

The institutional planning exercise enabled DEMATT to prepare a work plan that clearly spelled out, for the first time, how DEMATT would be able to implement its institutional plan objectives. The work plan (drawn up at the end of 1987) is characterized by its focus on field support and the importance it places on feedback from the field. It is clear that DEMATT's focus has turned increasingly to the field and to the needs of both its field officers as well as its true client base since its incorporation within the READI Project.

Moreover, the work plan set out a new "client methodology" for client selection, assistance, and monitoring. The work plan also set out the parameters for DEMATT's resource survey, which currently is being conducted. It is hoped that the resource survey will collect information about available resources (from agricultural to human) in the SME sector. The survey will provide a profile of businesses in the SME sector to enable DEMATT to promote enterprises in a more systematic fashion. It also will provide DEMATT with a foundation upon which to build its new business development strategy.

The work plan also sets out a program for "retooling" staff (Training, below). This implies retraining all staff by introducing them to the new client methodology, thereby enabling them to focus more clearly on client needs and potential. New, more highly qualified staff have recently been employed to strengthen DEMATT's field presence. Women have been recruited actively (DEMATT's first four women consultants were brought on as a result of this "retooling"). A study tour to Kenya was financed to provide further training for senior consultants, and two more visits are planned to Zimbabwe and Botswana.

There have been considerable changes within DEMATT over the past year and a half. The institutional plan and work plan, with subsequent field and staff changes, point to positive changes in the organization. The new methodology points to a fundamental change in DEMATT's direction. While field morale is high, however, and the quality of field staff is impressive, there are definite field perceptions that senior management is "out of touch" with their needs and capabilities and that senior management needs a clearer vision of where DEMATT is actually going.

Much of this confusion stems from the changes that have shaken the organization over the past year and a half. Some derive from the simultaneous development of both the institutional plan (with considerable staff involvement) and the "management by objectives" (MBO) exercise attempted since March 1987 (also with considerable field staff involvement).

Under the senior technical adviser's guidance, DEMATT set about in 1987 to develop a program of management by objectives (MBO). The MBO exercise was an attempt by senior management to get field staff to articulate clearly their objectives and targets. This was done through a series of intensive (and repetitive) meetings that clearly baffled many field staff.

It is obvious from field interviews and a thorough review of field reports to headquarters (as well as DHS documentation), that the field staff felt increasingly alienated from headquarters until early 1988 because of the MBO exercise. They felt that the MBO process was foisted upon them and that they were expected to understand MBO conceptually before they could get on with their work. A review of this period of DEMATT's history is insightful insofar as it shows that any system that is imposed from above, without the enthusiastic involvement and participation of field staff, is bound to create unnecessary confusion (see READI Sector Training of Trainers Section, Training, below).

The contrast between the entire MBO exercise and the new client methodology illustrates this point. The new client methodology starts with two explicit assumptions. First, before DEMATT can assist any client, the DEMATT officer must understand the client's problem. Second, before the client can solve the problem, the client must understand the problem. Once both parties have reached a consensus on the problem, they can then work together towards solving the problem. This methodology is reiterative, and is remarkably easy to understand for both client and field staff alike. Interviews and visits in the field during the course of this evaluation showed a wholehearted endorsement of the approach. But, strong concerns are expressed that senior management has not given up on the MBO approach and that the field will once again be asked to plan activities utilizing the MBO technique.

The evaluation team strongly endorses DEMATT's new client methodology and has been impressed by the extent to which the field has understood and adopted it. The team believes it is important to point out that DEMATT has undergone so many fundamental changes over the past two years that it faces a skeptical audience of donors and counterpart agencies. It is not clear to the evaluation team that management views DEMATT's current focus as what the organization should really be doing. Until management makes clearer to its own field staff and the outside community that it has bought into the new client methodology and the field approach embodied in the methodology, that audience will remain skeptical about what DEMATT can truly provide by way of BAS/TAS to the SME sector.

INDEFUND

READI Project Assistance. INDEFUND has also faced many difficulties over the past several years as the SME sector in Malawi has evolved. The

READI Project Grant Agreement set out to provide INDEFUND with credit to fund enterprises in the rural SME sector. In addition, the READI Project targeted US$ 200,000 for commodity and institutional support to develop business advisory services. It was anticipated that Africare would provide INDEFUND, as it did MUSCCO and the SME sector at large, with technical advisory and training inputs to support its activities.

From the start of the READI Project, there have been misunderstandings and disagreements on the exact nature of the technical assistance the READI Project mechanism was to provide. First, INDEFUND maintained that Africare was obligated to provide in-house, on-line business advisory services, in the form of a long-term small business adviser as well as dedicated short-term technical assistance. The READI Project Grant Agreement, indeed the Project Paper itself, did not specify the means by which Africare would assist INDEFUND, much less set out that Africare would provide INDEFUND with full-time technical assistance.

In the early stages of the READI Project, Africare did accede to INDEFUND's insistence on placing a small business adviser within the institution. The first Africare small business adviser headed INDEFUND's Project Monitoring division. Rather than serve as an adviser, the Africare expatriate functioned as an INDEFUND staffer. When the adviser was removed and replaced with another small business specialist, Africare took the opportunity to distance itself from an on-line function. Africare believes that by taking its small business adviser out of a line function, it is now better able to develop business and technical advisory services for the SME sector at large.

The current Africare adviser works primarily with INDEFUND and its newly created Client Services division. It is unfortunate that neither INDEFUND management, nor Africare, are pleased with the arrangement. The problems stem not only from perceptions of roles, but from initial project design. Africare funds a full-time INDEFUND employee (senior business adviser) and provides logistical support through the services of its small business specialist. Most of the Africare adviser's time is dedicated fully to

INDEFUND clients and promotional activities; however, lines of communication and responsibility remain indistinct. Until a better defined set of reporting and management criteria is agreed upon, both parties will remain dissatisfied with READI's BAS/TAS provision, and their efforts toward the same objectives (promoting and supporting development of the SME sector) will remain less than optimal.

INDEFUND has undergone substantial managerial and structural changes since the READI Project's inception. A new general manager took up his position in January 1987, confronted with severe performance and management problems. INDEFUND has been reorganized and an attempt has been made to differentiate the functions of project promotion, appraisal, and monitoring, on the one hand, and business advisory and technical advisory services, on the other.

Prior to the current reorganization, project appraisal was housed in one division, while project monitoring was housed in another. Management recognized that this created problems in that those responsible for project promotion and appraisal did not have to "live with" the projects they created. Rather, when a project was insufficiently appraised (as often happened), it was incumbent upon the project monitoring staff to try to keep the project viable. Project monitoring staff were not introduced at an early enough stage to the actual screening and design of a project. Now, the organizational structure attempts to put appraisal and monitoring within the same branch (there are two branches, Southern Regional and Northern/Central Regional branches) ostensibly responsible for every stage of project identification, appraisal, and monitoring.

A separate, overextended, and insufficiently funded division is charged with client services. Client services range from project implementation (essentially getting all the registrations, legal, and other paperwork in order for project implementation) to ongoing business advisory services, in the broadest sense. This division, between appraisal/monitoring branches and client services, serves two purposes.

First, attempting to separate the actual appraisal and monitoring from BAS/TAS provides management with a means for dividing, in an accounting sense, the costs of appraisal and monitoring (viewed in a commercial banking sense) from the costs of business and technical services. Theoretically, this makes it easier for INDEFUND management to demonstrate to its (increasingly) conservative Board of Directors that actual banking functions can pay for themselves, while the advisory functions of the institutions can be more clearly delineated for subsidization (e.g., by donors).[2]

Second, and in the same vein, this separation of banking and credit provision from advisory activities permits INDEFUND management to seek external donor support to subsidize the advisory activities. INDEFUND (management and, we presume, the Board) want Africare to provide the funds and, to some extent, the technical assistance, to finance the advisory functions of the institution.

In the opinion of the evaluation team, the current organizational structure has some problems. First, there is a noticeable tendency to push actual monitoring activities from the two branch divisions to the client services division. That is, branch officers understandably find it easier to identify and appraise projects and act as traditional loan officers when a project is in trouble, rather than take on the oftentimes more difficult tasks of working closely with the client (or "sponsor," in INDEFUND's terminology).

Thus, it appears from interviews and reviews of project portfolios that the newly created client services division spends most of its time trying to

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2. It should be noted that INDEFUND's Board of Directors comprises representatives of INDEBANK (the Investment and Development Bank of Malawi, INDEFUND's parent organization) and ADMARC and other representatives (e.g., FMO). The Board meets quarterly to review all matters of INDEFUND policy, management and to review loans appraised by INDEFUND. Special loan approval meetings are held, when necessary, at six-week intervals.

The team recognizes several reasons for the Board's growing conservatism. INDEFUND's debt-equity ratio is currently 6.5 to 1. INDEFUND's net worth is down to K 600,000, and INDEFUND cannot lend more than one-quarter (K 150,000) on any one project. The Board realizes INDEFUND requires more equity, but, at present, has been unable to obtain it.

get clients out of trouble rather than systematically working with each and every client to prevent problems from arising. It can be argued that a good portion of INDEFUND's "problem" projects can be traced to this lack of integration and systematic attention to clients' business and technical advisory needs from project identification through the long stages of monitoring.

The team suggests that INDEFUND management reexamine the assumptions underlying the roles of its various departments. That is, the two branch management divisions must become much more actively involved with true development credit institution monitoring than is the case today. Client services division staff should be involved from the onset of project appraisal in an advisory and review capacity to set out client needs, identify potential problem areas, and recommend means by which problems can be addressed systematically. Means for addressing those problems include assistance in marketing, bookkeeping, foreign exchange acquisition, and product selection.

READI Coordinating Unit Assistance. The READI Project Coordinating Unit has been instrumental in assisting INDEFUND in developing its first institutional development plan and its annual work plans. There is a recognition on INDEFUND management's part that a clearer articulation of INDEFUND's developmental role in the SME sector is necessary to better performance, in an institutional as well as a banking sense.

Some tensions, however, do exist. First, INDEFUND is not merely answerable to the USAID/READI Coordinating Unit. Unlike MUSCCO, INDEFUND is not a movement, with a large, highly motivated constituency (i.e., client base). Rather, it responds in a more functional banking manner to its clients than does MUSCCO. Second, INDEFUND's primary constituency is its Board of Directors. That Board is composed of INDEFUND's parent organization (INDEBANK) and other donors (namely the Dutch FMO). INDEFUND's Board has adopted an increasingly cautious, conservative, and skeptical posture on "development" projects, given the high costs and risks involved and the many problems already experienced with such projects.

This highlights the third area of tension in INDEFUND's relation with the READI Project Coordinating Unit. That is, USAID's funds are targeted towards specific developmental objectives, namely promoting rural-based and agro-industrial projects. This developmental focus is often at odds with the profit, bottom-line approach of the Board of Directors. Given the importance of A.I.D. credit funds and the BAS/TAS supplied to INDEFUND through the READI mechanism (including the Energy Initiatives for Africa (EIA) energy/technical adviser subproject), management finds itself between two divergent positions.

These tensions are compounded by the divergence in the Coordinating Unit's perceptions of the role Africare should play in promoting INDEFUND credit initiatives. The Unit's management clearly feels that Africare should provide INDEFUND with a pool of resources (long- and short-term technical assistance, logistical support) in building up INDEFUND's business promotional and advisory capabilities. INDEFUND management endorses that position, to a certain extent, but views Africare as more of a direct implementation mechanism than an advisory service. Africare maintains that it is charged within the READI Project with assisting entrepreneurs in the SME sector at large (including MUSCCO and SEDOM), not just with INDEFUND.

Africare recognizes that promotion is a proactive developmental exercise; entrepreneurs are actively identified and trained for credit assistance. Africare maintains that this was one of the cornerstones of its READI Project OPG, but that it has been unable to pursue this mandate within the more confined institutional boundaries in which it works today (i.e., with an agri-business adviser attached primarily to MUSCCO and a small-business adviser working primarily with INDEFUND).

The READI Project Promotional Subproject

In January 1988, READI launched a subproject effort to promote the identification of bankable SME projects. This effort was initiated for the following reasons:

- INDEFUND had been dispersing significantly less than originally anticipated.
- In 1986 and 1987, the number of applications received by INDEFUND had lessened sharply.
- The promotional efforts had been at a more reduced level than originally envisioned in the Project Paper, and had not identified a significant number of bankable projects or increased INDEFUND's ability to do so.

The main purpose, therefore, of the promotional subproject is to fill INDEFUND's pipeline of bankable projects. A key issue of this effort is to see whether, as stated in the original Project Paper, the READI Project can influence the demand for credit and thereby stimulate INDEFUND to become a more active participant in the SME sector.

The promotional subproject employs four full-time staff members, and has trained an additional 25 consultants from various fields who are available on a part-time basis. The staff members and consultants are to develop 100 to 200 project proposals for financing in the area of rural agro-related enterprise development. These proposals are reviewed each month by a Project Committee composed of representatives from INDEFUND, SEDOM, DEMATT, MTIT, Africare, the READI CU, and the Commercial Banks.

The coordinator maintains that the promotional subproject has no immediate institutional development objectives. The primary purpose of this effort is to present INDEFUND with as many bankable projects as possible. The coordinator considers INDEFUND's inability to promote and finance viable projects an impediment that must be overcome if the SME sector is to grow.

The broader agenda is also to investigate whether this type of activity is indeed necessary for SME development to occur in Malawi. The participation of other institutions working in the sector is a mechanism for engendering discussion on this point. In the team's opinion, project promotion is needed in Malawi, and we hope that this effort will highlight some of the constraints and requirements for bringing more projects to lending.

The project preparation cycle being completed by the Promotion Unit has two phases. In the first phase, brief project overviews are presented to the Project Committee to be approved or rejected for full feasibility analysis. The second phase results in a full project appraisal which the entrepreneur is responsible for presenting to a financial institution, generally INDEFUND. Since the subproject began in February 1988, 100 preliminary dossiers have been presented to the Project Committee, with an approval rate for phase two development of approximately 75 percent. Thus far 14 have completed phase two; 3 of these have been presented to the INDEFUND Board, with 1 approved for financing.

The evaluation team, however, has some concerns about this effort. As stated above, we agree that active project promotion should be a part of SME development in Malawi. We also recognize that this was not being adequately addressed by Africare as originally intended under the READI Project. We also we are concerned about INDEFUND's slow portfolio development.

Two points need to be addressed: cost-effectiveness and sustainability. The total budget for the promotional subproject is US$ 160,000. The CU expects its efforts to result in 40 sanctioned loans. Were INDEFUND to finance this number, each will have cost an average of US$ 4,000 to prepare. If we assume an average loan amount of K 100,000 or US$ 40,000, the preparation cost becomes equivalent to 10 percent of the loan amount, which is high. Based on the fact that only one project has been approved so far, 40 projects may be unrealistic and may result in an even higher cost per sanctioned loan.

The evaluation team recognizes that initially the costs of pilot efforts can be high because they are experimental. This raises our second primary concern, that of institutionalization or sustainability. Active project promotion should be a part of SME development in Malawi; however, this is a costly proposition and not part of the normal operations of a lending institution. It is therefore paramount that such an effort be developed gradually within the context of an existing SME intermediary, to nurture its ability to link entrepreneurs with financing institutions. If this is not done before the subproject ends in December 1988, the current efforts may end without engendering a positive institutional development impact. We strongly recommend that the Coordinating Unit, USAID, and the PIC place this issue on the agenda for its next PIC meeting and determine how it can be directed to result in institutional development.

The Energy Initiatives for Africa Subproject (632-0842)

INDEFUND received US$ 150,000 in grant funds from A.I.D./Washington's centrally funded Energy Initiatives for Africa Project (EIA) for an Energy for Small and Medium Enterprises subproject in August 1985. The subproject was formally presented to the READI PIC and brought within the READI Coordinating Unit in September 1985.

The EIA subproject paid for the services of a senior technical/energy adviser (Malawian) for INDEFUND and for assisting the SME sector. Initially, one quarter of the funds was designated for the adviser and associated costs, while US$ 110,000 was set aside for a Technical Assistance Fund and an Energy Improvement (Investment) Fund. INDEFUND was provided monies to finance the full-time services of a Malawian engineer. Funds were also provided for contracting technical assistance to assist INDEFUND and other SME sector clients in improving their energy utilization and in meeting their energy needs and for financing identified needs and improvements. The project's original PACD was extended to December 1988.

The subproject was briefly evaluated by Oak Ridge National Laboratories for the Science and Technology Bureau (A.I.D./Washington) in April 1988. That evaluation and the current READI Project Evaluation highlight several important features of the subproject. First, the subproject has not resulted in as much inter-SME sector support and cooperation as was hoped. The adviser was not recruited until almost one year into the subproject. INDEFUND's management at the time chose not to use the training funds set aside for the adviser and treated the adviser as an INDEFUND employee, not as someone to serve the sector at large. This should have been anticipated during subproject design. It was unrealistic to expect any institution to relinquish willingly the services of one of its best staff members when it has so much need for that person's services.

Second, the subproject assumed a fairly innovative utilization of grant funds. Few investments have been made with grant funds, and a review of the data available indicates that perhaps as much as US$ 50,000 in unspent funds will be returned (deobligated) to A.I.D./Washington in December 1988 (even after a 1½-year subproject extension).

Failure to use these funds can be attributed to another design fault. Since the onset, there has been confusion as to what the subproject should accomplish and who should be responsible for approving any subproject expenditures such as investments or consultancies. The subproject was managed (within the A.I.D. context) by an already overburdened READI Coordinating Unit, and INDEFUND's managers were unsure from the onset just how much discretion they could exercise in using EIA funds.

The subproject suffered from another design fault. During subproject design, INDEFUND managers noted that placing a technical person within a credit institution would be difficult for three reasons. First, it would be difficult for management to judge performance of the technical/energy adviser. Second, because INDEFUND is not a technical agency, options for career advancement within the institution would be limited. Finally, management was concerned about how the technical adviser's services would be funded once subproject funding ceased.

Management's concerns were well-founded. The Malawian adviser has performed well. He has made numerous efforts to integrate his activities with those of a variety of institutions (including the government). He conducted the country's first SME sector energy survey in coordination with both DEMATT and SEDOM. He has assisted about 50 INDEFUND clients in a variety of technical areas. He sits on the National Energy Committee and regularly participates in Energy Unit (Office of the President and Cabinet) activities (including improved charcoal production and commercial fuelwood utilization).

For a variety of reasons, however, the adviser's position has not been integrated into INDEFUND's overall structure. Indeed, the energy/technical adviser is not even included within INDEFUND's Client Services division, and has, at best, an ad hoc working relationship with that division. Moreover, other relevant technical staff in associated SME institutions (MUSCCO, SEDOM, and DEMATT) know little about the subproject or the activities of the adviser. This reveals a lack of coordination within the sector, and between the sector and the technical/energy adviser within INDEFUND.

The quality of consultancies and studies contracted under the subproject has been poor, largely because of poor terms of reference drawn up by EIA staff in Nairobi, as well as a general lack of good consultancy services within Malawi. The subproject was designed to be able to contract consultancies from anywhere, but INDEFUND's management initially insisted on limiting the use of EIA funds to local consultancies. This limitation also applied to training for the adviser, although the current management has changed this policy to allow training for the adviser. Finally, there existed confusion about the allocation of subproject funds for commodity procurements.

The subproject has been of limited value to the SME sector. Its original purpose was to provid SMEs with the same technical and advisory assistance (as well as to limit risks in technical investments) that is available to large-scale enterprises. This has not been done. The lessons learned from the EIA subproject should be of considerable importance for DEMATT as it establishes its own technical advisory services. Several important lessons to be learned are that

- Technical staff should be guided by people who are qualified to judge their performance.
- Technical staff who are placed within non-technical institutions should be provided with some sense of career advancement. It is one thing for project designers to

view such activities as pilots; employees rarely appreciate the same sense of pioneering.

- Funds must be made available to technical staff to carry out proposed innovations. Even with a pool of resources at its disposal, INDEFUND has had considerable difficulty using those funds in either conventional or innovative ways.

- Technical staff in non-technical agencies should be well-integrated (within their own institutions) and associated with other technical agencies and individuals. There must be clear paths for communication with "peers" who can understand and appreciate the activities and problems of technical staff.

- Finally, technical staff should have access to specialists. While good engineers can know a little about many things, it is impossible for them to know all about everything. Without providing some means for financing more specific technical assistance (as with financing specific technical interventions), technical staff can become disillusioned and poorly used.

One-third of the subproject's original funds will return to Washington unless spent within the next five months. The evaluation team strongly recommends that DEMATT work closely with INDEFUND to learn as much as possible about the subproject before its completion, and for INDEFUND and the READI CU to expedite prudently the use of remaining monies.

Other Cooperating Agencies

The team visited with representatives of SEDOM, MDC, and MEDI to determine what BAS/TAS linkages exist between them and READI, and between various funded agencies (DEMATT, MUSCCO, and INDEFUND).

SEDOM

The Small Enterprises Development Organization of Malawi (SEDOM) was established in the early 1980s as an SME development assistance agency under the Ministry of Trade and Industry. It has received technical assistance (and financing) from the European Economic Community. SEDOM employs more than 170 staff members, most of whom are located in their Blantyre headquarters. The team visited their Southern and Northern Regional Offices and visited nine SEDOM clients (all of whom were DEMATT clients) during the evaluation.

In theory, SEDOM has two types of officers: loan officers and technical officers. Ideally, technical officers are technicians who receive in-service, local, and third country training; however, SEDOM's technical officers are actually loan/technical officers. They routinely screen loan applications and perform regular loan monitoring tasks. SEDOM has a substantial program for training its clients and potential clients, which includes seminars and actual on-the-job training. SEDOM provides its clients BAS/TAS during the course of loan appraisal and monitoring. It assists clients in determining equipment specifications, and attempts to provide them with appropriate technical packages.

SEDOM, like INDEFUND, is a fairly centralized agency; however, SEDOM does not operate field offices like DEMATT. Only nine professional staff are located in its Northern Regional Office. Field officers look to DEMATT to provide their clients with day-to-day services including accounting, marketing, and general business management. Field relations between SEDOM and DEMATT are very good. DEMATT field staff are familiar with SEDOM loan appraisal and application procedures and routinely assist potential SEDOM clients with their loan applications.

SEDOM has cooperated with the READI Project in a number of ways. SEDOM has a representative on the READI Project Selection (Promotion) Committee as well as the READI PIC. SEDOM staff assisted INDEFUND's technical/energy adviser in developing and administering the national SME Energy Survey. SEDOM routinely invites DEMATT, INDEFUND, and MUSCCO clients to its workshops and field seminars. Again, relations at a field level are supportive. SEDOM field staff believe DEMATT should take more of a BAS/TAS role in assisting clients.

There already exists a de facto mechanism with DEMATT providing field advisory services to SEDOM clients and potential clients. The evaluation team strongly recommends SEDOM and DEMATT cooperate more closely, and encourages SEDOM and DEMATT to consider more formalized advisory services on the line between DEMATT and MUSCCO, MEDI, and INDEFUND.

MEDI

The Malawian Entrepreneurial Development Institute (MEDI) provides its graduates with both start-up capital and initial in-kind credit such as tools and materials; however, MEDI readily acknowledges that its ability to follow up MEDI training is difficult. MEDI students learn a variety of business skills and must prepare business plans as part of their training exercise. The business plan sets out start-up, production, and marketing strategies for graduates.

While at the Institute, many MEDI graduates do not receive as much practical training on business skills development as they do on technical skills. Consequently, many are not fully prepared to succeed in the competitive business environment that awaits them. Many graduates are in financial trouble (MEDI's in-kind loans must be repaid and many have taken out SEDOM loans). Many graduates become DEMATT clients by chance, not by design.

The team visited four MEDI graduates receiving DEMATT field assistance. It was clear that DEMATT provides these entrepreneurs with much needed services that MEDI is unable to provide in the field. The team encourages MEDI and DEMATT to complete negotiations on DEMATT's provision of BAS/TAS to MEDI graduates as a matter of course.

MDC

The Malawian Development Corporation receives support from the UNDP for assisting SEDOM and INDEFUND with industrial advisory services. An expatriate works out of MDC's Blantyre headquarters and provides in-service training and formal seminars. The adviser works with SEDOM and INDEFUND clients in areas such as production planning, layout, and inventory. There has been no direct contact with the READI Project. It is hoped that the UNDP Project will strengthen MTIT's role in providing BAS/TAS to the SME sector. An Industrial Consultancy Services Project document is currently under review at the SSI Unit at MTIT.

Training Program Performance

Training was one of the least well-defined components of the original READI Project Paper. Specific outputs were not clearly delineated; however, each of the participating institutions realizes that training is an integral part of institutional development. Recently, greater attention has been paid to assessing real training needs in the sector.

The READI Project provided US$ 210,000 in training to strengthen the participating institutions, namely INDEFUND and MUSCCO, to serve their clients' needs better. Table II - 6 breaks down the original training budget by each participating institution.

A READI Project Training Subcommittee was set up in late 1987, two years after project implementation started. The READI Coordinating Unit and the Training Subcommittee are currently formulating a sector-wide Training of Trainers (TOT) program. This training element evolved from an original plan to hire an external agency (that had worked closely with MEDI) for the current subproject, which is based locally.

Africare and WOCCU/CUNA

The READI Project's entire approach to training evolved as the project progressed. The two U.S. grantees, Africare and WOCCU/CUNA, developed their programs within their own work plans. WOCCU/CUNA focused on on-the-job training of MUSCCO staff and on formal training of MUSCCO's members, societies, and study groups — groups preparing for registration as credit union members. Africare conducted various seminars and workshops in areas ranging from beekeeping to brick-tile manufacturing.

The Project Paper outlines two specific training roles for Africare:

- To conduct seminars and training sessions for groups of entrepreneurs who express interest in participating in credit programs offered by the Project
- To provide on-the-job and informal training while working with INDEFUND and MUSCCO staff

Table II - 7: Original READI Project Training Budget
(U.S. dollars)

	Year 1	Year 2	Year 3	Total
INDEFUND				
U.S. & Third Country	20,000	15,000	10,000	45,000
On-the-job (contract)	10,000	10,000	10,000	30,000
Subtotal INDEFUND	30,000	25,000	20,000	75,000
MUSCCO				
Staff training	3,000	3,000	4,000	10,000
Credit leaders	10,000	10,000	15,000	35,000
CFD workshop	10,000	10,000	10,000	30,000
Subtotal MUSCCO	23,000	23,000	24,000	75,000
Africare				
Client seminars	10,000	10,000	10,000	30,000
Entrep training				
In-country	5,000	5,000	5,000	15,000
Third country	5,000	5,000	5,000	15,000
Subtotal Africare	20,000	20,000	20,000	60,000
Total original	73,000	68,000	64,000	210,000

Note: The Energy Initiatives for Africa (EIA) Subproject initially targeted US$ 10,000 in training for INDEFUND. This amount was reduced to US$ 5,000 during subsequent amendments and PILs.

The Project Paper suggests that Africare would also consider "establishing a revolving fund for financing individual training programs on a no or low interest repay basis." Africare was to explore the possibility of having a permanent organization such as the African Businessmen's Association or the Chamber of Commerce administer such a fund.

Africare's records show that it has conducted 19 training sessions, of which 15 were in conjunction with MUSCCO and 4 with INDEFUND. Eight-hundred-six participants from MUSCCO's member societies and 32 INDEFUND clients took part in these sessions.

When the READI Project Grant Agreement was prepared, USAID increased the technical assistance component of WOCCU/CUNA's existing OPG by US$ 370,000; at the same time, US$ 114,112 was shifted out of the Institutional Support line item into training. The Grant Agreement called for WOCCU/CUNA's involvement in three training areas:

- The long-term technical assistance to assist in developing field service programs, training field staff, and developing training materials for Credit Union membership education programs and MUSCCO staff training activities
- Short-term technical assistance to reinforce the various training programs MUSCCO conducts
- A limited amount of off-shore training for senior-level MUSCCO management staff

MUSCCO

The READI Project design closely followed MUSCCO's institutional strategy of improving its member societies' operations and strengthening member cooperatives. The MUSCCO training element within READI has followed more of a needs-driven (and defined) strategy than any other training component within the Project. The Project Grant Agreement foresaw the need to improve MUSCCO's educational and training programs and to link these programs to its central finance program. The Project did not set out an

Institutional Training Program, but provided for logistical and commodity support to strengthen the Field Services Program.

MUSCCO Staff Training

Most READI-supported staff training for MUSCCO has been in-service. WOCCU/CUNA has provided a senior financial management and planning adviser to "assist and advise the Chief of Training and Field Services" in various training fields. The adviser was also called upon to "assist through both formal and on-the-job training, in assuring" institutional development (MUSCCO Staff Job Descriptions). In addition, WOCCU/CUNA has provided a field services and training technician, assigned to the Field Services and Training Department, charged with assisting the department head to "train MUSCCO field staff, societies' staff and elected officials to prepare written operational plans [and various training manuals]" (MUSCCO Staff Job Descriptions).

Senior management and evaluation team observations indicate that READI-funded staff training has been satisfactory and has assisted MUSCCO's institutional development. The evaluation team believes that more emphasis needs to be placed on developing the financial management skills of the head of the Central Finance Department (see BAS/TAS, above). The head of CFD should have a counterpart charged with the specific duties of transferring necessary skills to computerize the financial management systems (again, emphasizing the "needs driven" approach to technical assistance). The present Africare adviser is an agribusiness specialist and does not have the background to provide this type of training.

MUSCCO Member Society Training

MUSCCO places considerable emphasis on educating its members, through their societies, in the general concepts of credit unions. The team was able to visit seven MUSCCO urban and rural societies in all three regions (Northern, Central, and Southern). Members from all societies considered

MUSCCO's educational assistance the foremost service rendered to the societies. Leaders of societies visited also felt the area of greatest need was improved and strengthened training assistance.

It is important to understand MUSCCO's field training philosophy. First, MUSCCO is a movement. Staff and members view the process of credit union building as a "mission." The core of this mission is to teach members how to mobilize savings and how to utilize credit wisely. They view their primary problems as members' inability to understand these core concepts. Hence, much of member training focuses on the philosophy of savings and credit.

When a group applies for MUSCCO membership, they form a study group. A study group consists of people who are trained on MUSCCO's core concepts for a period of about six months. They meet, on average, two times a month. MUSCCO has three Peace Corps Volunteers (one in each region) who serve as its field training officers, assigned to each MUSCCO field office. These training advisers meet with study group members, provide them with training materials, and help the groups develop their core philosophies, which include the identification of a common bond, or central unifying feature, of each society.

Once a study group understands the key concepts of MUSCCO's philosophy, they then apply for full membership as a MUSCCO society. If accepted, they request and receive regular field training assistance in a variety of areas, from bookkeeping to management. Societies range widely in size and in level of sophistication, and, therefore, in their need for training assistance. Discussions with head office and field staff, as well as with members themselves, revealed some important issues that MUSCCO needs to address:

- Staffing. As this evaluation has shown elsewhere, MUSCCO field officers are seriously overextended. One of their primary responsibilities and concerns is training new groups and existing societies. It is clear that as MUSCCO continues to expand, it must increase its field staff. This will require additional assistance for an expanded staff, including logistical support and operating funds.

- Field staff, while very highly motivated, would like, and require, additional training to carry out their routine duties, as well as to serve member societies better. It is difficult, given present work loads and understaffing, to take these field officers out even for short-term training, much less long-term training. These issues need to be addressed to make their work more effective as well as to provide career incentives for dedicated staff.

- The Training and Field Services Office has performed laudably over the past eight years. However, it too, suffers from the same basic constraints as field operations. Senior staff see their primary needs as improved organization, improved quality of teaching materials, improved monitoring and reporting (from the field), and the development of better adult education techniques. The office's quality of support and delivery to field staff and member societies could be improved through the provision of

  - Malawi-specific teaching materials (particularly in the vernacular)

  - Audiovisual equipment (with backup maintenance and spares)

  - Adequate transport

  - Improved methods for following up and monitoring training performance (which should follow from better access to transport and from more staff)

DEMATT

As stated previously, DEMATT did not become funded through the READI Project until early 1987. Training was funded by USAID through the PfP Operational Program Grant. Under the READI Project, technical assistance includes the services of a training specialist.

DEMATT Staff Training

DEMATT has a Personnel and Training Department. The Department's major role is to upgrade staff skills. In doing so, the Training Department works closely with the Field Services Department to improve field officers' skills. In addition, and in conjunction with the field services officers, any external training offers (short- and long-term training) must be developed and approved in conjunction with the Field Services Department. Currently two business promotion consultants (BPCs) are training in Zambia.

The READI Project provides the operational support for the Personnel and Training Department. In addition, the READI Project funds a technical adviser for training. This individual is charged with "advising Management on all aspects of training affecting DEMATT's staff and clients...assisting in the development and implementation of specific annual training objectives...and regularly visit[ing] DEMATT field offices and monitor[ing] field reports in order to better understand and respond to training needs" (DEMATT Annual Plan).

DEMATT staff participate in pre-service training during their first 12 weeks on the job. The current pre-service training program differs markedly from the past when the major emphasis was placed on classroom training in basic business subjects such as bookkeeping and accounting.

DEMATT's current pre-service training program emphasizes its new client methodology, which stresses working with the client to identify and solve business problems. The new pre-service training is practical and emphasizes the importance of actively interviewing clients. It uses role playing to stress this point. This approach provides all new staff with a much higher level of understanding of actual client needs. DEMATT has also raised entry-level qualifications for hiring new staff.

This new training program was introduced in February 1988. All DEMATT field staff were retrained using the new system during January and February, 1988 in a three-week intensive course. On-the-job training and follow-up on the new methodology took place during subsequent months. The positive effects of DEMATT's new pre-service training program are particularly apparent in the field.

In June and July of 1988, DEMATT trained its field staff to conduct resource surveys to facilitate the development of business promotion. The resource survey is an attempt to collect data on resources available throughout the country. Resources include anything from agricultural products to manufactured goods and even human resources available for SME development. The resource survey training exercise and the survey itself have provided DEMATT field staff with a better understanding of the geographic areas they cover. Moreover, field staff acquire survey, interview, data collection, and data analysis skills during the course of the resource survey. Finally, the exercise should provide a useful database that will enable DEMATT staff to access information useful in assisting clients, promoting new project ideas, and assisting sister organizations.

The new client methodology (and intensive training on the methodology), the resource survey, and third country training (commencing with Kenya in May 1988 and planned for Zimbabwe and Botswana in October 1988) all make up what DEMATT calls its "staff retooling." In essence, DEMATT sees the "staff retooling" exercise as a means to enable field staff to provide client services in a more practical and integrated manner than has been the case in the past. Moreover, the "retooling" exercise provides staff with a clear sense that DEMATT is interested in upgrading their skill levels and advancing their careers.

While the team has been very impressed with DEMATT's approach to staff improvement, DEMATT is faced with an important staff training issue that management must address if its training goals are to be achieved. DEMATT does not have, at present, a satisfactory mechanism for transferring the skills and knowledge of its expatriate training adviser to his counterpart. The training and personnel manager does not have the requisite training skills or background to meet the demands of the job. The evaluation team notes the exceptional dedication shown by the training and personnel manager to his job. However, because the training and personnel manager lacks training (as a trainer), the expatriate training adviser is currently serving as the DEMATT's de facto training manager.

DEMATT Client Training

Prior to DEMATT's direct participation in the READI Project, DEMATT's approach to client training could best be characterized as "group training." Group training was practiced ad hoc. That is to say, client training was not needs driven; rather, it was seen as an end in itself. It was more of a numbers exercise (i.e., number of clients trained) than a quality training program. Previous topics ranged from soap-making to introducing prospective (or existing) clients to DEMATT (and other agencies within the sector). The situation deteriorated to the point that regional offices competed with one another on the number of courses they could offer and the number of people they could train.

The current DEMATT approach to client training, while still emphasizing "group training," focuses on the needs of entrepreneurs. Two approaches are used. First, the new client methodology (see BAS/TAS, above) enables the field officer (BPC) and the client to identify specific client needs (e.g., bookkeeping, marketing). Second, after identifying 10-15 clients with the same basic needs, DEMATT then provides "group training" to address those needs.

This system is new, and it is difficult to judge the quality of the approach. Several new group training seminars have been conducted by DEMATT during the past quarter. Seminar topics have included record-keeping and quality control. Future seminar topics will emerge as needs are better defined. This is directly in line with DEMATT's new client methodology approach: needs driven, not target driven.

Follow-up to group training is viewed as essential by DEMATT. All follow-up is one on one. Follow-up is ensured by DEMATT through its normal client service program; this works because all trainees are DEMATT clients selected by DEMATT field officers. It is incumbent upon field officers not only to select, but to ensure follow-up. Because client training is tied directly to solving a client's needs, the field officer gauges how effective the training has been by the extent to which the client's problems are addressed. This emphasizes the integrated, needs-driven approach of DEMATT training and fits in very well with DEMATT's overall approach to field services as set out specifically in its annual work plan. That is, client training is not viewed as an end in itself; it is viewed as a means to address a client's needs by removing particular obstacles.

The team is favorably impressed, not only with the strides DEMATT has made in developing its new client (and staff) training programs, but also with the enthusiasm with which field staff are greeting the new approach. However, three related areas deserve further attention:

- <u>Client Selection</u>. Headquarters staff has yet to develop an effective means to monitor the method by which field staff select clients for training. It is important for DEMATT to realize that, with its widely dispersed field staff, the tendency to fall back into the "numbers" approach to training (i.e., a BPC sending a client on group training to show she or he is actually addressing problems) is a real danger. While routine Field Services monitoring should be able to identify such tendencies, other formal techniques (e.g., interviewing trainees during group training to determine how they were selected and how they view their true needs) should be used to monitor client selection for training.

- <u>Quality of Training</u>. Effective monitoring systems have yet to be established to determine if training actually meets client needs. It is difficult for non-technical staff (BPCs) to judge the quality of technical training (e.g., metalworking, or specific carpentry skills). DEMATT must put in place effective and objective means for gauging the quality of their group training within the field context. One method for determining quality of training is a random sampling mechanism for visiting clients to determine the effectiveness of the training.

- A system for <u>post-training follow-up</u> needs to be developed. Field staff require some means for routinely relaying to headquarters their own observations of the quality of training and any follow-up needs. It is too much to expect an officer with 20-25 clients to report monthly on all topics, including training, and to expect headquarters staff to pick up on every issue raised by the field on training. It is recommended that, again, the Field Training Department develop <u>simple</u> means to monitor post-training. Perhaps the same survey instrument (as above) could be utilized to develop an effective feedback mechanism.

INDEFUND

As set forth in the Grant Agreement, the purpose of READI Project training assistance was to help strengthen client advisory services within INDEFUND. The focus was on on-the-job training for professional staff to be provided "by the Project's technical assistance team (Africare), from local accounting/management consulting firms or individuals, and from training programs developed jointly with other participating organizations within the READI Project (DEMATT, MUSCCO, etc.)." In addition, the Project Paper called for funds to provide some off-shore training for INDEFUND's senior management staff.

INDEFUND Staff Development

On-the-job training, provided by Africare, has essentially been ad hoc; this is primarily the result of a disagreement over Africare's proper role within INDEFUND. The Training of Trainers Program is an effort by both INDEFUND management (with Dutch support) and the READI Project to develop a more formal approach to staff training. The evaluation team views this effort as a step in the right direction.

One area of staff training that needs immediate attention is loan monitoring. Project officers who formerly only had responsibility for loan appraisal now have monitoring responsibilities as well, as a result of INDEFUND's reorganization. Project officers have not been trained to carry out these monitoring responsibilities.

INDEFUND Client Training

INDEFUND staff, most recently through the newly created Client Services Department, have conducted a client seminar on bookkeeping. INDEFUND Client Services Staff have helped Africare conduct several client workshops/seminars. In addition, INDEFUND Client Services staff provide considerable on-the-job training to their clients in management, bookkeeping, and accounting. The INDEFUND Client Services Department, with Africare assistance, plans several more seminars during the remainder of the READI Project. The team supports these more systematic client training efforts as means to strengthen the business performance of INDEFUND borrowers.

The Training of Trainers Program

INDEFUND, as a member of the READI PIC and Training Subcommittee, agreed to co-finance the Training of Trainers (TOT) program with Dutch FMO assistance. The purpose of the TOT is to make INDEFUND's project officers more effective trainers of entrepreneurs. An expatriate adviser and two professional Malawians make up the TOT staff. They are working with MEDI, INDEFUND, other SME institutions, and the READI Coordinating Unit to develop teaching curricula and a TOT program for other participating institutions, as well as INDEFUND. The program began in July 1988. The team interviewed numerous staff from proposed participating agencies who raised the following points:

- Many staff, both senior and junior, within participating institutions are unclear on the true objectives of the TOT Program. Senior staff (in DEMATT, INDEFUND, MUSCCO, and SEDOM) told several members of the evaluation team that the TOT concept is new and that its staff have not adequately explained the real value of the program. Consequently, many senior staff — with the exception of INDEFUND's general manager — are not sure if the TOT Program can meet their training needs.

- Several INDEFUND project officers, who are to be the primary beneficiaries of the program, are skeptical about it. They believe it will preclude more formalized training (both at home and abroad) and they do not believe they can be trained by people who are not experts in credit management. An effort needs to be made immediately to try and clarify TOT objectives and methodology to the participants.

- As PIC minutes, other correspondence, and interviews show, the TOT Program is designed to be housed (eventually) within MEDI. However, MEDI is a government body. Salaries and incentives provided under the current TOT Program are very much out of line with MEDI's own. Careful attention needs to be paid to these

> factors if the TOT Program is to be transferred eventually to MEDI, and if it is to serve as an institution-building exercise, and not just an expedient.

Training of trainers working in SME development institutions is a priority need for Malawi. It is unfortunate that these efforts were not initiated earlier in the READI Project; however, the lessons learned from the current exercise should be instructive for directing future TOT activities.

The program being implemented at INDEFUND should be monitored carefully in order to determine whether the training methodology being used is the most suitable for Malawi and the needs of the sector. To the degree possible, trainers and training program designers employed for TOT involvement should be familiar with SME issues, including technical assistance and credit for small enterprise development.

III. READI AND ITS RELATIONSHIP TO USAID/MALAWI PROGRAM INITIATIVES

USAID/Malawi Action Plan Goals and Objectives

The USAID/Malawi FY 1987-1989 Action Plan strategy focuses on four major development problems impeding growth in Malawi:

- Low per capita income because of low smallholder agriculture productivity and limited sources of rural income and off-farm employment opportunities
- Critical shortage of foreign and domestic financial resources
- High population growth rate, low child survival rates, and overall poor rural health
- Insufficient technical, development planning, analytical, and management capacities in both the public and private sector

Table III - 1 sets out USAID's May 1988 investment strategy to address these key problem areas. As can be seen, USAID sees READI playing an important role in addressing three of the four major development problems identified above.

This chapter outlines the major contributions the READI Project has made to strengthen the SME sector in Malawi. It pays particular attention to the unique initiatives USAID has begun, through READI, to strengthen the Ministry of Trade, Industry, and Tourism, and other intermediary institutions

Table III - 1: USAID/Malawi's Investment Strategy
(Prepared May 11, 1988)

Major Development Problems to be Addressed by USAID/Malawi	Program Interventions
1. Low per capita income due to low smallholder agricultural productivity and limited off-farm employment opportunities	a) Malawi Agricultural Research and Extension b) Fertilizer Subsidy Removal (EPRP I) *c) Rural Enterprise and Agribusiness Development Institutions (READI)* d) Rural Development Linkages e) Policy dialogue f) Rural Water Supply g) CCD/Health Mass Media h) Human Resources & Institutional Development (HRID) i) Malawi Employment Generation Program (now the Malawi Enterprise Development Sector Assistance Program -- MED) j) Promoting Health Interventions for Child Survival k) Services for Health, Agriculture, and Rural Enterprise (PVO)
2. High population growth rate, low child survival rates and overall poor health status	a) Health Institutions Development b) CCD/Health Mass Media c) Rural Water Supply d) AID/S&T funded resources e) Child Survival Fund f) Human Resources & Institutional Development (HRID) g) SOMARC (?) h) Promoting Health Interventions for Child Survival i) Services for Health, Agriculture, and Rural Enterprise (PVO) i) Malawi Employment Generation Program (now the Malawi Enterprise Development Sector Assistance Program -- MED)
3. Insufficient technical, developoment planning, analytical and management capacities in both public and private sectors	a) Human Resources & Institutional Development (HRID) b) Malawi Employment Generation Program (now the Malawi Enterprise Development Sector Assistance Program -- MED) c) Health Institutions Development d) Malawi Agricultural Research and Extension *e) Rural Enterprise and Agribusiness Development Institutions (READI)* f) AMDP/AFGRAD (?) g) Polytechnic
4. Critical shortages of both foreign and domestic financial resources	a) Policy dialogue and donor coordination b) Fertilizer Subsidy Removal (EPRP I)\\ c) Northern Corridor Access d) Commercial Transport e) Malawi Agricultural Research and Extension *f) Rural Enterprise and Agribusiness Development Institutions (READI)* g) ADMARC Divestiture (EPRP II) h) Human Resources & Institutional Development (HRID) i) Malawi Export Revolving Fund (EPRP III) j) Malawi Employment Generation Program (now the Malawi Enterprise Development Sector Assistance Program -- MED)

working in the sector. Building upon the lessons learned from the READI Project, it suggests initiatives which USAID/Malawi should promote to sustain this momentum in institutional development.

READI Contribution to Program Objectives

Efforts to Date

Both GOM ministries and SME support institutions recognize the positive contribution the READI Project has made to strengthening SME development in Malawi. This recognition is based on the following:

- READI completed the first SME sector survey in Malawi.
- The READI Project Implementation Committee has brought together a critical mass of SME development institutions and has laid the foundation for future coordination.
- The READI Project contributed to the development of three key institutions — DEMATT, INDEFUND, and MUSCCO. The latter two institutions are more self-sustaining today than they were four years ago.
- The READI Project has contributed to the SME policy dialogue. Among other impacts, the project has contributed to the recognition that the MTIT's Small-scale Industries unit should broaden its mandate to encompass the entire SME sector.

The lessons learned from the READI Project clearly show that credit financing provided by INDEFUND and MUSCCO and the business advisory services provided by DEMATT meet real sector needs. The project further indicates that the needs of the sector exceed the ability of these institutions at current levels of operation to meet them.

Lessons Learned

The following sections outline important issues which the team feels should guide USAID in charting its course for future support to the SME sector in Malawi.

Institutional Support

Several donors are active in supporting the SME sector in Malawi. We see USAID's effort to enhance coordination among governmental and non-governmental agencies as a unique contribution and one which will have a continuing demand in the future. With its long history of support to and involvement with most institutions in the Malawian SME sector, USAID is in a strong position to continue working closely with them and enhancing the services provided to small-scale businesses.

Two levels of institutional support will require continued involvement by USAID. These are

- MTIT: With support of the READI Project, MTIT has expanded its reach to the SME sector in Malawi. As part of its overall management development plan, MTIT sees strengthening its small-scale unit as a priority. To achieve this, USAID should provide appropriate technical assistance to plan an expansion of the small-scale unit's activities and to strengthen the skill of its staff to carry out its mandate.

- Intermediary Institutions: DEMATT, INDEFUND, MUSCCO, and MEDI will require operational support, technical assistance, and training beyond December 1989. Any reduction in the support of these institutions will have a detrimental effect on their ability to meet critical sector needs.

It is important that the READI Project work closely with these institutions from now to the end of the Project (December 1989) to develop a plan for continued project support; therefore, an ongoing dialogue between READI, USAID, MTIT, and the intermediary institutions will be beneficial. The team believes it is important for USAID to examine how the functions funded under the READI Project (and often funded directly within the READI Project Coordinating Unit) can be transferred to relevant institutions before the READI Project's PACD.

SME Credit

Lessons learned from the READI Project highlight critical problems in providing credit to the SME sector in Malawi. One problem involves the capacity of local financing agencies to manage the risks of lending to new or expanding small-scale enterprises. As demonstrated in the cases of both INDEFUND and MUSCCO, institution building is a slow process. It is particularly difficult when a lending agency has the dual objective of becoming financially self-sustaining and at the same time having a developmental impact.

Another problem concerns the availability of foreign exchange to meet the import requirements of SMEs. Through the MED Program, USAID will support efforts to liberalize the importation of spare parts and raw materials for all large and small businesses. However, there is no program in the A.I.D. portfolio to assist the small entrepreneur who will need foreign exchange to import the capital equipment needed to begin a new operation or to expand an existing one.

Business Advisory and Technical Advisory Services Needs

The evaluation team has reviewed the programs of the key institutions (DEMATT, INDEFUND, MUSCCO SEDOM, and MEDI,) which provide business advisory and technical advisory services to the SME sector. Lessons learned from the READI Project have confirmed the immense need for such services to SMEs in Malawi. In fact, experience has demonstrated that BAS/TAS is crucial for the sector's development.

Critical business advisory needs in Malawi include the following:

- Management
- Marketing
- Production management
- Personnel management
- Stocks and inventories
- Bookkeeping and accounting
- Quality control
- Financial management
    - Credit
    - Profit and Loss
    - Cash flow
    - Capital
- Tax and legal
- Banking and credit (including FX)

Technical advisory needs include the following:

- Production management
- Technology selection
    - Appropriate technology
    - Tools
    - Sources
    - Applications
- Upkeep and maintenance
- Energy sources
- Spares and sources
- Technical training
- Installation
- Technology adaptation

SME Sector Business Promotion

Another important area for sector development includes the identification and promotion of new business opportunities. At present, most SME institutions carry out this activity at best in an *ad hoc* manner. The READI Coordinating Unit is currently attempting to fill this gap by systematically promoting new enterprise development. READI is funding a Project Promotion Unit that has identified a number of potential projects for funding, primarily intended for INDEFUND.

Lessons learned from the READI Project have demonstrated that the ability of existing Malawian institutions to promote new businesses is limited. Promotional activities that should be further developed include the following:

- Project or product conceptualization
- Project identification
- Sponsor identification
- Project feasibility
- Locating appropriate financing

Training

The READI Project has clearly demonstrated both the need for and the positive impact that can result from properly targeted training programs. Such programs are necessary for developing institutional and human resources, as well as for strengthening SME businesses themselves. READI has initiated many programs that should continue in order to truly enhance local Malawian intermediary institutions servicing the SME sector.

It is important that future training supported by USAID be delivered by organizations and individuals which have expertise in strengthening SME intermediary institutions.

An Overview of USAID/Malawi SME Initiatives

The joint efforts of the READI project and GOM have contributed greatly to coordinating the efforts of agencies working in SME development. The field of SME development in Malawi is much larger than the services currently being offered, warranting a continued focus on expanding of service agencies working in the sector.

USAID's action plan for Malawi contains several key projects for supporting SME development, including the Human Resources and Institutional Development (HRID) project, the Support for Health, Agriculture and Rural Enterprises (SHARE) project, and the Malawi Enterprise Development (MED) Sector Assistance program. The following sections discuss these three initiatives in light of the sector's development requirements.

Human Resources and Institutional Development (HRID)

The objectives of the HRID project in respect to the SME sector are

- To improve technical and professional capabilities within MTIT
- To strengthen SME business and technical advisory services, and credit provision capabilities within DEMATT, INDEFUND, MUSCCO, and SEDOM .

The Malawian organizations targeted to receive HRID assistance in the SME sector are MTIT, DEMATT, INDEFUND, MUSCCO, SEDOM, and MEDI. The Project Paper describes specific types of institution building and staff training priorities for these agencies working in the SME sector, including

- Long-term technical assistance — 18 person years
- Short-term technical assistance — 57 person months
- Long-term participant training — 10 person years
- Short-term participant training — 43 person months

The HRID project could prove to be an invaluable tool for expanding HTIT's and other institutions' institutional capabilities for promoting SME development. However, implementing the project has been slow, raising questions about whether resources can be mobilized fast enough. Discussions with SME development institutions suggested that some confusion and concern exists about the application approval process for technical assistance and training.

During the upcoming months, it will be important for USAID and the READI CU to focus on assisting READI Project participants in preparing training and institutional development proposals to the HRID Project Implementation Committee. It will also be important to look closely at HRID's ability to meet the SME sector's training needs. The evaluation team believes that USAID should take a more active role in working with SME support institutions to determine their needs and mobilize resources to meet them.

Malawi Enterprise Development (MED)

The Malawi Enterprise Development (MED) Sector Assistance Program has two components:

- Direct program assistance in support of policy and institutional reform
- Technical assistance, studies, and training in support of program objectives and the policy dialogue process

The program assistance component provides US$ 35 million for stimulating policy reforms aimed at liberalizing foreign exchange allocations for spare parts and raw materials; the program is designed to closely parallel reforms embodied in the World Bank Industrial Trade Policy Adjustment Credit (ITPAC). MED conditionality in its second and third years of implementation is directed at removing obstacles to the expansion of small and medium enterprises and to increasing the labor absorptive capacity of the economy.

MED provides US$ 1.6 million in resources to monitor and evaluate progress toward the attainment of program objectives, conduct various studies that will serve to broaden and deepen the policy dialogue, and finance technical assistance and training important to development of Malawian businesses.

MED monies are not dedicated for specific SME development institutions. The US$ 35 million in program assistance can be utilized by GOM for line item budget support only. Therefore, the SME development institutions eligible for operation support include DEMATT, MUSCCO, SEDOM, and MEDI. Any expansion in these institutions' programs would have to be approved by MTIT and MOE.

The evaluation team is concerned that this centralized, public sector funding strategy may not meet the institutional development needs of the SME development agencies that USAID has supported. Although we recognize that MED is the result of a shift toward greater program lending, in the case of SME development in Malawi, a project strategy containing specific and clearly identified sectoral goals is also needed to continue the institutional development efforts already begun by USAID.

Services for Health, Agriculture, and Rural Enterprises (PVOs)

This project is at a preliminary stage of development. Basically, it would serve as an umbrella for funding the efforts of PVOs working in the SME sector. It could serve as the funding mechanism for WOCCU, Africare, and other U.S. PVOs operating in Malawi. It is scheduled to come on line in FY 1989.

Based on the lessons learned during the course of the READI Project, the team feels strongly that the utilization of PVO staff and resources in SME development should be closely linked to the ongoing efforts of Malawian institutions working in the sector. GOM officials and senior management of Malawian institutions believe that expatriate advisers can play an important role in training and institutional development <u>only</u> if there is a clearly defined program for counterpart staff development. Open dialogue between USAID, GOM and other local organizations will be vital to ensure that the best and most appropriate technical assistance and training resources are employed for development of SMEs in Malawi.

IV. ISSUES AND RECOMMENDATIONS CONCERNING THE POLICY ENVIRONMENT FOR SME DEVELOPMENT IN MALAWI

As mentioned earlier, DEVPOL places a high priority on SME sector development; however, the actions necessary to realize fully this policy objective still need to be developed. Some efforts have already begun, such as the World Bank Industrial and Trade Policy Adjustment Credit, in which USAID/Malawi is participating with a US$ 35 million sectoral assistance program. It will be important for the GOM to closely monitor the impact of these programs on the SME sector. Furthermore, some consideration should be given to assisting businesses, particularly the smaller ones of the SME sector, in gaining the full benefit of these new programs. These points are discussed in greater detail below.

Key Policy Issues

DEVPOL outlined several strategies to pursue its overall industrial and SME development objectives. These strategies will have a direct impact on the provision and delivery of credit, business and technical advisory services, and training to the SME sector. The key policy issues surrounding the development of SMEs in Malawi focus on the availability and cost of credit, access to foreign exchange, and favorable adjustments in the system of business taxation and licensing.

SME Credit

Several of the strategies outlined in DEVPOL will have a direct bearing on the flow of credit to small- and medium-size enterprises in Malawi. Under the general heading of strategies for industrial development, DEVPOL recommends that action be taken to

- Attain a simple, moderate, and uniform corporate income tax structure
- Continue a liberal policy on industrial licensing
- Improve the availability of long-term capital, particularly loan capital for small ventures with foreign investors, as well as short-term working capital, particularly for new Malawian-owned enterprises

When focusing more closely on the SME sector, DEVPOL recommends additional strategies to

- Prepare and introduce a number of legal and administrative measures concerned with taxation, foreign exchange, and credit, which will directly stimulate the subsector
- Enhance in parallel with the progression of institutional capability, the availability of credit, including that from the commercial banking sector, and review the resources made available to support small-scale manufacturing enterprises' credit administration in light of lending rates and on-lending margins

Based upon its analysis of the credit component of the READI project, the evaluation team believes that DEVPOL has pinpointed accurately the types of strategies needed to improve the flow of credit to the SME sector. The paragraphs that follow review these recommended strategies.

Availability of Credit

DEVPOL recommends legal and administrative measures to improve the flow of credit to the SME sector. A clearer understanding of the specific and unique roles of the three institutions that provide credit to the SME sector would be helpful. There is too much unnecessary overlap in the areas that INDEFUND, MUSCCO, and SEDOM serve. For example, the short-term loans that MUSCCO's primary societies provide to members and SEDOM's mini-loan program service the same segment of the market. There is considerable overlap between SEDOM and INDEFUND as well. SEDOM makes term loans up to K 75,000, while INDEFUND's targeted range is set currently at K 30,000 to K 150,000.

It would be useful for the MTIT to work with these three institutions to develop a clearer understanding of the market segments they were individually best suited to serve. In addition, this would outline a process to "graduate" entrepreneurs up through successively higher levels of credit. Finally, the ultimate objective of a unified credit strategy should be to turn over the more successful and faster growing SMEs to the commercial banks as their credit requirements increase.

On the subject of the availability of credit, it is important to mention the ITPAC proposal to establish a credit guarantee scheme. Specifically, the proposal calls for SEDOM to manage the scheme through the commercial banks. As a risk-reducing measure, a guarantee scheme could have a positive impact on the flow of credit to the SME sector. However, no financial intermediary should take on this responsibility if it is going to divert it from the primary objective to become self-sustaining.

On the issue of the availability of credit, there is a need to investigate what the market will bear in terms of interest rates. According to the original project design, READI was to experiment with demand responsive credit schemes. Currently, there is a huge gap between the country's informal credit markets, where interest rates can range from 100 to more than 1,000 percent per annum on very small loans (K 100 or less), to the formal markets, where current rates range from 16 percent on agricultural loans to 26 percent on some leasing arrangements. With the possible exception of SEDOM's mini-loan program, the three financial institutions providing credit to SMEs take the same basic approach to lending: they charge low interest rates, given market rates and the risks involved, and make high demands for equity participation and collateral and other security. (However, given the difficulties in seizing the assets often pledged as collateral, it is arguable just how effective this approach is.) Any study of measures to increase the flow of credit should investigate the possibility of encouraging INDEFUND, MUSCCO and SEDOM to modify the risks and rewards of their lending. One possibility might be to increase interest charged in return for a reduction in equity or collateral requirements.

Foreign Exchange

Difficulty of access to foreign exchange restrains SME development. During the course of the evaluation, several entrepreneurs related stories of projects that were delayed because of difficulties in obtaining the Reserve Bank's permission to import and access foreign cash. The worst example of this was the SEDOM client whose request for financing to import a lathe was approved four years ago, but whose request for foreign exchange was approved just recently.

The foreign exchange problem is twofold. One problem is the limited availability of foreign exchange, which affects all sectors of the economy, large and small. However, this situation is improving. The evaluation team met with executives of Malawi's commercial banks and other financial institutions which reported that they are experiencing few if any problems obtaining foreign exchange for their larger clients.

A more pressing problem appears to be small-scale borrowers' inability to manage the bureaucratic procedures required to gain access to foreign exchange. It is unfortunate that the foreign currency the READI project was supposed to make available to the SME sector through INDEFUND was never used in the way originally intended. Strategies to make the Reserve Bank more responsive to the needs of SME borrowers are needed.

Licensing and Taxation

Although only indirectly related to credit, licensing and taxation are two factors that have a profound impact on the SME sector. Based on the evaluation team's visits to more than 20 small- and medium-size businesses, licensing may be more of an issue now than taxation. To many small entrepreneurs, the licensing procedures appear complicated, time consuming, and sometimes expensive. The K250 licensing fee can be onerous for the small enterprise. However, the data that the government can collect on the application is valuable. The team recommends that licensing fees for SMEs be scaled down.

As for taxation, it is difficult to argue that the current tax system has a serious negative effect on the cash flow and profitability of SMEs; however, it is clear that the current procedures are confusing. It is evident that many SMEs do not have the bookkeeping systems and accounting expertise that would make tax collection easier and more understandable. As a result, tax authorities come into a small business, gather up whatever records are available, and calculate the amount of tax the business owes. In any review of the tax system, it would be instructive to investigate the cost effectiveness of the current system for collecting taxes from SMEs.

BAS/TAS Services

The key business and technical advisory service issues within the Malawian SME sector are well defined in the Government of Malawi's "Statement of Development Policies: 1987-1996." According to this statement, the GOM has set priorities to

- Review all regulations, rules, and practices which affect the sector
- Prepare and introduce a number of legal and administrative measures concerned with taxation, government procurement, and marketing which will directly stimulate the sub-sector

- Clarify and harmonize the roles of various public, parastatal, and private organizations concerned [and] involved in [SME] development
- Tariff and tax reform will be concerned with simplicity, stability, and creating an adequate and clear incentive to undertake efficient investment.

In its "DEVPOL" statement, the GOM calls for "an urgent review of all laws, regulations, rules, and common business practices which bear on [SMEs]."

As the READI Small Enterprise Survey highlights and as field interviews confirmed during the course of this evaluation, there is an urgent need for the GOM to review numerous policies that affect the development and growth of the sector.

The following examples highlight business and technical problems that face the small and medium enterprise entrepreneur:

1. Securing the title to a lease as collateral for an INDEFUND loan routinely takes over three months; it can take as long as two years. INDEFUND has one full-time staff member who, as Senior Implementation Officer, secures the necessary legal documentation on securing INDEFUND loans. This process should be significantly streamlined to benefit the small and medium enterprise entrepreneur.
2. For testing and product approval, visit and initial valuation by the Malawi Bureau of Standards routinely costs the applicant K 2,000. Bureau of Standards approval is required for a variety of products, particularly any processed agricultural goods, food products, or consumer items such as soap or paper products. The fees that apply to large-scale producers apply equally to small-scale producers, thereby discouraging development of the latter.

Costs for testing products such as meat can be prohibitive for the small producer, barring entry for small and medium entrepreneurs. They provide little incentive to advance from the artisan stage to larger scale production. These barriers could be significantly reduced by decreasing, or eliminating entirely, valuation and testing costs charged to small and medium entrepreneurs by the Bureau of Standards and other government agencies such as the Veterinary Department.

3. Government field extension and support agencies could play a more significant role in assisting off-farm SMEs. Many government extension services are not geared towards the SME sector, particularly in the agricultural and food production (e.g., fishing) sectors.

4. Taxes are little understood by most small entrepreneurs. Most SME business people have little knowledge of tax policies affecting either their business or their personal incomes. It would be useful for an agency such as DEMATT to work with relevant GOM authorities to review existing laws and determine if simple publications (brochures) could be developed to enable entrepreneurs to understand tax and other laws better.

5. In general, procuring necessary inputs remains a problem for many small-scale producers. Everything from paints to nails to spares are usually unavailable in the rural areas. Businessmen spend amazing amounts of time in Blantyre and Lilongwe trying to obtain these inputs. The evaluation team notes that rural wholesaling is poorly developed and that many entrepreneurs suffer high costs in both time and transport because they do not have easy access to wholesale networks.

MDC-funded Import-Export Shops are located in all District Centers. These shops should be able to provide a variety of necessary wholesale inputs to the SME sector. Such inputs should include hardware and industrial goods (nails, sheet metal, paints, and glues). The evaluation team recommends that the Import-Export Company research the market in their districts more thoroughly to address the input requirements for SMEs.

6. In several instances, government procurement practices and standards do not favor small businessmen. This is an area that should be studied carefully. The government is a major procurer of many kinds of goods produced in the SME sector. It is recommended that the government encourage its agencies to explore actively how to buy from SMEs, when appropriate (e.g., uniforms, school supplies, foodstuffs).

Strengthening Training Programs for SME Development

The following observations are offered to assist in setting training objectives and priorities among an array of Malawian institutions affecting the human resources for SME development:

- Malawian colleges offering courses in education should expand their curriculum to include adult education. Pedagogical techniques stressing rote learning and repetition are poorly suited to the needs and temperament of adult learners.

- All GOM agencies which influence perceptions concerning training should make a concerted and sustained effort to upgrade its image and importance. This is equally true for development agencies and donor organizations. Training must be perceived as being of equal importance with credit services, technical assistance, and business advisory services. Today, few Malawians consider training as a career with its own theory and techniques separate from traditional classroom teaching. As a result of the underestimation of training as a career, people enter SME organization training departments with little relevant education.

- General managers and supervisory personnel in SME service organizations that provide training should facilitate and encourage informal meetings of trainers to exchange information, experiences, and equipment and to attempt to design and implement collaborative problem-solving strategies.

- The GOM should provide radio access to SME training departments expressing the desire to begin pilot radio school training programs. DEMATT has expressed interest, if results are favorable, in examining and implementing a radio training curriculum for SME-related programming. Training funds should be made available for radio curriculum development and the training of facilitators in villages throughout the country. This approach offers significant potential to reduce training service delivery costs by eliminating or reducing extension officers' travel needs and expenses.

- Malawian members in the training departments of organizations that provide SME services should be given whatever technical assistance they need to prepare funding proposals for HRID to upgrade their skills. This assistance should be provided by the READI/TOT Program staff within HRID.

Institutional Development Requirements for Implementing SME Policy Initiatives

Institutional development should correspond to the goals and objectives identified by an organization to increase its managerial and human resources capacity. In the case of SMEs in Malawi, institutional development at several levels in the public and non-governmental sectors wouid create a better environment in which businesses could grow. These levels can be broadly characterized as the Government of Malawi, primarily the Ministerial and Departmental levels, and intermediary institutions serving the sector, such as DEMATT and INDEFUND.

Strengthening the Role of the GOM

As discussed in various sections of this evaluation, the team believes that recent steps taken by the MTIT in establishing a Small-Scale Industry Unit (SSI) are laudable. Further efforts should be considered to broaden the scope of this unit to address the SME sector as a whole. Strengthening this leadership role of MTIT in SME development should be a priority for the remainder of the current READI agreement and for any follow-on effort.

As part of strengthening its capacity, MTIT should also act more as a liaison, reaching into the donor community to share information about initiatives and to coordinate resources for the maximum impact from training and institutional development efforts in the sector. Regular communication between MTIT and donors should also identify and monitor appropriate implementation programs for achieving policy objectives.

The Role of READI in Policy Dialogue

The READI Project, working in close association with MTIT, has played a central role in furthering the dialogue about SME development policy and in achieving the goals and objectives spelled out in DEVPOL. READI's influence in this effort has indeed been impressive:

- The PIC has served as one of the first forums for exchanging views between government and the private sector about SMEs in Malawi.

- The READI CU has assisted each funded institution in developing their first institutional plans, which set the stage for long-term planning in the sector.

- A study tour to Botswana and Kenya arranged by READI resulted in a set of SME development recommendations addressed to the GOM by representatives of the government and other intermediary institutions working in the sector.

- The information gathered by the READI SME survey provided some of the background on which the GOM based its policy statements for DEVPOL.

The activities undertaken by READI in supporting SME policy initiatives have facilitated greater communication among participating SME institutions and donors working in the sector. We see this coordinating function as an appropriate effort to move into the Ministry of Trade, Industry, and Tourism. However, we would caution against burdening MTIT with any project management responsibilities unless they are supported by an appropriate level of technical assistance and operational programming.

V. CONCLUSIONS AND RECOMMENDATIONS

The READI Project has played an important role in strengthening several key institutions involved in SME development in Malawi. This chapter summarizes our conclusions and recommendations in three areas of concern: the performance and future direction of the READI Project, the role of USAID/Malawi in further strengthening SMEs in the country, and strategies and actions needed to implement GOM small enterprise development policy.

READI Project Performance

The overall impact of the READI Project on the institutional planning capabilities of funded agencies has been positive. The team recommends that during the remainder of the project priority be placed on

- Evaluating and transferring the Project Promotion function within the Coordinating Unit to DEMATT
- Transferring sectoral coordination responsibilities — not to include project management responsibilities — to an expanded SME Unit within MTIT
- Further developing the management and field capabilities of MUSCCO
- Liberalizing the guidelines for INDEFUND on-lending of READI credit funds
- Strengthening the management and field operations of DEMATT (and expanding them to include more active project promotion)

- Better defining the training needs of the TOT program, and clearly defining a program for developing and institutionalizing the TOT
- Funding appropriate studies and surveys as outlined in the READI Project Coordinating Unit Workplan

The design of the READI Project was complex, which explains why there were so many financial and managerial problems. The utilization of OPGs has made it difficult to track budgetary expenditures.

Accountability of technical advisers, in an institutional sense, has been difficult because of the numerous funding mechanisms. The team recommends that expatriate advisers be selected by and accountable to their relevant institutions. Future design should ensure that all participating agencies fully report fiscal matters and implementation issues within a centralized framework.

Project design suffered from the lack of a clear definition of the responsibilities of contractors and PVOs, as well as poor definition of the expectations of participating institutions. This has proven particularly problematic in Africare's role with participating institutions.

Future design should define fully institutional needs for technical assistance and the expectations of institutions for contractors and technical advisers.

Institutional Development

The team believes that the overall impact of the READI Project on both intermediary institutions and MTIT has been positive.

The Role of MTIT

The active role taken by MTIT has been lauded by all institutions working in the sector. Key actors within the sector would like to see MTIT further develop its role in coordinating and supporting growth in the sector.

Given the increase in momentum through the efforts of READI and other agencies working in the sector, USAID/Malawi should continue its support to further strengthen MTIT in its efforts to establish an expanded small-scale unit to service the SME sector. A strengthened SME Unit would have the following responsibilities in the sector:

- Reviewing institutional development and sectoral workplans prepared by funded agencies — e.g., MUSCCO, INDEFUND, SEDOM, Africare, WOCCU/CUNA, and others — active in SME development
- Coordinating information requirements for the sector such as surveys and statistical database maintenance (in collaboration with Statistical Bureau), coordinating policy studies, and monitoring policy implementation and impact
- Sponsoring forums for discussion among GOM, SME development intermediary institutions, finance institutions, and the private sector
- Negotiating and periodically reviewing, as well as coordinating, donor-funded programs and projects for SME development

The development of an implementation plan for achieving these objectives within MTIT is an immediate priority.

The Delivery of BAS/TAS to the Sector

DEMATT has undergone significant changes over the past two years. The READI Project's most significant contribution to DEMATT has been to assist the institution in focusing its attention on its primary base, the field staff and its field network. However, the evaluation has shown that there appear to be differences in opinion between senior management and the field as to how DEMATT will achieve its objectives.

During the READI Project, INDEFUND's management has been moving towards a more developmental role; however, INDEFUND's Board appears to have grown more conservative (financially) in its approach to development. (Among other factors, INDEFUND's high debt to equity ratio is a factor that reinforces this conservatism.) This has placed considerable pressure on management to separate INDEFUND's business and technical advisory services from its credit operations, to the detriment of effective project monitoring.

Because of poor design, the READI Project did not provide INDEFUND with funds adequate to meet its growing BAS/TAS needs. Africare support, while useful in many ways, has not met many of INDEFUND's institutional needs. Consequently, INDEFUND's Client Services Division is weak, understaffed, and over-extended. The team recommends that INDEFUND collaborate with DEMATT in providing BAS/TAS to INDEFUND clients.

Project Promotion

The team believes that the promotion of new projects is an important area in SME sector development. The READI CU's promotional activities have served to bring together various financial institutions to discuss new project ideas. However, while it is too early to evaluate the effectiveness of this effort, it is clear that costs per project approved will be high and probably beyond the financial means of any institution to sustain. The promotion of new projects needs to be strengthened among participating institutions.

The Provision of SME Credit

The delivery of credit under the project has been less experimental than envisaged by the Project Paper. As a new effort, the MUSCCO long-term loan program has been experimental. However, INDEFUND has followed its traditional procedures to on-lend READI funds to selected enterprises. For example, lending to agribusinesses has an experimental aspect.

Because the Board is the only mechanism for loan approval, approving INDEFUND loans is a slow process. INDEFUND is the only development finance institution in Malawi that does not have a standing loans committee. INDEFUND's Board meets only eight times per year to review and approve loan applications, and four of these meetings coincide with the board's regular quarterly meetings, at which it discusses all aspects of INDEFUND's business.

This, we believe, leads to its cautious approach and slow loan approval. In addition, the requirement that INDEFUND send loans approved by its board to USAID, through the CU, adds yet an additional step in an already cumbersome approval process.

The rate at which both INDEFUND and MUSCCO have been able to disburse READI project funds has been slower than anticipated. The authors of the Project Paper were overly optimistic in estimating the time required to strengthen the lending capacities of INDEFUND and MUSCCO, and they seriously underestimated the problems inherent in lending to SMEs.

Both INDEFUND and MUSCCO have significantly improved the management of loans. INDEFUND has recently computerized its loan accounting operations. This should result in better monitoring and fewer delinquencies. MUSCCO's manual loan processing and accounting system is adequate for the current small volume of long-term loans. However, if this program is to grow, the CFD will need dedicated hardware, software, and appropriate technical assistance to computerize its operations.

Both institutions need additional vehicles to support their appraisal and monitoring efforts.

Key Credit Recommendations

The READI Project should restore both INDEFUND's and MUSCCO's credit line item to the levels originally proposed in the project plan. The CU and USAID should prepare a contingency plan to insure that INDEFUND, in particular, will have funds available to meet its anticipated disbursement schedule if additional funding is delayed.

The READI Project should not consider any additional funding for credit operations to either financial intermediary until each demonstrates that it has the management capability to monitor the performance of its borrowers closely and that each is able to reduce the high levels of delinquencies. The evaluation team recommends that both INDEFUND and MUSCCO report monthly to USAID, through the CU, on the status of the READI-financed portion of their portfolios.

We recommend that INDEFUND's Board of Directors create a loans committee that will meet monthly and have the authority to approve loans of up to K100,000. Further, we recommend that a representative of USAID be present when the committee or board reviews loans to be funded by the READI Project.

INDEFUND's foreign exchange portion of the line of credit has not been used as originally planned, and the reasons for this are not fully understood by the parties involved. INDEFUND, with the support of the CU and USAID, needs to study the reasons and obtain the Reserve Bank's permission to use the dollar account established for it as originally intended.

MUSCCO's long-term credit program should continue, but cautiously, in order to ensure proper institutional strengthening, particularly at the field level. USAID should continue to support this program, but at a pace that is more realistic in terms of MUSCCO's capacity, which should be determined by MUSCCO itself.

We recommend that both INDEFUND and MUSCCO develop plans to strengthen their accounting departments. These plans should detail the staff training and technical assistance in accounting, financial management, and computerized information systems required to do. The CU should work with both institutions to turn their plans into proposals for assistance from the HRID Project.

Finally, the team encourages the study of a guarantee scheme to increase the flow of credit to the SME sector; however, any guarantee scheme should be housed in a separate institution, rather than in an existing SME financial intermediary. Placing the additional task of managing a guarantee scheme within an existing institution deters that institution from its principal operations and slows the pace at which it becomes self-sustaining.

Training

Training instructors will continue to be a critical element for supporting SME sector development. Training can reduce delivery costs and increase the efficacy of training. However, there is a need to sharpen the focus of the TOT Program under READI, to reduce the confusion about the program among recipient institutions, and to match TOT Program objectives with institutional needs.

USAID Program Initiatives

The evaluation team believes that the USAID/Malawi Program can provide the Malawian SME sector with significant development support over the next decade. However, USAID's growing emphasis on cross-sectoral programs could result in less focused attention and support to the crucial SME sector. Key areas for support include the following:

BAS/TAS

The Mission should provide assistance to Malawian SME agencies through host country contracting mechanisms. In the case of PVO OPG agreements, clear lines of accountability need to be established between the technical advisers and the participating institution.

BAS/TAS is a priority sectoral need. Institutional planning capability rising out of READI is a positive development and should provide the basis for defining appropriate technical assistance to strengthen this function. DEMATT is the institution which should be the focus of this effort because it is in a position to link with other agencies working in the sector.

Credit

In terms of future credit programming, the team believes that the MED program should provide local currency resources for SME credit. However, since MED only supports GOM budget line items, it will be unable to funnel additional credit funds to INDEFUND.

USAID's strict focus on the rural sector has created problems for INDEFUND. USAID should adopt a more flexible set of guidelines for the use of its credit funds, especially for INDEFUND. For instance, the network of wholesale outlets that should supply raw materials and supplies to SMEs is weak and underdeveloped. USAID should permit INDEFUND to loan its funds to wholesale enterprises serving rural areas. In addition, USAID should emphasize the use of credit to develop urban-based agribusinesses, which creates demand for locally produced crops and animals, thereby helping to increase rural income.

Training

As the Project Paper sets out, the HRID Project must serve as a major mechanism for funding training and institutional development in the SME sector. We believe that READI Project resources should be used to assist SME development institutions in developing proposals for HRID funding.

The Policy Environment for SME Development

The Government of Malawi has clearly enunciated its policy objective for the SME sector in its "Statement of Development Policy: 1987-1996." This document should guide policy development in the sector during the coming decade. The READI Project should contribute to these objectives by supporting studies in the following policy areas:

- Registration and licensing of SMEs
- Potential for utilizing differential interest rates to increase the availability of credit for SMEs
- Reducing costs for obtaining Bureau of Standards and other GOM certifications for SME products
- Potential for making foreign exchange more accessible to SMEs

- Streamlining GOM procurement procedures and regulations to make it easier for SMEs to sell to GOM agencies

APPENDIX A

ARIES MALAWI READI PROJECT EVALUATION

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APPENDIX B

APPENDIX B: LIST OF CONTACTS (PARTIAL)

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Chitedze Savings and Credit Union (Lilongwe/Chitedze)	

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