

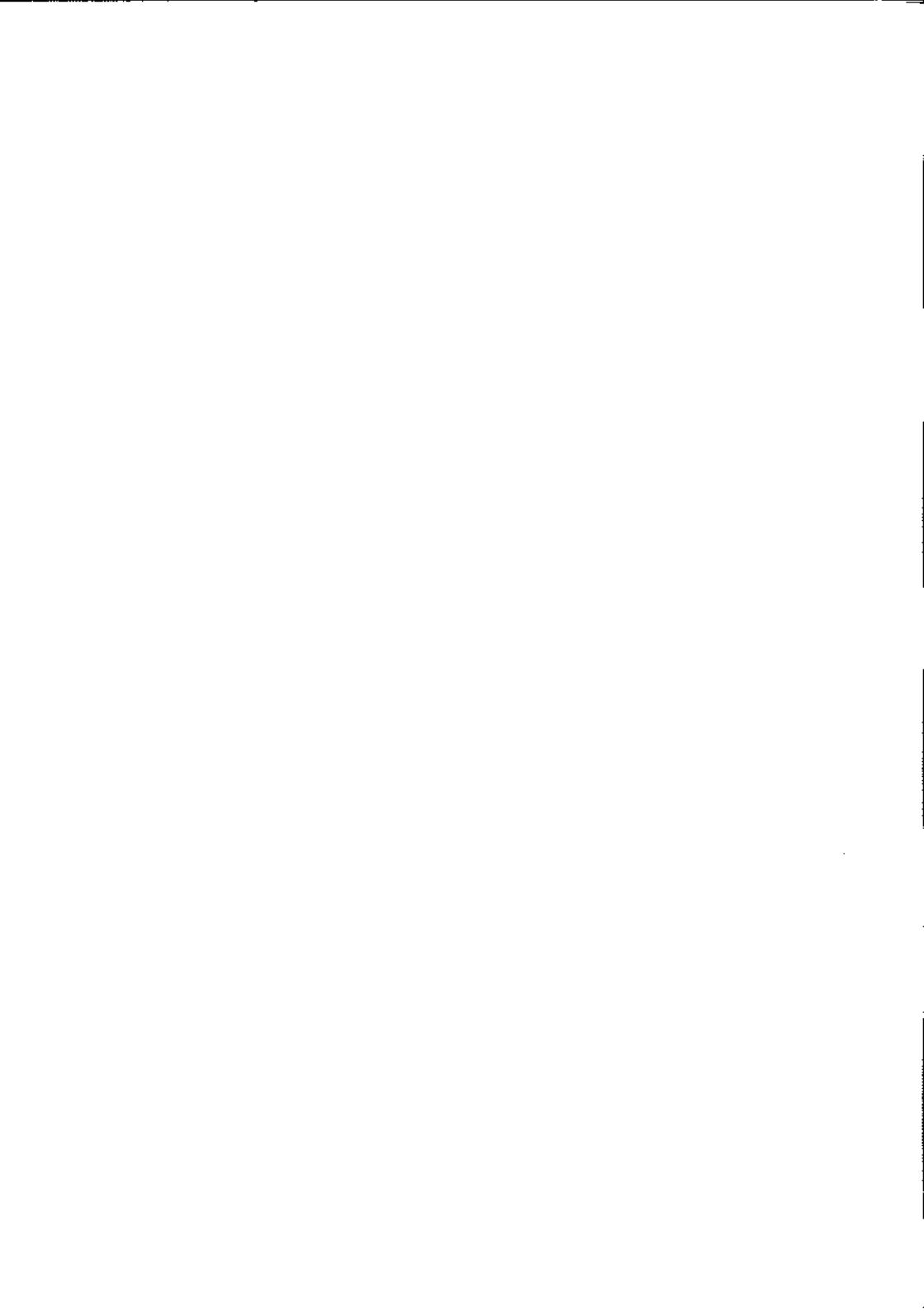
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SMALL ENTERPRISES, NEW APPROACHES





SMALL ENTERPRISES, NEW APPROACHES

Proceedings of the Workshop
"Small Scale Enterprise Development,
in Search of New Dutch Approaches"

The Hague, 6th and 7th March, 1989

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Foreword

It is with great pleasure that I accept to write the foreword to these proceedings from the workshop on "Small Scale Enterprise Development - In Search of New Dutch Approaches".

The relevance of micro and small-scale enterprises for income and employment generation and the production of basic goods and services, especially for the more vulnerable sections of society in the Third World, can hardly be overstated. Though the role of these enterprises has not always been recognized in the past and small-scale entrepreneurs were often ignored or even discriminated against in policy, the subject has increasingly received attention. Research on the subject has been intensified in the last two decades or so. A great number of studies and articles were published, devoted to various aspects of the subject ranging from more theoretical and conceptual issues to more descriptive, empirical studies and evaluation reports of projects in this field.

Consequently, at the present juncture the problem is not so much paucity of data and lack of knowledge, but rather the policy-relevant translation of available insights into realistic and operational goals, strategies and instruments for the development of micro and small-scale enterprises.

With this aim in mind the Dutch government invited Dutch as well as international experts, professionals, researchers and practitioners to discuss at this workshop policy-related issues in small and micro-scale enterprise development. A number of such initiatives were launched by the Dutch during the past five years, contributing at the one hand to a better understanding of the problem, but, on the other hand, pointing to the need of changes in policies pursued so far.

Now, these efforts are expected to converge into a more concerted and consistent formulation of "New Dutch Approaches" as the title of the workshop suggests. It is fair to acknowledge that, though aware of the relevance of the topic, the Dutch government till now lacked an explicit policy approach to the subject, even though development activities in the field were supported via bilateral and multilateral development cooperation. Recently a thematic evaluation of these efforts has taken place by the Netherlands government, the UNDP (United Nations Development Programme), the ILO (International Labour Organisation) and the UNIDO (United Nations Industrial Development Organization) jointly.

This evaluation has brought to the surface pertinent questions, dilemmas and issues to be taken into account when formulating policies and operational activities. It was shown that effective support of these small-scale, often informally organized, econo-

mic activities is far from simple, irrespective of whether it is done through general policies or through project interventions.

To reiterate a few problems:

- local authorities in many cases exhibit an attitude of neglect or even outright discrimination towards these enterprises;
- government policies do not take small-scale economic activities into proper account, but are directed towards more formal, larger-scale and urban enterprises;
- there has been too little appreciation of the impact of overall policies, especially the so-called demand-side policies;
- for a variety of reasons, project interventions to support the small-scale enterprises have been largely ineffective and were too costly;
- there are special problems in relation to labour circumstances of such groups as women and children. In addition, attention should be paid to the environmental effects of small-scale industrial activities;
- many of the existing (Dutch) policy instruments appear to be not very suitable for effective support of this category of enterprises. An exception are the instruments focussing on self-help, local organization and empowerment.

The workshop has paid attention to these and other issues. To my mind, an emerging consensus is developing as far as major questions are concerned. Also considering forthcoming reports on the subject by the NAR (National Advisory Council on Development Cooperation) and RAWOO (Advisory Council for Scientific Research related to International Cooperation) this may lead to concrete recommendations for future policy.

Therefore, I would like to thank all contributors to this workshop not only for their contribution per se, but even more so for their common effort to formulate ideas, suggestions and options for a new Dutch approach in this field. I sincerely hope that these efforts, together with the results of past and current initiatives, will lead to an explicit and effective Dutch approach that will reach and support – directly or indirectly – entrepreneurs and labourers in micro and small-scale industrial activities in the Third World.

Mr. J.J.A.M. van Gennip
Deputy Director General International Cooperation
Ministry of Foreign Affairs

The Hague, June 1989.

A word from the editors

Small and micro enterprises as well as other income-generating activities are at the heart of many development programmes; their significance varies according to the development level of their economic and social environment.

History shows that - especially in comparison with the United States or United Kingdom - the Netherlands have had relatively little experience with industrial development on the basis of local resources or raw materials, with the exception of the dairy and textile industry. Manufacturing industry in the Netherlands has nearly always been linked to commerce and trade. In spite of the international orientation in the Netherlands another remarkable fact is that the considerable available know-how and experience in the field of small enterprise development of banks such as NMB (the Netherlands Small Enterprises Bank) or RABO, (the Netherlands Cooperative Bank), small enterprise support institutes such as RND or CIMK (small enterprise extension services), or pressure groups have hardly ever been applied to Third World situations.

Still interest in the development and promotion of small and micro enterprises in developing countries has always been of substantive nature. Practitioners in the field have continuously made endeavours to establish links with universities and training institutes. Secondly a number of initiatives have been launched during the past years by various organization in the Netherlands, each in a specific way contributing to a better understanding of the role of small and micro enterprises, and of the need for policy changes.

The first attempts to come to a better understanding of the impact of adopted policies and methodologies were made informally in the early 1980s when a small group of individuals held study meetings related to off-farm employment. Broadly based discussions about the sector in general were held during the 1983 conference on Small Industry Promotion in Developing Countries hosted by RVB Delft (the Research Institute for Management Science). In 1984 the FMO (the Netherlands Finance Company for Developing Countries) organized a conference about Credit and Finance for Small and Micro Enterprises further promoting the understanding of the need of credit for the sector. The Institute for Social Studies (ISS), The Hague, initiated the discussion about industrialization processes and the role of small and micro enterprises in 1987 with an International Conference and policy seminar, later followed by an ongoing series of national workshops on the same topic. The forthcoming report by the RAWOO (Advisory Council for Scientific Research related to International Cooperation) on industrialization will be an important contribution too. And in 1989, the National Advisory Council on Development Cooperation (NAR), presented comprehensive views about the role and functions of the Informal Sector. Finally, the role of

Non-Governmental Organizations (NGOs) and Private Voluntary Organizations (PVOs) was discussed specifically during the 1987 conference on the basis of the study *Self-Help Promotion, a Challenge to the NGO Community*.

This wealth of information was recently complemented by two evaluation reports. The UNDP/Netherlands/ILO/UNIDO thematic evaluation *Development of Rural Small Industrial Enterprise, Lessons from Experience* (RSIE, 1988) provides an in depth insight in the numerous pitfalls encountered in small enterprises development and promotion programmes. But it also laid the foundation for renewed efforts on the basis of a better understanding of the required policy adjustments. The 1988 study *Women Entrepreneurs, Development Prospects for Women Entrepreneurs in Small and Micro Scale Industry*, by the Operations Review Unit (ORU, 1988) of the Directorate General for International Cooperation (DGIS) of the Netherlands Ministry of Foreign Affairs, must be seen as a balanced argumentation for further integration of women (i.e. group) specific programmes in overall (small and micro enterprise) development programmes.

The past decade in the Netherlands, the small and micro enterprise sector has been subject of research by a large number of individuals at various universities, resulting in an increasing number of theses on the role of the sector. Without denying the importance of studies and analyses made internationally, it was considered worthwhile to take stock where we stand in the Netherlands, in the field of small and micro enterprise promotion.

In spite of the many studies until now, very little feedback has been provided to policy makers and politicians regarding the policies to be adopted and programmes or projects to be supported in the coming years.

By and large, it has become clear that the various ideas and theories generated in the present decade form a sufficient basis to come to a reorientation of the policies and strategies for the sector.

Therefore, the Directorate General for International Cooperation of the Netherlands Ministry of Foreign Affairs deemed it necessary to hold in depth consultations with practitioners, researchers and professionals in the field of small and micro enterprise development in order to assess the possibility to formulate new, coherent and comprehensive approaches.

A position paper based on the findings of the RSIE study was prepared by Roger Teszler and sent for comments to a selected number of Dutch experts. The outcome of that process formed the basis of the first three chapters of this book. The consultations revealed that specific attention was to be paid to six different but interrelated topics

- (i) the role of the small and micro enterprise sector;
- (ii) the impact of macro policies;
- (iii) the need for classification;
- (iv) the need for innovative financing;
- (v) the impact of group specific programmes;
- (vi) the role of donor agencies.

Leading international experts in the field were invited to submit their thoughts on the above points, which formed the basis of the chapters IV through IX of this book.

Dutch experts, professionals, policy makers and researchers active in the small and micro enterprise sector were invited by the Netherlands Government to a two day workshop held in 1989 and organized by ETC Foundation, Consultants for Development Programmes, where intensive debates about the position paper and the aforementioned contributions by the international experts have thrown more light on the issues under consideration. Through these discussions, of which the result formed the basis of chapter X and the concluding chapter XI, it is felt that the enhanced understanding of the problems to be tackled will lead to a more concerted and comprehensive effort by all concerned.¹

This book is the result of the overall process of studies, analyses, consultations and debates. It is hoped that policy makers as well as professionals will be able to draw their own independent conclusions from the thoughts presented here, and that through a concerted effort at all levels a balanced, effective and efficient impetus can be given to the promotion of sustainable economic development.

The editors,
Antoinette Gosses
Klaas Molenaar
Quirin Sluijs
Roger Teszler

November 1989.

¹ See Annex 1 for a list of participants of the Workshop *Small Scale Enterprise Development, in Search of New Dutch Approaches*.

I. What are small enterprises?

by Roger Teszler

Development can be viewed as a process of structural change with individual or group self-sufficiency making way for economic activity of a more specialized nature. Generally speaking, this process can be said to have originated and advanced further in developed than in developing countries. The consequences of this evolutionary process can be illustrated with reference to certain characteristics of industry as it now exists in most developed countries. These are:

- *Industrial structure has diversified extensively, and has come to be characterized by a broad range of plant sizes and goods produced.*
- *Industry has developed a strong network of functional linkages, not only between individual industrial units but also between industry and other sectors of the economy.*
- *Industrial activity has spread out geographically in the wake of improving infrastructure outside the major urban areas.*

In rural areas similar developments have occurred:

- *Rural self-sufficiency has gradually given way to specialized agricultural production.*
- *Non-agricultural rural activities have tended to concentrate in small market centres and district towns.*
- *The initially clear-cut dividing line between city and countryside is being replaced by something more like an urban-rural continuum, with industrial processing and assembly activities increasingly being (re)located in more rural surroundings.*

The struggle for industrial development in developing countries has by and large not yielded impressive results. Developed and diversified industrial structures are but rarely (although of late increasingly) found outside the developed countries. The recognition in academic and policy-making circles of industry as a prime mover in the development process has not been translated at an acceptably large scale into a planned and empirically proven process of industrial development.

1. Why Focus on Small and Micro Enterprises?

The foregoing does not mean that industrial development in the Third World is non-existent (by now approximately one-seventh of the world's manufacturing production takes place in developing countries), but rather that major developments in Third World manufacturing are owing to specific circumstances and that these can be used as bench-marks for classification.

These circumstances refer to:

- The adoption of an industrialization policy of export-led growth at a time when the world economy was still expanding (Taiwan, Korea, Hong Kong and Singapore in the late fifties and early sixties). Attempts by other governments to follow this lead have only produced limited results (in a number of Latin American countries in particular), because by that time the expansion of the global economy had come to a halt. With the renewed expansion of the world economy in the present decade the results of countries such as Thailand, Malaysia and Indonesia appear promising.
- The existence of a large domestic market (India, Brazil, Indonesia, Mexico) implies that, even if per capita income levels are modest, the sheer quantity of purchasing power in absolute terms is sufficient to generate effective demand to allow for economies of scale in manufacturing activities.
- Specific conditions such as legislation for export processing zones and political stability which increase the attractiveness of a country for foreign productive investment. Examples are export platforms such as Mauritius and the 'maquiladora' industries of the border cities of Northern Mexico.

In the first category impressive results have been achieved by the effective use made by policy makers of latent development potential, which in turn was the result of a combination of land reform, integrated rural development policies and investment in human capital formation (Taiwan and Korea in particular). It is even questionable whether some of these countries can continue to be considered as developing countries.

The countries in the second and especially in the third category have achieved their industrial success mainly by virtue of specific characteristics and *ad hoc* legislation (economic size, attractiveness for foreign investment). Their often spectacular achievements in industrialization have only had a limited impact on the overall development process. In the third category, manufacturing has frequently remained a modern enclave with limited effects to other sectors of the economy. In spatial terms such modern industrial centres are in marked contrast to the poverty surrounding them, and from a functional point of view the linkages of modern industry to international business and markets are often more important than their domestic ones.

The low degree of integration of modern large-scale manufacturing in the national economy of most developing countries can be attributed to factors such as:

- The high capital intensity of modern manufacturing, while the labour force employed in such plants must be well-trained and experienced. Such a labour force in developing countries can sometimes be in even shorter supply than capital.
- Modern manufacturing in developing countries tends to remain dependent on the import of capital goods and technology. In some of the more developed Asian and Latin American countries the capital goods industry has attained a certain momentum as the result of licensing agreements with international producers. Purely local design, development and production of modern capital goods is only found in a few isolated cases (Brazil, Mexico, India, Korea). Partial manufacture of parts of capital goods and assembly is, however, more frequently found (e.g. wooden bus bodies for jeeps, small grain mills and coffee decorticators).
- It is usually the traditional export sectors (agricultural and mineral raw materials) that have to bear the brunt of the industrialization process. In some cases agriculture suffers a second blow via concessionary food imports for the urban population, from whom most of the labour force for modern manufacturing is recruited.

Summing up, a modern manufacturing structure of any significance is beyond the reach of many developing countries because of the high costs involved and poor access to markets. It provides no adequate solution to the problem of unemployment, and its derived spread effects on other sectors of the economy are limited. The disappointing results obtained by emphasizing modernization strategies for industrialization have led to policies of substitution rather than attempts to remedy any apparent deficiencies by complementary measures. Emphasis was thus laid on other aspects of economic development instead (substitution), such as human resources, agriculture and international trade. In due course, often stimulated by reasons of mass unemployment, small enterprise in general (and small-scale manufacturing in particular) has emerged as a potential source of development promise. Small and micro enterprise (SME) has now become one of many in a series of development fashions, mainly because:

- Large-scale enterprise, whether plantation, manufacturing plant or large business, has apparently, with few exceptions, not stimulated a wide ranging development process to the extent expected. In view of the continuing belief in the pivotal role of manufacturing as a leading sector in a developed economy, alternatives have to be found to stimulate industrial development. One of the most promising alternatives in this respect is increasingly thought to be the development of small and micro enterprises.
- As stated above, development implies structural change and specialization. The process of rationalization production leads to more clear-cut divisions of labour, which in turn are enhanced by technological change. The result is higher capital intensity which makes possible a larger, better and more diversified output. Because these processes can be implemented with decreasing inputs of labour, whereas at the same time improvements in public health have induced higher natural growth rates of population, a disequilibrium ensues because much available labour is not

effectively utilized. This untapped labour force attempts to survive by searching for alternative sources of income, which prove to be not readily available in modernized agriculture, industry and services.

- It would appear that small and micro enterprises make better use of scarce factors of production by the application of labour-intensive methods. This is apparent in lower inputs of capital and larger ones of labour as well as in the higher production volume obtained per unit of equipment used (Liedholm & Mead, 1987; for a dissenting view see Little, 1987).

With formal and modern enterprise absorbing only small amounts of labour, those failing to find work have to search for alternative opportunities, such as those offered by small and micro enterprises. This process results in large numbers of street-hawkers and fixed position small enterprises in low-income neighbourhoods and market areas of large cities, as well as in smaller administrative and market centres in rural areas.

Research has indicated (World Bank, 1978; Chuta & Liedholm, 1979; Liedholm & Mead, 1987) that:

- Industrial employment is on the increase in many developing countries (table 1).
- Industrial production and employment are concentrated mainly in smaller firms (table 2). As income per capita increases, the significance of the smallest category of firms (micro enterprise) as a source for employment decreases.
- In many developing countries small manufacturing plants account for the largest share of manufacturing employment (table 3).
- Increased incomes in rural areas often lead to a more than proportionate increase in the demand for the products of rural small industry. Income increase for the majority of the rural population results in more and more frequent purchases of goods from small and micro enterprises which used to be bought less frequently and/or in smaller quantities (Chuta & Liedholm 1979; Papola, 1987).

These findings have not failed to leave their mark on the policies for development and development cooperation. It has become clear that:

- Modernization by itself does not provide sufficient jobs for a rapidly increasing population.
- The struggle for economic survival is a desperate but not necessarily insignificant contribution to the development process. Many forms of enterprises, individual as well as collective or cooperative, emerge from such survival strategies amongst the urban poor. In this respect the important role of women entrepreneurs is worthy of note. For the poorest of the poor, often idle in agricultural slack periods, small and micro enterprises are probably the only way to make a living all the year round.

It makes a considerable difference whether one is reviewing small and micro enterprises in a Newly Industrialized Country (NIC), in a country with a large domestic

Table 1: *Percentage of Labour Force in Industry (including construction, transportation and utilities)*

Country	1965	1980
Ethiopia	5	8
India	12	13
Kenya	5	7
Zambia	8	10
Low Income Countries as a Group	9	13
Indonesia	9	13
Morocco	15	25
Dominican Republic	14	15
Costa Rica	19	23
Colombia	21	24
Lower Middle Income Countries as a Group	12	16
Malaysia	13	19
Korea	15	27
Iran	26	33
Higher Middle Income Countries as a Group	23	31

Source: World Bank (1987).

Table 2: *Employment in Industry, according to size of firm*

Country	GNP per capita (US\$, 1982)	Employment (%) according to size of firm		
		Micro (0-10)	Small (10-49)	Large (50+)
India (1971)	260	42	20	38
Tanzania (1967)	280	56	7	37
Kenya (1969)	390	49	10	41
Indonesia (1977)	580	77	7	16
Zambia (1985)	640	83	1	16
Philippines (1974)	820	66	5	29
Colombia (1973)	1460	52	13	35
Korea (1975)	1910	40	7	53

Source: Liedholm & Mead (1987).

Table 3: *Employment in Industry, in Urban and Rural Areas*

Country	Industrial Employment (%)	
	Rural	Urban
India (1967)	57	43
Indonesia (1976)	80	20
Zambia (1975)	64	36
Philippines (1976)	61	39
Malaysia (1970)	46	54
Korea (1975)	30	70

Source: Liedholm & Mead (1987).

market, in an 'export-platform' country, or in a small low income country where manufacturing does not account for a substantial share of Gross Domestic Product (most countries in Sub-Saharan Africa belong to this last category). Generally speaking there would appear to be a close relationship between the level of overall industrial development of a country and the development of its small and micro enterprises: The sector has a far longer tradition in certain countries of South and South East Asia than in most of Sub-Saharan Africa. The traditional small and micro enterprises found in the Andean Region of Latin America sharply contrast with thriving informal sector activities in cities such as Bogotá and Lima.

Nevertheless, it would appear possible to formulate a number of general questions, answers to which would help policy makers and their advisors to prepare and take decisions concerning the promotion of micro and small enterprise in developing countries. The aim of this exercise should not so much be to set another new trend in development fashions, but rather to make some overdue corrections on much of development policy. This is particularly true with respect to industrialization. Past policies are known to have:

- Overemphasized large enterprises.
- Failed to take SME into account as a vital element of an integrated industrial or economic structure.

By now it should be clear that small and micro enterprises are important for development. It remains less obvious whether:

- Macro policies, with or without direct support activities, can actively stimulate small and micro enterprises.
- Government intervention is able to clear away barriers to SME expansion.

In other words it remains unclear whether public sector intervention can stimulate or facilitate the spontaneous development of small and micro enterprises. A second,

closely related, question is whether donors, international agencies and foreign private institutions can stimulate the development of the sector in a developing country.

More aspects of large-scale enterprises and its development will be reviewed in chapters II, IV and V. Here, to round off this introduction, there follows a list of six questions; replies to these may help policy makers and their advisors to prepare and take decisions for the promotion of small and micro enterprise development. These questions (as well as any answers to them) should be viewed in the light of the complementary role of small enterprises to larger enterprises rather than a supplementary one to replace it. Similarly micro enterprise is to be considered as an important link in providing for local markets a variety of simple goods. The six questions referred to are the following:

- (i) What are the preconditions to be fulfilled if small and micro enterprises are to be stimulated in developing countries?
- (ii) How can small and micro enterprise be stimulated?
- (iii) Which channels are the most effective for such intervention?
- (iv) What are the best instruments for intervention?
- (v) Is the level of development of a country (or a region inside a country) relevant to the determination of method, channel, instrument and intensity of the intervention process?
- (vi) Is each intervention location-specific, or can policy recommendations of a more general nature be arrived at?

These questions will be further elaborated in chapter II.

2. Small and Micro Enterprise; Some Characteristics

Small and micro enterprises have an important role to play in developing countries. In general these firms:

- Produce simple implements and consumer goods (such as processed foods, clothing, footwear, household utensils, wooden furniture and farm implements). Usually the quality of these products cannot measure up to the branded output of large enterprise; however, the relatively low price they command brings them within the reach of large segments of the population. In some countries mass-produced goods can and have taken away markets from small and micro enterprises (e.g. soaps).
- Are less dependent (than large enterprises) on specialized services such as computer software, insurance, chartered accountants and maintenance services. Because such services in most developing countries tend to be found almost exclusively in urban areas, small and micro enterprises are more footloose and any policy aimed at stimulating the geographical spread of industry will stand more chance of success if directed specifically at the sector.

- Make use of existing artisan traditions and knowledge. Most entrepreneurs in SME would appear to have little time for external advice and assistance because they associate this all too easily with meddlesome civil servants looking for untapped sources of taxation. However, if the entrepreneur has any particular problem and outside advice seems to offer the solution, it is, more often than not, speedily adopted and copied by others.
- In rural areas, in particular, small and micro enterprises only function part of the time or in off-season periods. They commercialize much of the existing knowledge and crafts which previously only served the family households.
- Tend to make use only of locally available materials. This makes the sector less import-dependent. Hence, stimulating the development of small and micro enterprises generally has little adverse effect on a country's trade balance.

Of course this brief summary of selected characteristics is far from exhaustive (it was not meant to be). It is, however, necessary to establish some kind of definition and classification of small and micro enterprises. Until now the only characteristic that has crept into the analysis is to recognize a distinction between small and micro enterprise (the latter being even smaller than the former). At first practically all definitions attempted to establish absolute size criteria such as number of people employed, total wage bill or turnover volume. But even if such a yardstick was accepted in principle, the second problem of where to draw the lines between micro, small, medium and large led to a large number of individual country solutions.

The results were not encouraging:

- Many developing countries have no statistics on the small and micro enterprise sector at all.
- In those countries where they do exist they often offer only incomplete coverage (e.g. only the metropolitan areas) or undergo changes in time (e.g. Colombia in 1983).

The limited extent to which an international consensus has been reached is reflected in the following broad classification:

- *Micro enterprise* employs no more than five (or ten) people.
- *Small enterprise* employs between five (or ten) and twenty-five (or fifty) people.

In view of the differences in development levels between countries the criteria just mentioned should be supplemented by a third yardstick of a more relative nature:

- In each country the smallest categories of enterprises share common characteristics with similar firms in any other country; inter-country comparison of characteristics and experiences of these small firms may well make much development sense, whatever the absolute sizes may be in each country individually.

A different approach may be followed by classifying small and micro enterprises according to their entrepreneurial characteristics, thus introducing various levels of

entrepreneurial development; ranked from basic to more advanced. These could be the following:

- No fixed activity but rather anything that will enable the entrepreneur to survive (usually micro enterprise).
- A large range of activities with new ones being added to the list (and old ones discarded) whenever the opportunity arises. This type of enterprise is beginning to 'find its feet'.
- Specialized enterprise which can command a specific market for its produce (often as a subcontractor to large enterprise) and is established as an essential link in the economic structure of a country.

A third way of looking at the sector is to consider the level of technology it uses. From this point of view there are three categories of small and micro enterprises:

- (i) *Modern enterprise*, using up-to-date production techniques and fully integrated in the modernized economic structure of a country (e.g. via subcontracting).
- (ii) *Modernizing small enterprise* refers to firms that are in the process of establishing forward linkages to modern sectors of the economy by using intermediate technologies (UNIDO, 1979). The more successful of those could in due course mature into small modern enterprises.
- (iii) *Traditional enterprise* based on local levels of technology and mainly serving local markets (often micro enterprise).



Most small and micro entrepreneurs are basically loners.

Conclusion

Most small and micro entrepreneurs are basically loners (especially traditional and to a lesser degree modernizing enterprises); they rightly or wrongly tend to be extremely self-reliant and self-assured (RSIE, 1988). Thus:

- *They repair and design much of their own equipment.*
- *They accommodate their business at home or in specially acquired premises nearby.*
- *They train their own labour force.*
- *They finance the start-up of their enterprise from personal savings or those of close relatives and friends; they also autofinance most of their expansion.*
- *They tend not to look favourably on outside intervention (in part as a result of previous unfortunate experiences, especially with government agencies which are only too easily equated with tax collectors).*
- *They participate in all activities of the firm and are usually unwilling to delegate authority and responsibility.*
- *They tend to have a strong, and often correct, perception of their fundamental problems and are willing to accept external assistance only for the solution of these problems.*

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II. Development cooperation and promotion of small and micro enterprises in developing countries

by Roger Teszler

It should not be forgotten that small and micro enterprises (SMEs) remain a form of private enterprise. In situations where government restricts economic activity to the public sector, private enterprise is forced underground (where it often flourishes as the 'informal', 'grey', or 'parallel' sector).

Attempts at establishing public sector SMEs have not met with lasting success. Such establishments were set up usually with a view to serving special-interest groups, such as the disabled or as an ancillary activity to a training project in order to enhance the activity of the latter. No records of such activities reaching lasting sustainability have been found.¹

1. Preconditions for the Stimulation of Small and Micro Enterprises

Starting from the premise that all small and micro enterprises are private, four basic conditions remain to be fulfilled for SMEs to achieve at least a modicum of success:

- (i) There must be a market for goods produced by small and micro enterprises (effective demand based on large segments of the population).
- (ii) There must be a tradition of small-scale artisan or household production and marketing; i.e. an adequately functioning and competitive system of trade and transport. Potential entrepreneurs require an environment conducive to the emergence of small enterprises. In the absence of such a tradition a preliminary investigation is needed to verify whether such skills can be transmitted in a relatively short period of time and whether the necessary inputs and markets are available. No attempt should be made "to grow small industry where nothing else will grow" (Staley & Morse, 1965), because it probably won't either.

1. In the course of 1989 the autor came across SME in the public sector which holds out some promise: In Estonia public institutions such as Chambers of Commerce have begun to establish (and retain 100% share ownership) small-scale enterprises that are – for all practical purposes – run as private enterprise. Although this experiment is less than two years old, early results appear to be encouraging.

- (iii) There should be government recognition of SME's potential role in development, so that effective policy measures will at least be considered.
- (iv) Policy makers and practitioners should be convinced of their ability to implement policies that will enhance SME's development or, at least, refrain from taking measures that will hinder the development of small enterprise.

Assuming that the four preconditions mentioned above are partially met, attention can now switch to methods of stimulating small and micro enterprises.

2. How can Small and Micro Enterprises be Stimulated?

Recognizing, in theory, that small and micro enterprises can contribute meaningfully to the alleviation of unemployment and that it has important potential in terms of production and environmental planning, does not imply automatically that as such it can and will be applied universally. Situations can occur where the sector is virtually non-existent – precondition (ii) of the previous section; such situations are becoming increasingly rare – but it must also be remembered – precondition (i) – that small and micro enterprises can fortunately only thrive if they can 'feed' on effective demand for their products. If for example there is no demand for their products, a credit programme for small and micro enterprises may be effective but will not contribute significantly to the development of small enterprise. Loans may well be taken out by entrepreneurs, but will be used mainly for other purposes; giving subsidized credit programmes a worse reputation than they have already.

It should be noted that increased demand for SME products does not only result from increased effective demand of SME customers, but can also be the consequence of:

- SME producers being able to lower their costs (for example as the result of a waiver of duties on imports).
- SME producers being able to improve the quality of their products (as a result of improved inputs being made available).
- SME producers obtaining improved market information (e.g. via Chambers of Commerce).
- The stimulation of SME exports (assistance in quality improvement and cooperative marketing).
- The elimination of the bias against SME in existing legislature and institutions.
- A shortage of large-scale enterprise (LSE) products (import restrictions, scarcity of foreign exchange).
- A substitution effect when economic recession makes the price of LSE goods prohibitive.

Demand for SME products and the ability to supply them are the two lifelines for the development of the sector. Other forms of assistance will only give results if these two basic conditions are met.

Although the elevation of the demand-side approach as the ideal support mechanism for the development of small and micro enterprises has received an added impetus from the need for budget-cutting in most developing countries, it has not led to explicit recognition of this system.

Negotiations for structural adjustment programmes have not yet led to the explicit recognition of a stimulation of the development of the sector. Instead, the general advantages of these belt-tightening and liberalization exercises have been stressed.

A vacuum has formed between the dismantling of the broad-spectrum supply-side institutions and the adoption of a new policy. In particular, in a number of African countries, it would seem that all institutions involved (national and expatriate alike) are anxiously waiting for the World Bank or the International Monetary Fund (IMF) to bring about and assist in the implementation of their recommendations for a structural adjustment programme. Meanwhile, it has not gone unnoticed that it is precisely this policy vacuum which has served small and micro enterprises well:

- Whenever a government is forced to wind up its money-losing production or service activities; in certain cases small and micro enterprises are able to supply at least part of these goods and services. Thus, in Senegal, when the government was no longer able to bulk buy agricultural implements to be supplied to the farming community at concessionary rates, small and micro enterprises were able to capture a large segment of this market (even though some of this was 'only' repairs).
- When national institutions are broken up into smaller regional or even local units they attain an improved local outreach and the cutting of the subsidy-line forces them to fend for themselves; this new impulse for local activity has proved to be a good stimulant for the development of the SME sector, especially in non-metropolitan areas.

In a number of developing countries policy towards small and micro enterprises has come to include elements of demand stimulation. Thus, India was the first to experiment with a government purchasing scheme that limited the public sector purchase of specific goods and services to SME suppliers. Other countries (such as Kenya or Indonesia) have followed suit. In Kenya the policy towards industrialization in successive five-year plans has gradually shifted its emphasis from modern large via small enterprise to rural small industrial enterprise (RSIE) with the latter specifically being stimulated by local initiatives, limiting the import of competitive goods and stimulating agricultural production. The informal sector has also increasingly caught the attention of policy makers.²

2. This has gone so far that, for instance, in Kenya a systematic attempt is made to register informal sector activity.

It has also been noted that, in countries with a prosperous agricultural population, other rural activities have also done well (Mellor, 1976; Chuta & Liedholm, 1979). This agricultural lead was particularly noteworthy in a number of South and East Asian countries after 1970.

Stimulating effective demand for SME products requires a policy that aims to increase the purchasing power of the majority of the population. This is in fact just another way of saying that when development is successful small and micro enterprises prosper also. But even if bilateral donors and multilateral agencies are convinced of the positive contribution of the SME sector to the general development of a country, this should only lead to a structural agreement for development cooperation if the following two conditions are met:

- (i) The economic policy and environment of the recipient country stimulate demand for local SME products.
- (ii) Supply-side policies in the recipient country are limited mainly to intervention for specific target groups or the stimulation of development in relatively less developed areas.

Given the heterogeneous nature of the SME sector (i.e. modern, modernising and traditional enterprises), it would appear valid to doubt whether a single or unified policy can be suggested for their development. Even if the answer to this question, in general terms at least, is positive, a general policy may well have to include different approaches. The stimulation of the SME sector is judged desirable in order to achieve a variety of objectives, such as:

- to increase production;
- to diversify the structure of production;
- to absorb the flow of rural migrants;
- to strengthen the economic base of small towns.

It is neither a foregone conclusion that all of these objectives can be met with a single programme nor that each will require its own specific programme or policy. What may be good for modernizing enterprises might also serve traditional or modernizing enterprises, but this is not necessarily so. The basic argument of this chapter is that policies should be of a general nature allowing enterprise to develop according to its own abilities but that, depending on local circumstances, specific measures are needed; for instance those which guarantee the availability of physical and social infrastructure to all enterprises and those which give equal opportunity of access to existing institutional support facilities. Only when these conditions are met can other types of support be considered. Perhaps it should be stressed again that the discussion in this chapter is limited to ways of stimulating the development of the SME sector. It is not a foregone conclusion that what is good for small and micro enterprises is good for development; rather every attempt should be made to ensure that sectoral and overall development harmonize.



Small and micro enterprise in the driver seat of development.

As SME products find most of their markets among the lower income groups who cannot afford to buy many of the more expensive brand goods produced by large-scale national and international enterprise, it follows that any policy which contributes to real income increases for the masses will promote the development of small and micro enterprises. The reverse is not necessarily true: the development of small and micro enterprises does not automatically lead to across-the-board income increases, although it can contribute to the process.

Putting the SME sector in the 'driving seat' of the development process would seem to be counterproductive, because it would give rise to false hopes and in due course might even lead to SME promotion policy joining the long list of development fads that at one time were promoted as "*the*" solution to "*the*" problem but that for one reason or another could not solve the problem by themselves. Too much development thinking has been in terms of substitution with one leading sector making way for another. The SME sector derives its strength from its complementarity; it increases the development potential of other sectors of the economy and thus contributes to the integration of economic activities in the process of development. To consider the SME sector as "*the*" solution will only lead to its being discarded all together in due course.

Nevertheless not all types of small and micro enterprises can be considered as equally

relevant for development purposes. Small-scale industry and small-scale agriculture can have a more important stimulating role than other types of small and micro enterprises, because they do their own marketing or supply other small enterprise, whereas small traders often also sell products from large enterprises. Small industry and small agriculture thus can provide a double stimulus compared to small traders.

Stimulating the SME sector remains a matter for developing country policy. The way in which this is done to a large extent is determined by the nature of the target group that policy aims to assist. In this respect a distinction can be drawn between:

- (i) Target groups whose members are not small and micro enterprises entrepreneurs with or without a latent entrepreneurial potential.
- (ii) Existing enterprise.

In the first category it makes a considerable difference whether potential entrepreneurship occurs in a situation where the SME sector is already thriving, or whether stimulating potential entrepreneurship is judged as a means of stimulating development where it is obviously deficient. In the former situation interventions, as long as demand for SME products is growing, should be limited to removing any existing barriers to new entrants; here the skills that small and micro entrepreneurs require will already exist. Otherwise the removal of barriers (closed shop practices, guild-type institutions) will have to be preceded by a policy aimed at the expansion of effective demand.

If potential entrepreneurship has not been proved and development of the SME sector is considered as a means of getting development moving and of incorporating into the process groups who previously had access to development denied to them (such as women in patriarchal societies or rural communities in inaccessible areas) then the existence of an effective demand potential for any goods they might produce in this case will not get small and micro enterprises moving; it must be preceded by a process of responsiveness and training to establish the existence of potential entrepreneurship. Once it has been established a broad range of intervention measures is required to realize the demonstrated potential of small and micro entrepreneurship. The outcome of such a process is highly uncertain (ORU, 1988).

In the second category a similar dichotomy occurs. Much traditional micro enterprise consists of a variety of types of self-employment originating from struggle to survive. For this type of economic activity (part-time activities to increase the meagre family income) effective demand is again the best stimulant which can be supplemented (but not replaced) by extension activities. Under such conditions these supplementary measures can be very effective (RSIE, 1988).

Well-established small and micro enterprises follow a similar pattern; except that the types of supplementary intervention required in this case will be different and will

tend, as far as institutional support is concerned, to concentrate on equalizing opportunities for small, micro and large enterprises.

3. Which Channels for Intervention Programmes?

When the development of small and micro enterprises was considered simply for social reasons, assistance to this sector was by and large entrusted to broad-spectrum national institutions such as the SIDOs (Small Industries Development Organization) in Tanzania and Zambia, BIPIK (Small Industry Support Programme) in Indonesia and the Small Industry Corporations and Boards in the four provinces of Pakistan. These SMIDAs (Small Industry Development Agency) were supposed to provide all types of assistance imaginable to the SME sector. For reasons of efficiency and convenience SMIDAs exhibited a tendency to lump their clients in industrial estates where they could 'breed' safe from contamination by real economic life outside. Results obtained in this manner were, on the whole, disappointing, and the high costs born by national or provincial governments made SMIDAs and their estates prime victims in the budget-cutting exercises brought on by structural adjustment and economic recovery programmes. This has led to SMIDAs disposing of their estates and limiting their range of activities. Bereft of their central subsidy, estates are thus stimulated to search for ways to cover their expenses and this in turn has given these often lacklustre institutions a new burst of economic life.

From the point of view of the 'average' small or micro entrepreneur institutional interventions, no matter how well intended, are equated with undesirable interruptions of the day's work. The limited results obtained via external intervention and the increasing number of developing countries that have had to resort to structural adjustment programmes have paved the way for new approaches on how to assist the small and micro enterprises. These approaches consist of two complementary strategies (although they are only rarely presented as such):

- (i) Indirect support to small and micro enterprises via measures that aim to increase demand for their products.
- (ii) Limiting direct support to small and micro enterprises to special categories of traditional as well as modernizing via institutions that have an effective local outreach (for instance Non-Governmental Organizations).

These approaches go a long way towards respecting the self-sufficiency and assertiveness of the small or micro entrepreneur (a strong feature of this target group) and at the same time manage to keep costs down by limiting the relatively expensive 'broad-spectrum' approach. Delegating this type of institutional intervention to NGOs (Non-Governmental Organization) is cost-effective from a government's point of view because most NGOs also have recourse to other sources of finance (external assistance from foreign private organizations and international funding agencies such as the Inter American Development Bank).

In this context the marked increase in the number of institutions established by small and micro entrepreneurs themselves should be mentioned. Small industry and trade associations have the undeniable advantage that they have arisen from the perceived needs of the small and micro entrepreneurs themselves (cooperative purchasing, transport and marketing; pressure groups) and thus provide an effective receptacle for outside assistance.

4. What are the Best Instruments for Intervention?

Many evaluation studies have been carried out in order to establish the significance of various forms of direct intervention in the SME sector. A recent thematic evaluation (RSIE, 1988) concluded that direct intervention only stands a chance of success if it is bedded in a general economic environment that is favourable to small and micro enterprises, and that the degree of effectiveness of direct intervention in this respect is further determined by the category of enterprises that one wishes to support. In this way the best support for budding traditional enterprises will come from institutions that are effective locally. Larger traditional and some modernizing enterprises also stand to benefit from direct support by institutions with a more national field of operation (banks and other financial institutions, national training and extension services) as long as they also manage to operate effectively at the local level.

The effectiveness of direct support to small and micro enterprises is to a large extent determined by the following three factors:

- (i) The existence of an entrepreneurial tradition (crucial for potential entrepreneurs).
- (ii) An economic environment that favours the growth of effective demand for SME products.
- (iii) The local availability of institutions which have managed to gain the confidence of the small or micro entrepreneurs (often easier for NGOs).

The success of such direct intervention tends to depend on the degree to which the economic environment stimulates the SME sector. If an entrepreneur has no high expectations of future sales he will have a similar opinion of direct intervention.

But even taking economic environment and entrepreneurial traditions as given, there still is a tendency for some types of institutions to be more effective than others:

- Institutions established by the entrepreneurs themselves. FENAPI in Ecuador, APEMIPE in Peru and ACOPI in Colombia have grown into national associations of small and micro entrepreneurs. Similarly, in a number of West African countries examples are known of locally active pressure groups, and in India women's groups are not only actively supporting local activities, they have also become important pressure groups at local and national levels.

Table 4: Characteristics of Small and Micro Enterprises

	Method	Channel	Instrument	Intensity	Role of donor
(a) Low-key Rural Small Enterprises in areas without small enterpr. tradition.	Conscientization processes to discover and stimulate potential entrepreneurship.	Institution with good local contacts and a high degree of autonomy (NGO?).	Social and technical training; demonstrations and pilot projects.	High.	Funding; upgrading of institutional staff.
(b) Potential Rural Small Enterprises in areas with small enterpr. tradition.	Inventory of bottlenecks and a selective approach to their solution.	As type (a).	Depends on results of selection in 'Method'; stimulation of local organization.	Less high than in type (a).	As type (a).
(c) Market centre based small enterprises.	As type (b), but even more selective.	As type (b).	As type (b), with attempts to induce the involvement of national institutions (BINGOs?).	Less than type (b).	As type (b); leverage to involve national institutions.
(d) Urban based small enterprises (in slum areas).	As type (c).	NGOs, national institutions.	Highly specific assistance.	High but for short duration.	Funding; training the trainers; leverage.
(e) Modernizing small enterprises.	Specific programmes according to needs expressed by entrepreneurs.	Specialized institutions or special departments of national institutions.	Stimulating linkage with larger enterprise (sub-contracting exchanges); training for quality improvement and control.	Relatively low.	See type (d).

- Local NGOs and local branches of international NGOs (BINGOs, Big International NGOs) can be effective as long as the branch NGOs are allowed a high degree of autonomy (authority and responsibilities).
- Local branches of national institutions in the public sector (Parastatals) if highly autonomous. (In times of structural adjustment such autonomy may well be a blessing in disguise, because it forces local civil servants to become actively innovative).

Direct support does not necessarily have to be left to the NGOs; many of them are sorely lacking in professional efficiency and knowledge for which no degree of dedication and enthusiasm can adequately compensate. There also is a tendency for NGOs to over-concentrate on social aspects. Public institutions however, can also be effective providers of support to the SME sector, if:

- they have a strong local outreach;
- they have a large degree of autonomy as far as decision-making and finance are concerned;
- they are professionally competent.

5. Is the Level of Development Relevant to a New Policy?

Just as different types and categories of small and micro enterprises require different elaborations of policy, so differences in levels of development between countries (or between regions) can lead to differences in policies adopted. One type of small and micro enterprises may be an effective tool of development in one country but out of place in another. Subcontracting to SME, for example, is important and effective in a number of South-East Asian countries, but remains beyond the capabilities of many African small entrepreneurs. It is not the intention of this chapter to add to the list of country classifications, such as used by the World Bank (1987).³ Important differences to be taken into consideration include:

- differences in population density and levels of urbanization;
- differences in economic structure and per capita income;
- differences within a country, between urban and rural areas.

The more developed the economic structure of a country and the higher its per capita income, the broader the range of small and micro enterprises normally found. This implies the need for a more diversified strategy in such diverse economies.

The share of agriculture in employment and GNP tends to decline and the degree of urbanization tends to grow as per capita income increases. This purposely exaggerated generalization permits an attempt at classifying relevant institutional intervention according to various categories of small and micro enterprises.

³. See also chapter I, table 1.

If one takes the demand-side approach as the ideal policy environment for SME development all institutional support should be considered in terms of complementarity and not substitution. The outline presented in table 4 gives a first indication of the results this approach can produce for various categories of small and micro enterprises.

The general drift of this classification is that institutional interventions become more specific and less intensive as small and micro enterprises matures. The five categories of small and micro enterprises presented in table 4 are not universal. Furthermore, differences in development levels allow certain countries to rely on their own knowledge whereas others will depend more on external assistance.

6. Is Each Intervention Uniquely Location Specific?

Each locality in every developing country exhibits a unique set of characteristics. These can only be described and evaluated with the aid of identification missions and pre-feasibility studies in order to determine the extent to which intervention in general makes sense and what specific shape such intervention should take. The typology presented in table 4, which classifies SMEs according to possible interventions, can be supplemented by a number of factors that refer to the development context. By integrating typology and development indicators, a line of thought should emerge that can assist in the *ex-ante* appraisal of intervention for the development of the SME sector. The relevant factors here include:

- The existence of an artisan and an entrepreneurial tradition.
- The existence of effective demand for SME products.
- The condition of national industry.
- The condition of infrastructural amenities, especially concerning transport, communication and education.
- The effectiveness of the network of institutions which can provide a stimulus for the development of the SME sector.

Where deficiencies occur in the above mentioned factors, a donor must seriously consider whether the alleviation of these shortages should not take priority in the aid relationship between donor and recipient.

7. The Role of the Donor

The role of the external donor in technical and financial assistance can be manifold. Against the background of the various preconditions outlined in the previous paragraphs, this role can be determined at the outset of interventions and, maybe even more importantly, be evaluated in the course of implementation proper.

7.1. *Preconditions for Small and Micro Enterprise Development*

In case the basic preconditions necessary to stimulate small and micro enterprises are in no sense fulfilled no direct attempt should be considered to promote small and micro enterprises. External assistance should in that case follow one of the following options:

- Channel assistance towards the creation of preconditions for SME development (agricultural development leading to broad income increases in rural areas, technical assistance for the revision of existing macro policies).
- Channel assistance earmarked for SME development via international agencies to other recipient countries where conditions do favour small enterprise.
- Provide or finance direct support to small and micro enterprises for purposes of demonstration and persuasion.

7.2. *Policy Environment*

If the policies of the recipient country do not comply with conditions favourably supporting the small and micro enterprise sector conditions, no long-term agreement on SME development is possible unless the external 'partner' is willing to assist the formulation of policy changes that favour small and micro enterprises or to provide direct assistance in the shape of a pilot project.

This may well be a cautious first step on the part of the donor to bring about change in the development policy of the recipient country. For this assistance, policy should follow a two level approach:

- (i) In the *short term* emphasis should be given to persuasion on the relevance of stimulating small and micro enterprises for development purposes.
- (ii) In the *long term* the emphasis should shift towards building up host-country capabilities for formulating policies that stimulate small and micro enterprises development (preferably by making existing local institutions 'see the light').

Experiences of donors influencing macro-policies of recipient countries have on the whole not been successful where small and micro enterprises are concerned. At present the only external agencies that seem to be able to influence host-country policies are the IMF and the World Bank; but neither seem to consider the development of the SME sector as an important element of a development strategy in terms of economic recovery or structural adjustment. In cases where bilateral donors have a special relationship with a particular developing country (former colonizer or by far the largest donor) no use of this relationship appears to have been made to further SME development. Attempts such as the AEPRP (African Economic Policy Reform Programme) of USAID have tried to link policy reform with specific external assistance by withholding the latter until an agreed policy reform had been implemented. This has been limited to general economic and agricultural policies although in at least one case it has been used to stimulate small and micro enterprises when in Sierra Leone aid was withheld until the import duty on sewing machines for tailoring was lowered from a luxury level to that of capital goods (zero level).

These otherwise disappointing results can be summed up as follows:

- Attempts to influence host country development policies by donors or international agencies are only too easily identified with unwarranted intrusion or pedantic paternalism.
- Host countries are usually only receptive to external advice when they are in a vulnerable position as the result of an escalating financial and economic crisis.
- Structural adjustment programmes do not consider the interests of small and micro enterprises (they can, however, benefit from such programmes).
- Policy advice for structural adjustment will usually only find acceptance if it is given by a donor or an agency with some influence because of its pivotal role in the drawing up and implementation of such a programme.

For a medium-sized donor such as the Netherlands the above list of conclusions implies that the possibility of effectively influencing host-country policies are limited:

- Even in countries which have a structural aid relationship with the Netherlands, the Dutch contribution to the total aid volume received is modest (e.g. India). There are but a few developing countries where the Netherlands is a leading donor (Surinam before the military take-over, North Yemen).
- The Netherlands is at best only indirectly involved in the drawing up of structural adjustment programmes.
- As a donor the Netherlands has not yet clarified its position on according priority to its policy of development cooperation to SME development.

The conclusion to be drawn from the above is that the most effective possibilities for the Netherlands to contribute to SME development, once it has outlined its position, are basically indirect:

- Support for educational and research institutions in developing countries, where the academic staff (and in future the graduates) can hope to influence policy formation in their own country (local training institutes, fellowships, programmes of inter-university cooperation).
- Directing development cooperation to the solution of a number of specific problems that thwart the development of the SME sector (technical assistance for 'getting prices right' in the economy or for revising laws and instruments of monetary and banking policy).
- Making better use of membership of multilateral organizations such as the European Community, international funding agencies such as IMF and the World Bank and international agencies such as FAO, ILO and UNIDO, to promote attention to the SME sector in the development strategies of these organizations. The effectiveness of this action can be enhanced by specific projects or programme contributions⁴.

4. This is demonstrated by for example the Small Projects Programme of the Inter American Development Bank, 'multi-bi' projects of ILO, or co-financing arrangements for larger programmes.

- Drawing attention to successes and failures in past development projects and programmes aimed at SME promotion ('What works?' and 'What obviously does not?') as well as to experiences of other donors, NGOs and international agencies. The mistakes and successes of others can assist in showing how a policy should be adjusted. Drawing on the experiences of others can help to prevent the wheel being reinvented yet again.

Only where a special relationship exists between donor and recipient country can a donor such as the Netherlands consider one more possibility:

- Policy dialogue in order to stimulate the adoption of a macro policy that assists the development of small and micro enterprises. It may well be that before such steps are taken serious consideration is also given to the step-by-step approach outlined in the beginning of this section. It will remain open to doubt whether the Netherlands have sufficient leverage to make use of this possibility effectively.

In cases where policy dialogue is not possible and the existing economic environment does not favour the development of the SME sector, but the donor is of the opinion that it should be developed, possibilities are limited and intervention for all practical purposes will be confined to special target groups or less developed areas.

In view of the need to put intervention for the support of the SME sector on a structural footing, a long-term agreement is required. The consequences of this position are that whenever the Netherlands wishes to accord priority to the development of small and micro enterprises, this external assistance must be bedded in a structural relationship for development cooperation between donor and recipient country which allows for policy dialogue.

7.3. Direct Intervention

Only if the economic and institutional environment favours the development of small and micro enterprises, external support to these direct intervention programmes can enhance their outreach and their effectiveness by:

- financing the expansion of the activities of local institutions;
- providing specialist knowledge to these local institutions;
- upgrading their professional and managerial capabilities.

The role of external assistance in this field depends on the needs expressed by local entrepreneurs and their institutions. Much assistance for the traditional enterprises will undoubtedly come from private voluntary organizations. Small projects financed by embassies of donors and international agencies may also prove useful.

Conclusion

In general the role of external assistance for the development of small and micro enterprises should be limited to funding and to assisting in 'getting policies right'. Other foreign intervention is highly specific for each recipient country (training the trainers, professionalising NGOs, pilot projects).

It is hard to imagine any cases where donors or international agencies would apply a broad-spectrum approach to SME development; unless it refers to specific target groups or relatively less developed and remote areas. From the point of view of the recipient country such assistance tends to have a low priority.

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III. In search of new approaches; major areas of attention

by Roger Teszler and Klaas Molenaar

A number of issues related to small and micro enterprise development should be studied further. We have come to recognize the SME sector increasingly as an important promotor of employment income and growth in developing countries; but its stimulation, while providing an undoubted contribution to the development process does not deserve to become the latest in a long list of panaceas or philosophers' stones that purport to solve the problems of underdevelopment once and for all. Many fads have thus been discovered, promoted, and discarded by development practitioners during the last forty years or so. Small and micro enterprises seem too important to be treated that way.

1. Small and Micro Enterprise as Integral Part of Development Policies

The potential of the SME sector has to be defined more exactly. It has an important role to play in the process of structural change. However, this role is only complementary; it enhances rather than leads the development process. It can have widely differing roles which are determined by the level of development of the country concerned. In countries such as the Newly Industrialized Countries (NICs), where the overall industrialization process has come a considerable way, subcontracting and other linkages between large and small enterprise can assist in consolidating the industrialization process. In other countries the SME sector, as the embodiment of most existing industry, constitutes a necessary and perhaps even the only available base for industrial development. And, of course, many intermediate positions can be imagined and do occur.

However, SMEs have not always been considered from this viewpoint. Those development strategies which stress modernization as a long-term objective have tended to ignore the potential of existing small and micro enterprises; instead, they preferred to concentrate on establishing large-scale enterprise as the cornerstone for development and growth. In particular this has been the case in a number of countries in Sub-Saharan Africa where a presumed lack of entrepreneurial skills has stimulated the establishment of government controlled parastatals as the spearheads of industrial

modernization. Economic recessions and consequently structural adjustment policies were required to get things back into a more realistic perspective. This had far reaching consequences for the development process in these countries; the ongoing reorientation of economic and social policies would appear to offer a good opportunity for reconsidering the potential of the SME sector and how to stimulate it.

The considerable scope of the sector in virtually all developing countries has not remained unnoticed. Early attempts at stimulating it, however, have tended to emphasize its supposedly particular characteristics (the early ILO characterization of the informal sector is a case in point) which prevent it from surviving in the cut-throat atmosphere of the modern market place which is dominated by the clout of large enterprise. This line of thought, however, would seem to confuse the survival of a specific small enterprise with the survival of the sector as a whole. It is a harsh fact of economic life that individual small and micro enterprises may come and go but the SME sector as a source of employment, growth and income is here to stay. Echoes of this 'protective urge' are still found in the range of programmes and projects for special target groups and remote or relatively less developed regions within a country. It would be a good idea to bear this in mind when considering how to cater for the needs of special target groups. The application of the infant industry argument should always require justification.

In this protective spirit all kinds of inputs have been supplied to the sector, often via multifunctional institutions (SMIDAs) specially set up for this purpose. A fair number of small enterprises have indeed been reached in this manner, but the outreach of those institutions has remained somewhat restricted and overly bureaucratic. Many small and micro entrepreneurs, furthermore, do not like being interfered with (e.g. shades of the tax collector, the labour inspector, the health or sanitary inspector). The demand for what SMIDAs had to offer was anything but overwhelming and the way in which it was supplied was often ineffective (e.g. centralized training instead of extension on the shop floor).

Much recent thinking and intervention in the field of small enterprise development have focussed on the role of SMEs in separate or alternative development rather than on its significance for the development of industrial or economic structures. This thinking can be refocussed on an integrated approach. This should consider whether economic and industrial policies address themselves to all enterprise equally and indiscriminately. Similarly, can arguments, such as the need for protecting weak enterprise until it can catch up, be marshalled to justify a more segmented approach? In chapter IV Subrahmanyam Nanjundan provides further insight on this issue. More specifically he elaborates on:

- Policy dialogue and leverage (conditionality).
- The long-term implications of funding of host country training and research programmes.
- The stimulation of entrepreneurial training and development.

Major changes in programmes for the development and promotion of the SME sector are only possible if overall policies are reformulated. In that respect a careful assessment of the relation between this SME sector and other economic sectors is of utmost importance. In chapter IV the outlines for such policies are being presented providing also an overall framework for the other contributions in the following chapters.

In chapter IV arguments are given why changes are needed and what lessons can be learned from other countries. The points brought forward are closely linked to the results of the RSIE study (1988). Although ample evidence is provided that changes in overall policy and adjustments of programmes are needed, a number of implications have to be taken into consideration as well. A critical analysis of the impact of policy changes is henceforth required. In the annex to chapter IV such an analysis is given by Henk Thomas. The points raised in that annex have further been incorporated in the concluding remarks given in chapter XI.

2. Policy Changes, From Supply to Demand Side Approach

What small and micro entrepreneurs would appear to need most is a good market for their goods and services, and anything that can contribute to this will be appreciated by them.

Thus, the demand-side approach with its emphasis on the creation of a favourable or enabling environment for the development of the SME sector was advanced as a solution that at the same time neither interfered in the day-to-day operations of small and micro enterprises, nor had an outreach which remained limited to only a few enterprises. It also requires considerably less outlay of public funds; a fact which is particularly welcome in times of harsh structural adjustment policies. Once such a favourable environment has been established, additional supply-side support will tend to be far more effective than if the same support is provided in an environment that is more hostile to small and micro enterprises. For any type of institutional support to the SME sector to be effective the fertile ground of a demand creating policy environment would appear to be a prerequisite.

This line of thought has received added impetus from the structural adjustment programmes, when government activities had to be curtailed and the hold of large enterprise on many markets was correspondingly loosened. So far, explicit priority for the SME sector has never formed part of the average structural adjustment package. The benefits derived by small and micro enterprises from such measures have always been indirect and unintentional. But they are there and cannot be ignored.

In this context we must consider whether all small and micro enterprises could benefit equally from such changes in economic and policy environment. Recent reports and

studies (such as RSIE, 1988) tend to indicate a preference for a two-pronged approach to small enterprise development:

- (i) The creation of a macro policy environment that stimulates the growth of small enterprise through increased sales demand creation enhanced by infrastructural development; and
- (ii) The recognition of the desirability of a strong institutional presence at the local level for effective intervention in SME development (in practice mainly through NGOs, PVOs or small enterprise associations).

In chapter V Frances Stewart pays further attention to these issues. She tries to lay the foundation for answering the following questions:

- Should these two 'extremes' in SME development strategies be linked up in an overall policy plan?
- Is it necessary, desirable or worthwhile to institutionalize the 'middle ground' between macro policy and effective local outreach by measures such as establishing institutions for the decentralization of macropolicy mechanisms or enhancement of the professional and managerial capabilities of local intervention institutions (establishment of large national NGOs or BINGOs).

3. Classification and Policy

There are many different ways in looking at and classifying small and micro enterprises. The easiest way undoubtedly is to classify firms according to the size of their labour force. This in most cases leaves us with some nice looking statistics. But we know that they often do not provide much useful information. The classification itself is highly subjective (different countries use different classifications) and especially in smaller firms where much labour can be casual, absolute numbers do not signify all that much. Also firms of the same size defined in this manner may be considered as small in one country but as quite large in another. A uniform approach is sorely lacking.

Attempts at bypassing this problem have concentrated on classifying firms by the level of technology that they use, according to the nature of their entrepreneurship, or by emphasizing the formality of the organization of the business activity. Be that as it may, it cannot be denied that different firms may require different types of support; if only because the term SME covers such a wide range of enterprise. There is a need for equal opportunity for all types of small and micro enterprises which in turn may well imply different measures for different categories; in other words short-run differentiation as a necessary step towards long-run equality of opportunity and a unified approach to development.

Confusion still abounds concerning the way to define and classify small enterprises. Virtually all attempts to arrive at such a classification have been beset by problems of

definition (key words such as 'small', 'informal sector', or 'employment'), applicability (a refinement of the definition), and the quality and quantity of the statistical material available. The consequences of this dilemma for policy formulation and implementation require some consideration:

- Is some sort of classification necessary; e.g. by sector, type of business organization, class of entrepreneurship (such as barely surviving, diversifying, specializing); do different types or sizes of small and micro enterprises require different approaches for policy support, institutional support or direct intervention?
- Can a uniform approach combining national macro policies and local institutional outreach be applied to the SME sector indiscriminately?

In chapter VI Michael Farbman and Alan Lessik present a general framework for classifying the sector in a very challenging way and try to formulate answers to those questions.

4. Finance and Credit for Small and Micro Enterprises

There probably is no field where this differentiation shows up so clearly as the financial one. Credit often appears to be denied to small firms, with financial sources such



Small and micro entrepreneurs have often managed to find their own answers.

as they exist and operate catering only for foreign firms, for large firms and for those entrepreneurs who 'know their way about town' and are willing and able to pay for the privilege. In many countries existing banking laws and the way they are put into practice tend to restrict credit. This has led to the establishment of special credit programmes for the small entrepreneur and thus to a further segmentation of the credit market into concessionary and non-concessionary fragments. If savings are only attracted by high interest rates then that is the price the borrower will have to pay. (Similarly if agricultural production is only stimulated by higher farmgate prices, in the long run it is the consumer who will have to foot the bill and will have to be weaned off food aid and other concessionary food imports).

The amazing thing is that small and micro entrepreneurs can and do pay unsubsidized market prices in far more cases than is often imagined. Start-up capital usually comes from personal savings or from relatives as does initial working capital; credit from suppliers and customers is frequent. In this way small and micro entrepreneurs have often managed to find their own answer to being virtually excluded from more formal sources of credit. The need should be considered for an integrated approach to credit as well as what steps are required to ensure such integration. In other words:

Should the formal credit establishment get involved with the SME sector and how can this be achieved; and, at the same time, should efforts by the small and micro entrepreneurs themselves to obtain funding be institutionalized and how can that be done?

Finance and credit are traditionally singled out by many institutions, experts and entrepreneurs as a major problem in SME development, if not "*the*" major problem. Others have taken the view that this issue has been used as a scapegoat for the many other problems faced by the SME sector. Without fully going into the pros and cons of this argument, a case could be made for:

- The need for a new approach to previously untapped sources of finance such as debt conversion or counterpart funds.
- Stimulating policy changes that make existing sources of finance more accessible to small and micro enterprises, via donor/agency leverage (is this feasible or desirable?), or by stimulating the awareness of bank officials to the requirements of small and micro enterprises.

Should these two lines come together and how can this be achieved? Jacob Levitsky tries to answer these questions in chapter VII.

5. Group Specific Programmes; Lessons Learned

Similar lines of thought may be considered for women entrepreneurs. Not only small and micro enterprises are often discriminated against; but women in this field are often

confronted with double discrimination. They have to face up to an environment which is hostile to small and micro entrepreneurs in general and even more to women entrepreneurs.

Nevertheless, in many countries the majority of micro entrepreneurs are women and there are also many such women entrepreneurs who manage to achieve far more than mere survival:

- Can the successes achieved in certain countries or environments be replicated elsewhere?
- Is success a result of circumstances, organization or both?
- Can governments, NGOs, or donors be of any assistance?

Observations up to this point would appear to be pointing towards the need to integrate the SME sector in the national economy by removing barriers that confront the various categories of small and micro enterprises and that are different for each category. Once the rudiments of such an integrated economy are achieved, further stimulation is best ensured by policies that stimulate the demand for the SME sector goods and services. To reach this point, however, it is necessary to pursue specific lines of support tailored to the requirements of the various categories of SMEs. Such requirements are highly specific as regards the country, region, sector and type of small or micro enterprise concerned. There may be a standard approach, but there is no standard solution!

India has taken the lead in the conceptualization, development and application of a large number of innovative approaches to SME development (such as breeder industrial estates), which - while meeting with some degree of success in India itself - have not lived up to expectations when applied elsewhere. One of the fields in which Indian initiative, however, is widely recognized is in its approach to the development of female entrepreneurship (and other potential sources of income generation). This is based on the role of women in specific economic sectors and the development objective of integrating women in the national production structure. This raises the following issues:

- To what extent has the Indian approach to the development of women entrepreneurs met with success? What, if any, are its weak points?
- To what extent can the Indian experience be transferred to other countries?

Marty Chen provides further details about these programmes in chapter VIII.

6. Donor Interventions

Where does this leave the donor? In the first place, due consideration must be given to the degree of agreement between recipient and donor concerning the actual policy towards the SME sector in the latter. Where agreement more or less exists, the role of

the donor can simply be to strengthen the efforts of the recipient country by providing funds or specialist training. Where there is no such agreement, the easiest way out is to do nothing at all and to concentrate assistance efforts on countries that do see eye to eye with the donor.

The nagging doubt lingers, however, whether or not some kind of persuasive effort should be made to change the mind of the recipient country; perhaps even the unassailable donor policies should come in for a thorough overhaul. This requires considerable skills in navigating between the Scylla of overbearing paternalism and superior knowledge and the Charybdis of undesirable outside intervention and the sovereignty of national policy.

This is where methods of persuasion can come in. A number of approaches for this purpose come to mind; to mention but a few:

- Pilot projects for demonstration purposes (to show how it is possible to assist certain groups after all).
- To channel external assistance via local NGOs (including the upgrading of their professional and managerial skills).
- The establishment of local training and research institutions with a view to training future policy makers and improving local data on small and micro enterprises.
- To review (or perhaps even formulate) donor policies with a view to make them more relevant for SME development purposes. Here useful information could be obtained from a systematic study of the policies of other donors and international agencies; not to mention, of course, the range of situations in developing countries. Pioneering efforts of USAID and CIDA come to mind.
- To coordinate the policies of donors and international agencies at field as well as at headquarters level. A uniform approach to external assistance can go a long way towards improving its acceptance and its effectiveness in the recipient country.

The very nature of the small entrepreneur often makes her or him unreceptive to outside, especially expatriate, intervention. This should not warrant the conclusion that all interventions should be left to local and national institutions alone. The role of foreign donors and international agencies, described in chapter IX by Marilyn Carr, could be a comprehensive one, touching upon issues such as:

- policy dialogue in cases where existing macro policies do not favour SME development;
- financing host country institutions and interventions (public and private sector);
- providing (limited) training when relevant specialist knowledge and experience are in short supply locally.

At the same time she tries to find answers to the question what the views are of the leading donors and agencies in this field, and whether there is scope for any substantial change.

Conclusion

Being confronted with a wealth of new ideas about the conditions for an appropriate development and promotion of the small and micro enterprise sector as well of the possibilities and opportunities of reorientation of policies and programmes we have to identify the elements of such new policies. New directions have to be identified, on the basis of which activities for the future can be determined and actions planned.

The RSIE study clearly argues that there is a great need for such readjustments and reformulations and the various authors provide empirical as well as analytical evidence that changes are urgently needed. Too easily the impression can be obtained that the major shift is that from supply-side policies towards those based on demand; or from micro policies towards macro policies. While it is indeed a lesson to be learned from the past that demand based policies are required, it is also understood that the intervention programmes such as training, business advisory services, or technological information remain important provided those programmes are in line with the overall macro policies. In chapter X a summary is given of discussions held on those aspects.

In the concluding chapter XI the new directions for policies and programmes for the small and micro enterprise sector are being highlighted by Antoinette Gosses and Klaas Molenaar.

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IV. Small and micro enterprises and overall development policy

by Subrahmanyam Nanjundan

The broad issue posed for consideration under this topic is that of an integrated economic or industrial policy for all sizes of enterprises versus a policy promoting the role of SME in terms of separate or alternative development. Since industrialization is a multisectoral and intersectoral process - having linkages with agriculture and other primary sectors, infrastructure, education, health, trade and services - permeating the economy as a whole, the short answer is that a priori an integrated approach is not only preferable but even essential for development. However, a unified strategy of development may conceivably comprise a mix of separate (though related) policies towards large-scale industry and small-scale industry.

In this chapter the policy (or policies) for small-scale (industrial) enterprise development will be considered in the light of the following aspects of development:

- *function and objectives of development;*
- *historical experience on effects of growth on size distribution of manufacturing enterprises, or the role of small-scale enterprises at different stages of growth;*
- *selected country experiences as to overall development policy in relation to small enterprise policy and their effects on industrial and economic development.*

After a review of the above aspects, the specific policy measures themselves for small enterprise development will be reviewed. Finally, as regards donor approaches some questions for discussion will be suggested.¹

1. Objectives of Industrialization

Industrialization is a process for bringing about growth in per capita incomes, through transformation or modernization of production, whereby the value added to the result-

1. The issues raised in this chapter and the corresponding thoughts laid down in the RSIE study (1988) are quite thought provoking and are generating new ideas about the policies and programmes for the small and micro enterprise sector. The possible implication of such policy changes are to be looked into carefully too. A critical analysis of the impact of the policy changes given by Henk Thomas is therefore presented in the annex to this chapter.

ing products or services is continuously enhanced. Successful industrialization permeates all sectors of the economy and results in improvement of productivity. The process is not confined (or should not be confined) to the manufacturing sector only, but includes agriculture, transport, trade and services. There is a short-term conflict between the objective of achieving increased income and of increased employment particularly where considerable unemployment or underemployment exists. However, if macro policies ensure that there is continuous growth in incomes, generating demand for industrial goods and services and resulting in further increase in investment and production, the conflict can be resolved in the long run. As illustrated later, an overall development policy aimed at agricultural growth, better distribution of incomes, or export promotion, is conducive to growth in incomes, resulting in additional demand for goods and services to be met by industrial growth.

The objective of development, to which the promotion of economic growth is crucial, also includes non-economic objectives, e.g. national security, equitable distribution of benefits of growth, development of certain cultural and political values. Industrialization is a necessary ingredient of policies for economic growth, since rapid growth of manufacturing is correlated with rapid growth of GDP. Furthermore, manufacturing makes possible rapid technical progress and increases in productivity, which in turn accelerates growth in other sectors.

The need for economic policy and thus the role of government arises from market failures, i.e. the inadequacy of the free play of market forces to enable achievement of national objectives. The inadequacy of the market mechanism may be due to the operation of monopolies, the effects of externalities, the lack of entrepreneurship or of investment resources to respond to market demands. While the market mechanism may ensure the optimum allocation of resources on the basis of (static) production possibilities, this may not be adequate where resource availability and production possibilities are affected by (the usual handicaps of developing countries) the inadequacy of entrepreneurship, investment funds, infrastructure, utilities, or services. On the other hand the limitations of government action (i.e. government failure) should also be recognized.

Non-economic objectives are often socio-economic, e.g. equitable distribution of incomes, self-sufficiency (especially to meet strategic and defense requirements), regional balance, protection of vulnerable groups (including rural poor, women), or fuller employment. The promotion of small-scale industry, rural industry and handicrafts is often motivated by the objectives of preservation and promotion of employment, of traditional arts and crafts and skills; creation of additional employment opportunities in semi-urban and rural areas at lower capital investment; equitable distribution of incomes between various income groups (vertically) and between regions of the country (horizontally) (i.e. balancing concentrated high income generating capital-intensive industries with low income generating but decentralized small-scale enter-

prises). Non-economic objectives may be in harmony with economic growth or may only be attainable at the cost of lower economic growth, depending on the particular circumstances. National policy usually aims at a mix of objectives involving some trade-off against economic growth. Such a policy may not be the best to meet the given objectives; it may represent a compromise among conflicting objectives or divergent interest groups in the country.

2. Growth and Size Distribution of Enterprises

Empirical evidence (Nanjundan, 1986) on the effects of economic growth on the size structure of manufacturing enterprises indicates three phases of growth. In the early stages household enterprises and cottage workshops predominate, accounting for up to three-quarters of total manufacturing employment. With accelerated agricultural and infrastructure development and the resulting growth of incomes, changes take place in demand patterns stimulating the development of technology, and leading to growth of small workshops and factories, mostly in urban areas, displacing household manufacturing to a considerable extent in this second phase of development. In a final phase, large-scale production eventually tends to dominate and displaces most of household manufacturing and a great proportion of small workshops and factories, the growth of the latter having contributed to the development of large industry scale.

Another study (Little, 1987) confirmed the above conclusion from analysis of selected developing country data. Household manufacturing, which is confined to a few industries and is most prevalent in rural areas, has declined, relatively at least, in all the economies examined (India, Republic of Korea, Malaysia, the Philippines and Taiwan). Workshops (1-5 workers) have also declined, except possibly in India. Yet cottage size manufacturing still accounts for over half of manufacturing employment in the poorer countries (India, Indonesia, the Philippines, and most of Africa). There has also been a relative fall in employment in small-to-medium size factories (5-100 workers) in the more rapidly industrializing economies (Colombia, Republic of Korea, Malaysia, Singapore and Taiwan). By contrast, in India the number of enterprises in the range 10-100 workers has risen since 1960 relative to large ones, especially those with over 500 workers, which partly redresses a previous anomaly.

While the trend towards a secular decline in the contribution of small-scale industry to total manufacturing value added is an established fact for most countries, there are several reasons for underlining the present-day role of small-scale industry in the process of industrialization as well as in a modern developed economy. As regards developing countries the overwhelming majority have not reached the stage where household manufacturing and small-scale industry begin to decline rapidly.

There are lessons to be learnt from the experiences of the successful and the not so

successful countries - both developing and developed - and the effects of the different policies pursued by them on the size distribution of manufacturing industry. Most developing economies continue to be of a dualistic nature, the stages of growth overlap (between, for instance, rural and urban areas), informal manufacturing dominating in the rural areas or in urban sub-contracting activities, and large-scale organized manufacturing taking over in certain branches and sectors of industry. In most developing countries linkages between small and larger scale industry, on the one hand, and small-scale industry (SSI) and agriculture, on the other, tend to be significant.

As regards developed economies, it should be noted that the importance of the number of small-scale manufacturing enterprises as a proportion of the total number of manufacturing enterprises still remains overwhelming (over 80% in the USA in 1977 and over 90% in Japan in 1984), for the reasons that

- small-scale industry is the seed-bed for entrepreneurship, some grow into bigger firms, some fail and disappear and new ones emerge in innovative areas;
- small-scale industry fills in the cracks meeting specialized demands and requirements of small total markets.

Thus enterprises of different size co-exist in most economies, since labour, capital and product markets are usually imperfect, and changes in technology, transportation, consumer preferences and life-styles continuously influence manufacturing. In recent years the trend towards a decline in small-scale manufacturing enterprises has been arrested in the developed countries both for technological and social reasons: the former including the accent on knowledge-intensive and skill-intensive industrialization (as against material- and energy-intensive industrialization), and the development of new processes of manufacturing arising from computerization and automation; the latter including the emphasis on quality of life, decentralized work centres, individualized consumer preferences, and informal (self-employed) work.

3. Country Experiences of Effects of Policies on Small Industry Development

The objectives of small industry development should be delineated in the context of the trend towards predominance of large-scale industry with growth and development, noted above. There are valid reasons for promoting small-scale industry in most of the developing countries, which have not yet reached the stage when household enterprises and small factories rapidly give place to large-scale enterprises. Small-scale enterprises in this context could cater more effectively to small scattered markets. They could be the appropriate means for meeting consumer demands generated at the initial stages of agricultural growth. They are also needed to meet forward and backward linkage demands of processing of agricultural outputs and supply of inputs and equipment to agriculture. Small-scale industry thus is an essential stage in growth, developing (learning by doing) production, management and entrepreneurial skills.

Progress from the early stages of industrialization towards maturity is influenced by the role of government, macro-policies of the country, industrial and trade policies (inward-looking or outward-looking), culture and politics. The pattern of industrialization and role of small-scale industry is considerably affected by these factors. Finally, at the stage of mature economies, there is a permanent though small role for small-scale industry, as a source of entrepreneurship and innovation, and as seed-bed for growth, and in the provision of specialized goods and services, almost tailor-made, to meet sophisticated small demands. The contribution of small-scale industry to the economy - as of large-scale industry or of other sectoral development - has to result in increase in per capita income and its more equitable distribution.

It is often thought that in labour abundant and capital scarce economies small-scale enterprises should by definition be labour-intensive and capital saving. This is not always true. Moreover, the crucial questions are those of absorption of labour, labour productivity and capital productivity. Evidence indicates that small-scale industry satisfies the criterion of efficiency only in a limited range of products. As development proceeds the middle range of 100-200 workers may be more efficient, in terms of capital productivity and labour absorption, than sizes below 100 workers.



Crucial question of absorption of labour.

The situation varies between countries depending on the macro and industrial policies pursued during growth. Four types of experiences could be identified:

- (i) Export-led growth increases the size of markets and advantage could be derived from increased scale of manufacturing operations (for example: the Republic of Korea).
- (ii) Better distribution of income, agrarian reform and rural infrastructure development could lead to decentralized production and increase the relative importance of small-scale industry (for example: China).
- (iii) Comprehensive government regulation of a command economy nature accompanied by inward-looking policies could lead to giant enterprises on the one hand and tiny small-scale enterprises on the other hand, leaving a vacuum in the middle-sized efficient categories of manufacturing (for example: India).
- (iv) Establishment of large public sector enterprises with imported technology and largely imported inputs, while paying lip-service to self-reliance through small-scale enterprises, in some cases, has led to an import-dependent development and stunted the goal of self-sustaining growth (for example: Tanzania).

To illustrate these differences, the contrasting experiences of these four countries will be briefly reviewed below.

3.1. *The Republic of Korea*

The Republic of Korea has emulated Japan in its emphasis on export-led industrialization. However, income distribution is more concentrated, rural transformation much less and export dependence much greater than in Japan. In 1986 exports equalled 36% of GNP (textiles and electronics accounted for just under half of the total exports). Outward looking policies have enlarged markets, resulting in scale economies and other advantages of (expanding) size, thus stimulating expansion of small plants and establishment of new large plants. Household manufacturing has virtually disappeared and small factories are becoming relatively less important.

Ho found that as of 1973 small and micro enterprises employing below 50 workers accounted for only 29% of employment and 13% of value added by manufacturing (Ho, 1986). A quarter of employment and value added is in the category 100-499 workers; 38% of employment and 53% of value added in factories employing 500 and more workers. In Korea higher size categories are found to be more efficient. The *chaebol*, the dozen or so giant business conglomerates, dominate the economy.

In this context, and again unlike Japan, subcontracting and division of labour between small and large enterprises is rare. The degree of vertical integration is high, large companies carrying out most operations within their plants. However, medium and large companies are involved as subcontractors to Japanese firms, i.e. international subcontracting.

As regards the effect of policies it should be noted that for a decade up to the middle sixties import substitution policies were followed leading to rapid growth of production of consumer goods and intermediate goods. The outward-looking policies followed thereafter included more realistic foreign exchange rates, liberalized import controls and export incentives (tax reductions and exemptions, improved access to credit and imported inputs). The export-induced industrial growth has been extremely successful in creating employment, since manufactured output (for exports) becomes increasingly labour-intensive. Direct controls during the period of import substitution discriminated against small enterprises in their access to imports and credits, nevertheless small enterprises grew rapidly. During the period of export development strategy, liberalization and reliance on the price mechanism reduced some of the disadvantages of small enterprises, nevertheless small enterprises languished, since they mainly catered to the domestic market and could not take advantage of the incentive framework for exports. Larger markets increased the importance and advantage of large plant size and some small-scale enterprises may have expanded to larger sizes.

There is a heavy concentration of both large and small establishments in Korea in and around the largest cities. Rural transformation followed the first phase of industrialization and did not precede it, unlike in Japan and Taiwan.

The wage gap between small and large firms is fairly small in Korea, and the differences in interest rates paid by them reflect differences in cost and perceived risk.

The development strategy has until recently strongly influenced the decline of the small-scale enterprise manufacturing sector in Korea.

The lessons from Korea are: firstly the overwhelming influence of macro-policies; secondly the unimportance of the small-scale manufacturing sector in creation of employment and labour absorption and thirdly, the more permanent and lasting role of small-scale enterprises in construction, trade, hotels, restaurants, transport and storage, financial and commercial services, recreation services, personal services and other services.

3.2. *China*²

Rural non-agricultural development has become a key component of China's development strategy. The Government wants to shift rural workers from agricultural to non-agricultural activities; but it also wants to achieve this with only a limited amount of rural-urban migration. The slogan is: "*Leave the land but not the countryside, enter the factory but not the city*".

2. Based on Ho, 1986.

Non-agricultural activities in the countryside are expected to promote agricultural production, generate funds for agricultural mechanization, create employment opportunities, help narrow rural-urban income differences and avoid a concentration pattern of industrialization and urbanization.

Chinese policy is to transform its agriculture from self-sufficient and semi self-sufficient production to large-scale commodity production. This involves increase in farm size and a substantial share of agricultural population moving out of cultivation. Specialization of households in crop production, forestry, fishery, livestock and sideline production (handicrafts, commercial, food and beverages, services, repair, transport, house renovation) is encouraged. Private undertakings in these lines are helped by local governments with credits, tax concessions, technical assistance and favourable prices.

Besides individuals, Community and Brigade Enterprises (CBEs), hitherto owned collectively by members of a commune or brigade, are being encouraged since 1984 under different forms of ownership arrangements - e.g. joint ownership by individual households, ownership by several brigades or communes, or equity and dividend distributed according to capital contributed. Communes are now in townships and brigades in villages. The term CBEs has been replaced by respectively township-town enterprises and township-village enterprises. Peasants involved in commerce, services or industry could establish household registration in market towns, while continuing to be responsible for their own grain (food) requirements. This is part of a general policy to revive market towns.

Market town development is regarded as essential for agricultural commercialization and rural non-agricultural development. Market towns provide the sites for most township-village enterprises; they are the centres for rural-urban trade and provide essential services to agriculture.

The 53,000 market towns existing in China are not classified as urban areas - they are being developed as alternatives to urban cities, with provision of schools, hospitals and cultural amenities. The principles governing the policy are to control the size of large cities, rationally develop medium cities and actively develop small towns. Future urban growth is expected in the 126 cities with population between 20,000 and 200,000 and the more than 3000 small (market) towns where township-village enterprises are being located. It is projected that by the year 2000 the share of the rural labour force in non-agricultural activities should increase (from 11% in 1982) to 44%. Activities that serve local needs or produce non-traded goods, e.g. commerce, services, service-type industries, are regarded as prospective for dispersed rural locations. As regards township village enterprises there is good development potential in agricultural processing (foodstuffs and processed feeds), building materials (tiles and bricks), energy (small coal mines and small hydropower stations), and processing or producing components and parts for large enterprises.

The lessons to be derived from the Chinese experience are that development strategy can influence the development of small-scale industry through area planning, investments in rural infrastructure, agricultural technology upgradation and enlarging the market/demand for SME products by - to use Chinese terminology - encouraging *side-line* production on the one hand and township-village enterprises on the other hand. The idea is that apart from rural households specializing in crop production, there will be more and more specialized households in forestry, fishery, livestock and side-line production. Non-agricultural side-line activities such as handicraft, commerce, food and beverage, services, repairs, transport and house renovation undertakings are encouraged to be established by individuals as private industrial and commercial activities in rural areas.

The deliberate expansion or establishment of small towns or rural towns enables promotion of somewhat larger sized processing industry, input industries (e.g. scaled-down fertilizer and cement plants), agricultural equipment manufacturing units and consumer goods industries. A counter-magnet is thus provided to stem rural-to-urban migration and create rural growth centres.

3.3. India

India's development strategy since the fifties and until recently, has been based on capital-intensive large-scale production of heavy industrial goods (capital goods) on the one hand and small-scale (and assumed to be labour-intensive) production of a wide range of consumer goods on the other hand. India's policies have been of a command economy nature, licensing and protecting large-scale industries as well as providing incentives and assistance to small-scale industry. Foreign exchange and import controls, as well as allocations of raw materials, have been administered through government agencies.

For small-scale industry, there has been a network of industrial extension services, industrial estates, credit allocation schemes, subcontracting arrangements, and so on. Product reservation has been one of the main means for encouraging the establishment of small-scale industries. Large-scale industrial enterprises were prohibited from expanding manufacture of products reserved for small-scale industries. Small-scale industries were afforded incentives through differential excise tax levies, as well as allocation of foreign exchange for imported inputs.

The result of these policies has been the development of a lop-sided industrial structure, heavily concentrated in large establishments on the one extreme and on households and cottage workshops on the other extreme, thus leaving a vacuum in the medium-size factory category, which is usually the most labour-intensive and most efficient as measured by total factor productivity.

The administrative definition of a small-scale enterprise by a ceiling on fixed assets rather than on number of workers, and the continuous raising of this ceiling, did enable some organic expansion of small-scale enterprises. This took place from the second half of the 1970s, when the number of items reserved for small-scale industries were also considerably increased. More recently during the eighties the economy has been considerably liberalized and several restrictions removed from both large and small industries. Market competition has increased and imports liberalized. This policy is likely to contribute to growth of medium-sized enterprises. Nevertheless the dominance of establishments of over 1000 workers continues in India.

It is estimated by Little (1987) that whereas the range 50-500 workers accounts for well over half of factory employment in the East Asian economies (Japan, Korea and Taiwan), it accounts for less than a third in India.

Little, Mazumdar and Page (1985) have examined product reservation policies with specific reference to the textile, sugar and light engineering industries. Their conclusion regarding textiles and sugar is that social benefit would have been greater in large-scale production. As regards production of diesel engines, bicycles and their components and hand tools,

"policies have had quite dramatic effects on the structure of these industries and on the adoption of technology. SSI reservation has resulted in reductions in the linkages between small and large enterprises, including the development of specialized subcontracting firms, although specialization by small enterprises and links between them remain important. The adoption of new products and processes has been inhibited, with consequential effects on exports, especially in the case of diesel engines and bicycles.

The deleterious effects of production reservation policies on technological development and export development of textiles and garments have also been noted".³

The study concludes,

"More generally it seems clear that product reservation policies reduce competition both within the large and small-scale sectors of the industry and between them. It prevents organic growth of establishments through the size barrier and artificially drives the large-scale sector to concentrate on higher priced goods, for which quality differentials are important".

3. The Khadi and Village Industries Commission (Khadi being a cotton cloth) has played a major role in implementation of Indian SSI policy. KVIC has been widely accused of failing in its initial objectives, both as specified by Gandhi and modified by the *practical planners* (Nehru and Mahalanobis). According to a recent critic, "the root of its ailment is in the KVIC operating less as a development catalyst and more as a holding company" (Jain, 1988, pp. 29-30).

3.4. *Tanzania*⁴

The Arusha Declaration (1967) marked a basic change of development strategy from the maximum growth strategy of the previous decade to that of endogenous development based on socialism and self-reliance. Emphasis was on domestic mobilization of resources and people through reorganization of the rural areas into consolidated settlements (Ujamaa) and state control over industry, trade, insurance and banking. Promotion of crafts and small-scale industries, particularly in rural areas, formed an element of the new strategy. The institutional framework combined centralization and decentralization. Government crop authorities, one for each crop, monopolized produce processing and marketing. Village committees, district development corporations and regional authorities were concerned with planning and development on a decentralized basis. They took over the functions of co-operatives, which were dissolved. Major industries were nationalized. In theory the role of industry was to be subordinated to social and economic development, and rural and agricultural development. Social change and rural development were the goals. Industrialization would be affected through changing pattern of ownership and income distribution, and consequent changes in products, markets and cost of production.

The Arusha Declaration did not, however, contain any specific guiding principles on industrial strategy. Therefore, in practice, the government followed a processing strategy in the late 1960s to early 1970s and thereafter a basic industry strategy, at the cost of or to the neglect of agriculture, small-scale industry and rural development. Capacities were built up to process a substantial part of hides and skins, cashews, cotton and sisal for export, on the assumption of value added and additional foreign exchange earned, without adequate consideration of comparative advantage of exports of finished goods *vis-à-vis* raw materials. The basic industry strategy of the seventies stressed production of capital goods for the domestic market, for transforming the economy and reducing dependence.

Whereas the Arusha Declaration might have involved a cutback in formal sector industrialization, in actual fact industrial investment was accelerated in the public sector between 1964 and 1975, resulting in real growth of manufacturing output of 8% on average per year and increase in the share of manufacturing in GDP from 7% to 11%. With large-scale manufacturing expanded to meet domestically half the total supply of manufacturing goods, there was little increase in manufactured exports or in non-factory small-scale industry. Agricultural production declined, resulting in raw material shortages and the failure of the processing strategy. Import dependence subsequently increased in food and raw materials.

In a planned economy with emphasis on public ownership and control down to the village level, small-scale and rural industry - usually suited to market orientation and

4. Keddie, Nanjundan & Teszler (1987).

localized entrepreneurship - proved incompatible. Despite the Arusha Declaration, the role of small-scale industry in national planning has been ambiguous. It did not receive priority allocations in the plan and did not grow until after the mid-seventies.

Until recently economic policy favoured medium and large enterprises through excessive protection to them, leaving insufficient resources to flow to SSI. However, there seems to have been a favourable effect of recent economic policies on small-scale industry. Improvement of agricultural production and liberalization of ownership and distribution has generated a sort of boom in some forward-linkage industries, e.g. maize mills, oil presses, coffee processing, saw mills, in rural areas as well as towns like Arusha and Moshi, being established both by partnerships and by co-operatives. On the other hand, higher prices (in local currency) for imported raw materials and spares seem to affect adversely the more capital-intensive and import dependent enterprises. More liberal imports of consumer goods, e.g. garments and shoes, are stated to affect small tailoring and footwear enterprises, though the evidence is not conclusive on this matter.

4. Policies and Programmes for Small and Micro Enterprise Development

4.1. Primacy of Macro Policies

The above review of contrasting country experiences points to the major role of economic policy in shifting demand towards or away from labour-intensive industrialization. Since the social benefit of industrial development in developing countries is to provide incomes to as many wage earners as possible through maximizing labour absorption (demand for labour), policies that promote labour-intensive (not capital-intensive) industrialization are obviously desirable. Experience indicates that such macro-policy measures relate to the development of agriculture, income redistribution and promotion of exports.

Agricultural development with due regard to equitable distribution of incomes arising therefrom leads to increased demand for consumer goods and stimulates initially small-scale industry able to meet local demands. Agricultural development also stimulates favourable processing linkages and backward linkages of input and equipment supplies, which again initially encourage the growth of small-scale industries. A better distribution of income whether from agrarian reform or other egalitarian policies also promotes demand for consumer goods. The effects of export-led growth have already been noted under country experiences. Both agricultural development and export growth after a certain stage expand the markets and lead to demand for larger sizes of manufacturing - massive increases in grain production from revolutionary agricultural technologies demand large-scale processing, expanding export markets give rise to scale economies in larger scale production of export products, e.g. garments. Demand stimulating macro policies are all compatible with enhancing the role of women in

industrialization, since they already have a significant role in agro-related enterprises and export products, e.g. garments, and handicrafts.

Besides the four countries analysed in section 3, other examples may be cited. High growth rates in the agricultural sector in Pakistan since 1977 were achieved through increased acreage, adoption of appropriate pricing policies and institutional support to farmers. The increase in agricultural output prices led to an improvement in the agriculture sector's terms of trade and incomes. This has accelerated the adoption of modern agricultural technology by the farmers. In particular, increased use of agricultural machinery and implements has expanded the market size, thus opening up opportunities of entry for small-scale metal-working firms. This had also led to an increase in repair or maintenance work which is often undertaken by workshops and small firms in the rural and urban areas. In Indonesia, government policies in the agricultural sector have largely favoured the rapidly increased agricultural production to a level where Indonesia is virtually self-sufficient. Coupled with the relatively high and stable real prices for the products (mainly rice) this has pushed up incomes in rural areas and increased buying power of the rural population, in turn stimulating small-scale industrial production through consumer demand as well as generating surplus capital for investment. In the Philippines flourishing non-agricultural development in the rural areas has accompanied growth in agriculture. In Thailand, in Taiwan and also in various regions of Malaysia and India, exceptional non-farm growth has been experienced in the wake of rapid improvements in farm incomes and farm production.

On the other hand, in many African countries, *de facto* policies, until recently, had the effect of depressing agriculture and turning the terms of trade against rural areas. As has been noted, it is only since the early eighties that price incentives, credit facilities and more competitive marketing arrangements have led to increase in agricultural production for the market. In response to this, the last two or three years have witnessed a spurt of small and micro enterprises in both Tanzania and Zambia, more so in the former. In other countries, such as Ghana, where price incentives had long been highly distorted through government policy interventions, the SME sector is recovering under the influence of more market-oriented economic policies (including a massive currency devaluation).

The elements of Chinese policy, viz. area planning, investment in rural infrastructure, agricultural technology upgrading, encouraging side-line production and other non-farm activities and providing counter-magnets to villages in market towns, have already been mentioned.

Macro policies should thus include investments in infrastructure and social services; investments in irrigation, agricultural extension and research, provision of farm credit and appropriate price policies to stimulate agricultural development, and wide distribution of benefits.

4.2. *Industrial and Trade Policies*

Besides policies affecting demand for SME products analysed above, other macro policies relating to structure and effects of protection, exchange rate, interest rate, credit, licensing, import quotas, and prices of factors and products, also influence small industry development.

These policies have to be unbiased and neutral in their effect irrespective of size or scale of production units (i.e. between large-scale and small-scale industries), and of location (i.e. between urban and rural areas). Often government policies are biased in favour of large-scale and capital-intensive industrialization and the distortions created are definitely a disincentive for small-scale industry.

Discrimination takes place in access to inputs (i.e. availability of and prices for raw materials, intermediates and services - whether local or imported - to small-scale enterprises *vis-à-vis* large-scale enterprises), access to credit (both short- and long-term), access to markets (government purchases, bulk purchases, exports) and affects costs of production and product prices for those reasons and due to incidence of tariff protection.

Industrial policy in developing countries has generally favoured large-scale industry in various ways. The system of licensing together with tariff protection provides a monopoly market and access to credit and imported equipment and raw materials at favourable terms. Foreign financing and development bank financing are available at favourable rates of interest. Overvalued exchange rates increase the real value of their benefits by providing inputs at prices below national market prices. On the other hand, overvalued exchange rates diminish the income of farmers producing export crops, by making them uncompetitive, as happened in Tanzania.

While in theory some of the above benefits for large industry may also be available to small-scale enterprises, in practice it is not possible to avail of them, e.g. credit from banks is usually out of reach of small and micro entrepreneurs because of the smaller size of loans required (often below the minimum sizes provided by development banks), insufficient collateral and high administrative and transaction costs of such loans to the banks. Furthermore, the policy of financial repression, i.e. ceilings on interest rates (and subsidy) to provide low interest loans to small and micro entrepreneurs, limits the availability of funds and lowers the supply of savings, further hurting small and micro enterprises at the end of the credit queue.

The structure of tariffs often discriminates against small and micro enterprises by levying higher import duty on parts and components, services or raw materials, than on finished products, in order to protect large-scale domestic manufacturers of intermediate products, e.g. duty on steel but not on agricultural tools, as in Zambia. Supplies of such inputs from domestic large producers to small and micro enterprises are

often scarce and available only at a premium on the notified selling price. Foreign exchange allocations for imports of inputs are usually available to large industry and not to small and micro enterprises. Furthermore, studies have shown that effective rates of tariff protection are high for sectors where large-scale enterprises predominate and negative for sectors which provide small industry employment. Small-scale industrial enterprises have been penalized through lower foreign exchange allocation, higher price paid for domestic raw materials, less subsidy on capital for equipment (from overvalued and subsidized exchange rate), and lower prices for outputs, because of marketing problems.

Many countries have undertaken structural adjustment programmes during the last five or six years to remove or reduce the effect of distortions, liberalize the economy and increase the influence of market forces in determining product and factor prices. The structure of tariffs and effects of protection are being made more equitable. The effect of liberalized imports is to increase competition for products. This has produced mixed results. On the one hand, liberalization has meant elimination or reduction of large sector licensed industries' monopoly and encouragement of the SME sector. In a competitive structure, the improvement of technology and productivity of small and micro enterprises and adaptation of products manufactured or change in product mix could in the medium-term benefit SMEs. On the other hand, in the absence of attention to structural adjustment problems of small and micro enterprises, competition from cheaper imports, or large-scale industry manufactures, could adversely affect existing enterprises. The demand-push from liberalization provided incentives to certain SME products but affected others negatively, depending on each country situation.

4.3. *Programmes for Small and Micro Enterprises*

We have noted above that macro policies could alter the pattern of demand in favour of labour-intensive industries. Non-discriminatory industrial and trade policies could again assist in achieving a desirable size distribution of industry. In practice, however, desirable policies have not been followed or have been initiated without fully correcting distortions. While *de facto* policies have favoured large-scale capital-intensive industry, governments have undertaken countervailing measures or direct supply-side programmes to influence the size distribution of industries in favour of small-scale or labour-intensive enterprises.

As compared to policy measures which could have widespread effects, a limitation of supply-side programmes is that they benefit only a small number of enterprises, usually at the upper end of the administrative definition of small-scale industry. Experience indicates that in terms of cost-benefit ratios, direct assistance programmes are seldom successful; usually the benefits are hardly commensurate with the costs incurred.

A fundamental factor is that, given the proper economic environment through appro-

priate policies, the small-scale entrepreneur in most countries operates – and prefers to operate – independently, with some help from family and friends, in establishing, financing, operating, marketing and developing his or her enterprise. Thus the typical small entrepreneur usually resents unwarranted intrusion from outside.

Are such independent small-scale entrepreneurs readily available in most developing countries? Do they not have to be identified and stimulated? One cannot deny that it is government's role and duty to create the environment through appropriate policies to bring forth such entrepreneurs. Governments' role is paramount in the provision of physical and social infrastructure. This includes education, health, roads, power and other utilities, and investments in agricultural and rural development. It may also be necessary in many developing countries to promote or strengthen institutional mechanisms to ensure equitable access to or availability of inputs and services to small-scale enterprises.

Supply-side programmes or measures take various forms. The more common are the following:

- General purpose small industry development organizations.
- Industrial estates.
- Credit institutions or facilities.
- Training institutions.
- Technology and research institutions.
- Market organizations.

As regards general purpose small industry development organizations (SIDOs), there is often a tendency to centralize their operations in the capital cities or large towns. They become bureaucratic and their outreach becomes limited. They could provide extension services to very few enterprises and their impact is more on the upper end of small-scale (or medium-scale) than on the average small-scale enterprise in a country. Experience indicates that it is more advantageous and cost-effective to have decentralised extension services in or around clusters or groups of small-scale enterprises, often managed by associations of small enterprises themselves or a non-government organization or foundation.

Small industry development organizations have not been very effective in providing policy advice to governments or in carrying out research studies to form the basis of policy formulation. Policy questions should preferably be centered on the economic ministry or industry ministry in government. Research studies need to be encouraged, perhaps through cooperation of industry associations and research institutions or universities.

As regards industrial estates, for small-scale industries they have in general been ineffective and have proved to be expensive instruments for location and development

of small-scale industry. They have not promoted inter-trading and complementarity. Governments and local authorities do certainly need to develop sites for industrial establishments, providing zoning and utilities, but should leave it to enterprises or construction firms to erect factory buildings.

Ensuring access to capital and credit for small-scale enterprises has to be considered in relation to the capital market structure and development requirements. Under a policy of financial repression, credit allocations and favourable treatment of large-scale enterprises, small-scale enterprises are undoubtedly discriminated against. But in normal circumstances, small enterprises depend on own resources or family and friends for about 80% of their capital requirements and on informal credit channels for their working capital requirements.

Special credit schemes operated by development or commercial banks have in practice met the needs of only an infinitesimal proportion of small-scale enterprises. The lessons of experience are that

- informal credit markets should be encouraged;
- savings and loan associations of enterprises could provide mutual guarantee and be linked to informal or formal credit institutions;
- interest rates charged should meet the transaction and risk costs of loans.

Skill upgrading through training programmes is certainly useful. In general, however, small-scale enterprises rely on training on the job, i.e. workers learn on the job as some sort of apprentices. It may be more useful to upgrade the basic educational and vocational training system than create special training programmes or institutions for small-scale industry. Such training programmes often become too specialized and in fact provide workers (e.g. welders in Tanzania or tool-makers in India) to large-scale industries.

Management training programmes and entrepreneur development programmes carried out through institutions or extension services could often be useful, provided it is possible to reach the right clients and provided the techniques are adaptable to small-scale industry practices in the particular context.

Technology upgrading through research into appropriate technology and its application could be carried out through sectoral or product-oriented institutions or research and development facilities of large enterprises. Designing appropriate farm equipment, disseminating its use and encouraging its manufacture is a usual field of endeavour. Equipment for mechanical and light metal industry, as well as processing operations, e.g. hammer mills, oil mills, also need to be designed and manufactured. Often it is a question of organizing technical information, identifying research carried out in other countries under similar conditions and adapting the design to local requirements. An industrial extension service linked to a central industrial documentation facility



Products should be competitive and have cost advantages.

could carry out this function, provided its outreach is effective. Extension services provided to clusters of enterprises in similar trade or product groups could be an effective means of technology upgrading.

Marketing services organized externally have not proved very effective. It is preferable to use marketing channels of private traders rather than set up a separate machinery, unless small-scale enterprises themselves organize as a group or co-operative to market their products. Purchases of inputs by small-scale enterprises could be organized in a similar fashion.

Other specific measures in support of the SME sector which have been adopted in some countries are: preferential government purchase programmes, product reservation schemes, and tax reliefs or differential tax rates. All those measures have in fact benefited urban small-scale enterprises at the upper end. Government purchase programmes could provide assured markets and initial stimulus for new products or new

designs. For example, in Tanzania and Zambia, education departments in rural provinces obtained school furniture from SMEs. In the long run, however, SME products should be competitive and should have cost advantages to be able to compete in the market. Reservation of products for manufacture by small and micro entrepreneurs assumes a totally planned industrial licensing system and could be beneficial only as an *infant industry* case and not on a long-term basis. Tax advantages, e.g. differential excise or sales taxes or income tax relief, may tend to perpetuate the cost disadvantages of SMEs. They should be employed to compensate for specific cost advantages of large-scale industry *vis-à-vis* small-scale industry, rather than merely to subsidize the smaller enterprises.

One field where there is considerable scope for promoting small-scale industry is the development of subcontracting. The experiences of countries such as India, Indonesia, Taiwan, Pakistan, the Philippines and, particularly, Japan indicate that there is a considerable potential for exploiting the subcontracting linkage for small and micro enterprises to share in the benefits that large-scale and medium-sized industries derive from import substitution and export promotion policies. The extensive development of such linkages requires a level of development of the engineering industry and sufficient infrastructure development. Differences in inter-sectoral and inter-locational wage rates are also essential. There are examples of urban small-scale industrial enterprise benefiting from subcontracting exchanges, ancillary industrial estates, supply of blueprints and designs by large firms. Examples of rural locations relate to garment industry in the Philippines, carpets in Pakistan, rattan furniture in Indonesia and shibori silk in Korea. Besides development of infrastructure, competition amongst contractors and subcontractors might encourage improvement of quality and cost-effectiveness. The governments' role should be to ensure prompt payment by contractors, encourage credit programmes as well as productivity and quality improvement through groups or clusters of small and micro enterprises, as in carpet weaving in Pakistan, batik and rattan furniture in Indonesia and garments in the Philippines. Subcontracting arrangements may be particularly beneficial to women working at home or part-time, provided fair and non-exploitative conditions are ensured, e.g. through a women's group or association.

5. Donor Approaches: Some Questions for Discussion

5.1. Assistance in Policies

The paramountcy of policy as a positive factor for small enterprise development makes it a priority area for attention, even prior to, or as a precondition for, assistance to a programme of development. It is obvious that macro policies, industrial and trade policies and specific policy measures towards small-scale enterprises have to be consistent with each other, under a unified strategy. In most developing countries, the highest echelons of government have access to national experts – albeit scarce in some

developing countries – who fully understand the policy implications of development. The problem more often is the trickling-down of such expertise to the level of the Ministry of Industry and the small industry development agencies, and the inadequacy of a machinery for implementation of a properly enunciated policy. Donor agencies have not only to coordinate action amongst themselves at the country level, but also to engage in dialogue with the appropriate official level of government.⁵

In formulating an appropriate strategy and a coherent set of policies, the national objectives of the country and the interplay of political and cultural factors should be taken into account. These factors include in most countries the priority given to enhancement of the role of women and rural development. Apart from ensuring income growth and favourable demand conditions, small enterprises should have equitable access to inputs, finance, incentives and other assistance.

Policy measures for SMEs should promote total factor productivity, remove inefficiencies, improve entrepreneurship and management, be positive and developmental, utilize decentralized delivery mechanisms and ensure growth. Separate preferential measures may usually be justified for an initial period for disadvantaged groups, e.g. women, rural poor.

5.2. Institutional Mechanisms

Donor assistance at the level of centralized institutions has met with very little success. Such institutions (e.g. SIDOs) are often not operationally linked to small enterprises, apply a rigid set of rules and regulations, suffer from bureaucratic inertia and inability to innovate and to take risks. In principle they are meant to indiscriminately assist small enterprises; in practice they find it less risky to assist the better-off enterprises which approach them and which are not the most in need of assistance.

The donor approach should show special concern for the effectiveness of institutional assistance. Mechanisms ensuring an operational linkage with the defined or desired target group(s) should alone be assisted. Such institutions are often localized in nature and formed by the members of the target groups themselves (e.g. women) as associations, savings and loan groups or cooperatives. Effective operational links may also be forged by a financial institution, a large enterprise (supplying equipment or other inputs or purchasing components or products), an engineering or technology research institution or a training institution.

The type of institutional link-up from the donor side is equally important. NGOs or volunteers are often more successful than full-blown experts or consultant firms. Twinning arrangements between small industry associations, between research or

5. A good example of such cooperation was found in Malawi in 1988 where the donor agencies had come together and met regularly with the Ministry of Industry.

training or technology institutions or between small and medium enterprises themselves (in the donor country and the recipient country) may be operationally more effective than government to government assistance.

5.3. *Training and Research*

The need for separate training or research institutions for small-scale enterprises may be doubtful. As far as training is concerned it should generally be integrated into the educational and vocational training system of the country, apart from apprenticeship training, on-the-job training, training provided by an extension agent in the enterprise itself and specialized programmes determined by requirements. Much of the research should probably be carried out in resource or sectoral research or technology institutions. Research and development institutions or departments of large enterprises may also undertake research for small industry. As regards the development of suitable or appropriate technology, and its transfer, much of the work has to be done in the developing country itself; however, advantage may be taken of research results from other similar developing countries. Other related questions may be:

- The usefulness of training fellowships in developed countries; could much training be done within the country (e.g. large enterprises) or in other developing countries?
- How best to effectively transfer technology; is it done better from firm-to-firm or from institutions to firms?
- Who should undertake management and entrepreneurship development programmes? What is the role of management development and consulting services? How should cultural factors (e.g. those not conformable to western rationality) be taken into account?

5.4. *Target Groups*

Having regarded the heterogeneity and wide spectrum of enterprises comprising the small-scale sector, donor approach to target groups has to be carefully defined, taking into account the country situation, circumstances and objectives. Two obvious priorities are women and the rural poor. The availability of infrastructure and support services, the suitability of the host institutions, and the best means of reaching target groups (delivery mechanisms), are relevant considerations. The viability and sustainability of such assistance has to be taken into account.

5.5. *Technical Assistance versus Resources Assistance*

The questions relating to financing of small-scale industry and the role that may be played by donors are being considered under chapter VII and chapter IX. Here it is relevant to review the essentially complementary role of technical assistance and assistance in resources, having regard to the severe resources crunch faced by developing countries in general and disadvantaged groups (e.g. women) in particular. At the same time the donor providing the entire package will only perpetuate external dependence. Mobilization of internal resources by mutual cooperation should be encouraged, so that operations could become self-sustaining within a reasonable period.

Conclusion

As has been demonstrated in the RSIE evaluation (1988) supply-side programmes have significant limitations, benefiting only a small number of enterprises. Policy measures are required that could result in creating an enabling environment for small and micro enterprises with more widespread effects. Agricultural development with due regard to equitable distribution of incomes leads to increased demand for consumer goods, eventually stimulating initially small and micro enterprises.

In formulating an appropriate strategy and a coherent set of policies the national objectives of the country are to be taken into account. Such policies should ensure growth of income and favourable demand conditions. Similarly they should be conducive to a situation whereby small enterprises have equitable access to material and immaterial inputs, finance, know-how and technology, incentives, and other forms of assistance.

Donor programmes should henceforth reflect the need for policy reforms and reorganization of support programmes. Macro policies and support programmes should become complementary to each other, at the same time ensuring that small and micro enterprise support programmes become an integral part of overall socio-economic development programme.

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Annex to chapter IV

Comments on: "Small and Micro Enterprises and Overall Development Policy"

by Henk Thomas

The chapter by Mr. Nanjundan represents a welcome trend in the analysis of small-scale industrialization. Indeed a trend, since small-scale industry always has been part of the literature on industrialization, whether in the context of applied policy approaches as are found e.g. with UNIDO, or within the framework of academic work, such as the field of industrial organizations.

This is in contrast to development "circles" which at times are inclined to isolate "small-scale industry" - phenomena from the deeper roots. It then appear as if "small-scale industry" has become a development strategy in itself – like trickling down or basic needs strategies of earlier days – to cater for employment, to improve the balance of payments, to use local resources, and so on as a major strategy to overcome poverty. The informal sector debate then frequently provides a starting point to discuss small-scale dimensions of production.

The chapter places small-scale industry in its proper setting; the process of industrialization. And I would like to add immediately the issues of national distribution of incomes and wealth as an essential further development aspect to be taken into account.

One of the key questions relating to the "degree of integration of small-scale policies in a wider developmental framework" is answered implicitly and at an early stage by the author in a positive sense.

Small-scale industrialization must be assessed in a wide framework. The chapter presents numerous important issues, raises a rather comprehensive range of theoretical issues while focussing sharply on policy dimensions.

My comments fall in the following three parts:

- (i) aspects of different strategies of industrialization;
- (ii) the need to emphasize the developmental aspects of distribution;
- (iii) a few remarks on the "old" Dutch approach, which perhaps could be fruitfully taken into account before searching for a new approach.

(i) Industrialization process

First, the chapter refers to trends of the past with respect to the role which small-scale activities may be expected to play in the future. Even when past trends are relatively stable, it must be realized that such global trends are the result of averaging out the observations of individual countries which may deviate considerably from such past trends. Yet, more important, there is any reason to expect new trends in the future. The present process of industrialization is characterized by unprecedented concentration of economic power in almost all important economic branches. The oligopolistic control by small numbers of huge transnational enterprises has become a common phenomenon in the international economy. Furthermore, technological innovations have been introduced – and this process is continuing without interruption – at such a

pace and with such far reaching consequences that the scale of production may well be influenced in one way or the other as far as economies of different size is concerned. Lastly, the role of governments has been changing considerably, mainly due to the overriding problems related to the steering of national economies in the face of at times unsurmountable balance of payments problems. The urge to reduce the role of public enterprises for instance may be mentioned at this point.

Second, the macrosetting asks for an elaborate and refined analysis. Agricultural development, export promotion and income re-distribution are important conditions which may foster small-scale labour-intensive development. However, in reality one meets with conflicting implications of e.g. absence of income re-distribution and an exaggerated emphasis on export promotion while neglecting somewhat agricultural development. A thorough understanding of the macro-economic performance of an economy is needed, e.g. with respect to the consequences of price distortions and disequilibria in the balance of payments and governmental finances for different economic branches first and next for the different categories of large, medium-sized, small, and even household units, before any such statements regarding e.g. the role of export promotion may be drawn. Small-scale labour-intensive development till now hardly has figured in the debate on structural adjustment policies. No straightforward recipes will be found; in some cases structural adjustment policies appear to favour small enterprise development; in other situations the opposite is the case. Systematic research still is wanting.

Thirdly, some tentative conclusions as for the relative efficiency of medium-sized enterprises are drawn. It is not certain whether the available evidence fully allows for such conclusions. Possibly the discussion will permit a further exploration of this important dimension of the debate: Is small-scale development an "economic or a social" proposition?

Fourthly, ideological preferences are to be identified precisely. In the East European and other command type economies – at least till very recently – the small enterprise – public or private – was identified with bourgeois capitalist production methods and thus small-scale production was discriminated against. In numerous mixed economies the small-scale entrepreneur is being glorified as if the conditions for perfect competition are fulfilled; one may refer to the disproportionate attention which is given to the arguments of De Soto (1989) regarding the production potential of the informal economy. Such enthusiastic support is no substitute for rigorous economic theory and applied policy analysis.

As a consequence of these observations I like to suggest that the author's approach to distinguish four main categories of industrialization can not yet provide definitive results in terms of industrialization strategies and their impact for small-scale production. I would prefer to concentrate on well known categories of industrialization strategies like import substitution – with different variants –, export promotion in its various forms, rural industrialization, regional cooperation, or public involvement in state enterprises, to mention some main chapter of literature as starting point for analysis.

The four categories as presented by the author lead to considerable problems. South Korea is indeed a case of export promotion; but also of major governmental intervention and oligopolistic industrial organization as a chosen strategy. Yet, these days in particular, a restoration of the balance of sizes is taken up as a central policy issue in that country. How is it that the role of

small-scale production in countries with a similar export promotion drive – like Japan and Taiwan – is entirely different? The Chinese case as presented in chapter IV is an illustration of redistribution policies. Is it so certain that the present upsurge in small-scale production is not related in a major way also to the inefficiency of large and medium-sized production and the removal of some major price distortions? Is the Indian case a solid example of command type of economies? Here the role of small-scale production in East European countries could tell us more. The Indian case, one could argue, is the outstanding example of a government which has implemented a most complete range of supporting policies for small-scale enterprises. It is obvious, that each case is too complex to allow for direct illustrations with respect to some very broad categories of industrialization which are insufficiently rooted in the complexities of the developmental and industrial processes.

(ii) Development policy and redistribution

The second major point of comments regards the labour situation of small-scale production. Too often an image is being created – see reference to De Soto – as if the small-scale entrepreneur is the corner stone of industrialization as was the case – to a large extent – during the Industrial Revolution of the 18th and 19th century, particularly in England as an early starter of modern industry. Such an image today makes for a caricature. Small-scale producers generally are extremely dependent on both the input and output side of production; in academic jargon, they form a sub-ordinate rather than a dominant phenomenon in national production. Their access to resources mostly is heavily constrained; their market outlets only in rare cases allow for true independent entrepreneurial behaviour. Stable subcontracting relationships with large and medium-sized firms perhaps form one of the best options available.

This dependence is reflected in the generally low level of incomes and profits; the low level of incomes being translated in generally very modest earnings for the owners and very low payments to any wage employees, apprentices, and “unpaid” family members. The weak profitability is reflected in the very modest investments and generally poor working conditions of the premises and infrastructure.

The South Korean case with earnings levels at par as between small enterprises and large ones is the exception rather than the rule. Regrettably, earnings analysis mostly is given little attention in research on small-scale production and often even entirely ignored.

Yet, from a developmental perspective it must be underscored that these aspects are of central importance. Earnings in order to provide for basic needs of the households which are involved; but also working conditions as these impair health and safety conditions and only allow – but for exceptions – for very modest learning and thus productivity enhancing circumstances.

A major point to draw attention to is the employment dimension. It is rather surprising that the employment creating potential of small-scale industry frequently is mentioned as a statistical information which mostly is of inacceptably poor quality. Part-time work may be included in jobs that have been counted; but also, long-term apprentice contracts at no or nominal pay are included. The hiring of children on a huge scale – thereby worsening the already weak labour situation in many countries – has become an alarming phenomenon. And lastly, the employment of women under conditions of labour market discrimination is to be mentioned as a further

illustration of the need to examine closely the actual practices in small enterprises before endorsing uncritically this “new” strategy of development.

These few observations may serve to underscore the need for including developmental aspects of distribution in any policy orientation to enhance the role of small-scale production, whether in industrial or services’ sectors. It seems mandatory that the role of the state is examined accurately, with respect to macro economic policies and with respect to specific interventions related to small-scale production.

(iii) *Old and New (Dutch) Approaches*

The “old” Dutch approach, finally refers to the view that any search for new approaches be accompanied by a critical examination of the policy intentions of the recent past and the achievements made till now. I like to present my assessment of developmental cooperation in Pakistan, partially undertaken with support of the Netherlands government.

The Pakistan case with respect to the role of small-scale industry is quite interesting. During the sixties all planning effort was devoted to the “Green Revolution” and industrialization of an import substituting nature; small-scale industry did emerge, in the absence of direct governmental recognition. During the seventies a major upswing is to be noted, mainly related to removal of price distortions which had favoured large-scale industry. The early eighties witnessed a continued strong performance – by the commonly accepted indicators – of small and micro enterprises, mainly linked to rapid agricultural development and growing governmental support. This undoubtedly strong performance during the past decade took place in a context of relatively strong agricultural development, a weak export performance, and highly unequal distributive outcomes of development.

A special point to be taken into account is the practice of large firms to evade labour legislation by splitting up their firm into enterprises of less than 50 workers; in some sectors, in particular this applies to textiles, the result has been an artificial growth of small-scale enterprises as a consequence of the breaking of large-scale firms in order to evade the impact of such labour protecting legislation. Lastly, as for characterization of the past developments, the impact of migratory remittances and of very favourable weather conditions during a long period of time – except for 1988 – must be accounted for in the search for causes of the actual performance of the small-scale sector.

The Pakistan-Netherlands development effort was from 1983 onwards as far as the industrial field of cooperation was concerned focused on the promotion of small-scale industry, particular in metal related activities (welding, automotive, and light engineering activities); in leather and shoe production; and handicraft earnings by women. Also, more recently, through FMO (the Netherlands Finance Company for Developing Countries) an elaborate programme of providing loans to small, mainly rural entrepreneurs has been introduced. The examination of the Country Policy document for Pakistan provides for a coherent programme which is largely reflected in the activities just mentioned. Summarizing, one observes a “human capital” and “financial capital” support programme which offer considerable scope for synergetic effects.

V. Macro policy mechanisms; new trends

by Frances Stewart¹

Most efforts to promote small-scale firms and appropriate technology have been concentrated at the micro-level, with finance and assistance devoted to particular interventions. In Tanzania, for example, a Small Industries Development Organization was established to promote and assist small-scale industries. The range of interventions supporting appropriate technologies has been wide - ranging, from cooking stoves to windmills, from mini-cement plants to micro-electronic devices for controlling hydraulic systems.² Although there were some good results, the effects tended to be confined to a small number of firms and to particular areas where the intervention took place. Appropriate technologies have rarely been widely disseminated. Moreover, spontaneous dynamism of small and micro enterprises and development and dissemination of appropriate technologies, in countries where both were badly needed, has been relatively unusual. A generally hostile policy environment appears to be one of the main factors responsible, the negative effects of this environment outweighing the positive effects of special schemes to support the small-scale sector.

This chapter explores how the macro and meso policy environment has impinged on the small-scale sector and on technology choices, drawing on some empirical work exploring the relationship between the macro policy environment and technology choice.³

In this chapter prime focus is on the need to make appropriate choices, rather than small size of production units per se. In some industries the most appropriate technology may consist of large-scale plants, when small-scale units are relatively inefficient. However, in practice, the bulk of appropriate technologies are small-scale, since smaller scale technologies are normally more accessible to low-income producers.

1. In writing this contribution I have been greatly assisted by Gustav Ranis.

2. See Carr (1986) for a survey of a number of appropriate technology interventions.

3. The research was supported by Appropriate Technology International. The initial project in this area, involving seven empirical studies, was published in 1987 as *Macro-policies for Appropriate Technology*; see Stewart (ed.) Subsequently, three regional conferences were held to discuss the findings and to provide regional inputs into the formulation of macro and meso policies for appropriate technology - in Thailand, in Kenya and in Mexico. For each meeting papers were prepared on the interaction between macro policies and micro enterprises, based on experience in the region. Participants at the regional conferences included members of the government and other politicians, civil servants, businessmen, representatives of NGOs and academics.

Moreover, for various reasons (historical and technological) there is a strong tendency for larger scale plants also to be more capital-intensive. Consequently, in practice there is a strong overlap between appropriate technologies and small-scale firms, and policies which favour (or harm) one tend to favour (or harm) the other. For the most part we do not differentiate between appropriate technology and small-scale industry and attempt to identify policies which favour both.

The chapter is organized as follows: The first two sections discuss what appropriate technology is, considering the relationship between appropriate technology and small-scale industry; some evidence is presented on the efficiency of appropriate technology and small-scale industry. Section 3 discusses how the policy environment affects the choice of product and of technology, first in general terms, and subsequently in detail, surveying evidence showing the ways in which policies have discriminated against appropriate technology and small-scale production in a large number of policy areas. In the light of these findings, section 4 presents a summary of the macro and meso policies identified as favouring the small-scale sector and appropriate technologies. The section includes some discussion of the political economy obstacles to achieving such policy change. In the final section some conclusions are presented.

1. Appropriate Technology

Defined simply, appropriate technology is the technology which best makes a use of a country's resources in order to achieve its development needs. These needs include the need to achieve sustained economic growth, to industrialize, to secure wide and equitable participation in the process of growth, to enable all the population to meet their basic needs, and to protect the environment. Appropriate technology encompasses products as well as techniques, that is it includes products with characteristics best suited to meeting the needs of low-income consumers and producers, as well as methods of production with appropriate characteristics. Defined in this way it is clear that there can be no unique appropriate technology to fit all circumstances. The technology which is appropriate will differ according to the nature of a country, its resources and opportunities.

A technology problem exists because the majority of technologies are developed in advanced countries, with different social, economic and cultural conditions from low-income countries, and therefore many of the techniques and products emanating from developed countries tend to be inappropriate for use in developing countries. Compared with developing countries, developed countries have more abundant capital resources (three to ten times that available per head in developing countries), larger markets, higher average incomes and therefore different consumption patterns, and a greater availability of skills. The use of technology from advanced countries, unmodi-

fied for use in developing countries, can lead to inequalities in work opportunities and consumption patterns, and high levels of un- and under-employment.

In contrast to developed country technology, appropriate technology tends to be more labour-intensive, smaller scale, use local materials, to include technologies especially suited for contributing to rural development, and to produce appropriate products - i.e. products suited for the mass of poor consumers.

It is important to emphasize that appropriate technology must be efficient, since sometimes it seems to be suggested that any technology that is labour-intensive and small-scale is appropriate, irrespective of its efficiency. An efficient technology is one that maximizes the value of output, in relation to resource costs, when resources and output are properly costed, allowing for social opportunity costs and benefits and not merely costs as valued on the market. An inefficient labour-intensive technology will not help those who use it in the long-run, because it will perpetuate very low incomes. Moreover, it is also important that appropriate technologies have dynamic potential, so that productivity increases over time, so as to raise the incomes of those using the technologies and to permit these technologies to compete with technologies with inappropriate characteristics, on which there are continuous Research and Development (R&D) efforts, with a consequent rise in productivity over time.

2. Does an efficient technology with appropriate characteristics exist?

One view, held fairly widely some years ago, was that an efficient technology with appropriate characteristics was non-existent, because of the nature of technological development, and particularly because of the domination of advanced countries in R&D (e.g. Eckaus, 1955; Kaldor, 1965; Emmanuel, 1982). However, there is now a considerable amount of evidence showing the existence of efficient small-scale and labour-intensive technologies in a large number of industries.

In the studies reviewed here, efficient technologies with appropriate characteristics were identified in a number of industries. Five examples are presented in table 5 – sugar processing, maize milling, pineapple canning, rice hulling and cotton spinning. In each, capital cost per person employed is much lower in the small-scale technique; the most extreme difference is in sugar processing in Kenya, where capital costs per head in the open pan sulphitation technique are less than 5% those in the large-scale vacuum pan technique. Capital costs per unit of output are also lower for the small-scale technologies, ranging from 9.5% in maize milling in Tanzania to 71% in sugar processing in India. Labour use is much larger among the small-scale techniques, with the amount of employment created for the same level of output being as much as five times as great as in the capital-intensive technology in Kenyan sugar processing. The efficiency of the various techniques is shown in column (4): In each unit costs are lower for the small-scale technology.

Table 5: *Performance of small-scale labour-intensive as a multiple of capital-intensive techniques*

		(1)	(2)	(3)	(4)
		K/O	L/O	K/L	operating costs
<i>Efficient small-scale technologies</i>					
Sugar processing,	India	0.71	2.9	0.24	0.84(c)
	Kenya	0.27	5.9	0.05	0.66
Pineapple canning,	Philippines and Taiwan	0.39	3.3	0.17	competitive
Rice mills,	Philippines	0.76(a)	1.7	0.30	0.96(c)
		0.61(b)			0.88(b)
Maize milling,	Tanzania	0.10	5.2	0.49	competitive. social costs of labour-intensive lower
Spinning,	Thailand	0.67	1.3(d)	0.50	0.76(e)
<i>Doubtfully efficient</i>					
Dhenki, rice huller	Bangladesh	0.42	13.5	0.06	6.8
Mosti,	Bangladesh	0.003	7.5	0.06	2.8

(a) Assumes large mill operates at 97% capacity; small mill at 77% as observed in survey.

(b) Assuming both rice mills operate at 100% capacity.

(c) When capital costs are costed at replacement value.

(d) Assuming labour use is proportionate to labour costs.

(e) Assuming no special promotion policies for the large scale.

It is clear from these examples that there are technologies which are labour-using, capital saving, skill-saving⁴ and efficient. The alternative technologies also typically produce more appropriate products. For example, in both maize and rice milling, the smaller mills produce a more nutritious, less refined product, which costs less and is more appropriate to low-income consumers. In pineapple canning, the more labour-intensive technology produces a lower standard product, the pineapples being more crushed and broken, but there is an international market for the cheaper product at the lower end of the market.

Two examples of inefficient small-scale technologies were identified. These were the *Dhenki* (a form of manual rice hulling) and the *Mosti* (a manually operated tube well).

4. Data on skill use is not provided in the table, because it is not available on a systematic basis, but most of the evidence shows the larger more sophisticated technologies requiring more skills than the smaller technologies.

As can be seen (table 5) fixed capital costs per head of both technologies are a fraction of the alternatives, and labour absorption per unit of output is far greater. But because of very low productivity of the technologies, unit costs are far greater. The Dhenki and the Mosti are both purely manually operated, whereas all the other examples involve some machinery: the two are basically traditional technologies which have not been upgraded by modern science and technology, while the efficient technologies embody some modern technological know-how.

Table 6: *Capital intensity and economic profit of seven industries in five countries*

	Relative capital intensity (a) of large-scale, compared with small (b)	Economic profit as % of capital stock (c)	
		Large-scale	Small-scale
BOTSWANA (1982)			
Sorghum beer	3.2	+130	+190
EGYPT (1982)			
Clothing	2.8	+17	+42
Metal products	12.3	-3	+103
HONDURAS (1980)			
Clothing	2.8	-21	+45
Furniture	7.3	-26	+58
Shoes	13.9	-22	+102
Leather products	7.1	-21	+79
Metal products	8.6	-24	+23
JAMAICA (1979)			
Clothing	6.6	-11	+86
Furniture	5.7	-0.4	+173
Shoes	7.7	-6	+247
Metal products	2.4	+16.6	+56
SIERRA LEONE (1974)			
Clothing	4.9	-27	+59
Bread	7.3	-11	+12
Rice milling	40.8	-30	+80

Source: Liedholm & Mead, 1987

- (a) Relative capital intensity is calculated by comparing the ratio of capital services to value added in large and small firms.
- (b) Large-scale firms are those employing 50 or more; small-scale those employing less than 50.
- (c) Economic profit is defined as value added less capital services (valued at shadow interest rate) and labour costs (including family labour, valued at the competitive wage rate in the industry).

Other powerful evidence showing the existence of efficient small-scale technologies comes from the work of Liedholm and Mead (table 6).

In studies of seven industries in five countries, Liedholm and Mead found that capital intensity (defined as the ratio of capital services to value added) was systematically higher in large-scale firms than small, the ratio varying from 2.4 to 40.8, while economic profit was consistently substantially higher for the small-scale firms, being negative in most of the large-scale activities and high and positive in all the small-scale activities.⁵

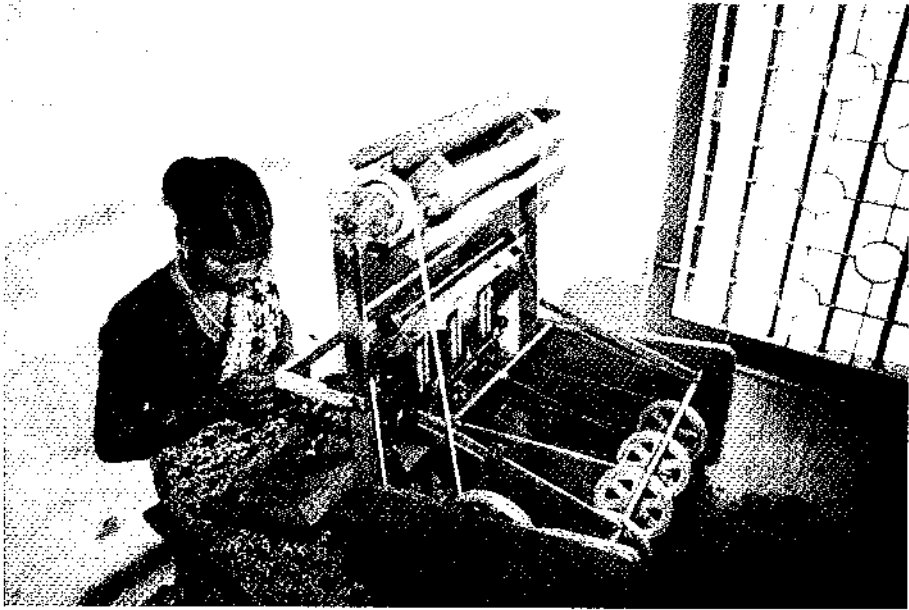
Most investment in Third World countries is in large-scale and often inappropriate technologies despite the superior efficiency of small-scale technologies, the fact that they economize on scarce capital resources, use more abundant labour and have a favourable impact on income distribution. For example, recent investment decisions in cotton spinning in Thailand were made in the semi-advanced technology, not the more efficient intermediate technology (Santikarn, 1988). In the Philippines, a sophisticated, large integrated rice mill was introduced which would make hundreds of small village rice mills redundant (Ranis & Stewart, 1987). In Tanzania, a multinational corporation chose to invest in a large capital-intensive roller-mill, even though the economic and social profitability was much lower than the smaller labour-intensive hammer mill (Bagachwa, 1988). In Kenya, the open pan sulphitation technology for sugar processing accounts for only 1.7% of total production (Kaplinsky, 1987). These are just a few examples among many. At an aggregate level, wage employment in manufacturing in the early 1970s rose by just 0.02% for every 1% increase in value-added in both Africa and Asia, while in the latter part of the decade it fell, while output rose, providing an aggregate indication of the capital-intensity of investment decisions over that period (see Van Ginneken & Van der Hoeven, 1988).

The choice of technology has thus, for the most part, met neither economic nor social objectives. One very important reason for this has been the macro and meso policy environment. The next section considers how this has affected technology choice.

3. The Policy Environment, Technology Choice and Technology Change

Government macro and meso policies affect technology choices and the development of technology by determining the environment in which decisions on technology are made. Actual investment decisions on choice of technology are, of course, made at the

5. See also the evidence surveyed by Pack (1982) who has shown that efficient appropriate technology can generate a very large amount of additional employment. Taking nine industries as a whole, use of appropriate technology would generate over four times as much employment as the capital-intensive technology.



Decisions on technology are made at the micro level.

micro level by a variety of decision-making units, private firms and farms, large and small, foreign and domestic, parastatals, co-ops, and family enterprises. These micro enterprises are greatly affected by the policy environment - which helps determine the prices they achieve, the cost of the factors they use, the availability of alternative technologies and their knowledge about these alternatives, the availability of infrastructure, and so on.

Macro policies are those that affect the aggregates of the economy, the total money supply and credit creation, the level of taxation and public expenditure, the ruling interest rate and the exchange rate. *Meso policies* are policies that are concerned with the distributional and sectoral consequences of the macro policies. While macro policies are concerned with the aggregates, meso policies are concerned with how these aggregates translate into burdens or benefits for particular sectors or income groups.⁶

3.1. Classification of Related Macro and Meso Policies

The studies suggested a broad categorization of the ways in which macro and meso policies affect technology choice and change. First, there are ways in which enterprise

6. In the earlier work (see Stewart [ed.], 1987) the term *macro policies* was used for both these categories, but this tends to create some confusion because the term *macro policies* is more commonly used for policies affecting the aggregates. Thus here we follow the terminology used in Cornia, Jolly & Stewart (1987), dividing the policies into macro and meso.

behaviour is directly affected by policies which influence their objectives, their markets, their access to resources, and technology availability - the four factors which together determine how an enterprise behaves. Then, cutting across these factors and operating at various levels in the economy, policies towards organization and institutional choices affect technology choice and change in a variety of ways. Finally, policies towards rural linkages determine the dynamism of the rural sector, and the extent of investments made using appropriate technology in the rural areas. We shall discuss some findings with respect to each of these categories before coming to a more detailed discussion of particular policies.

a. Objectives

The objectives of any micro enterprise may consist of profit maximization, satisficing including bureaucratic objectives, employment maximization, or maximising family income and employment. Objectives vary according to the type of enterprise and the general environment prevalent. In principle, if prices broadly reflect scarcities, then profit-maximising objectives are likely to lead to choice of appropriate technologies, while other objectives may result in over capital-intensive technologies.

The studies showed three types of decision-making unit whose objectives did not favour appropriate technologies. First, Santikarn showed that in Thailand many modern large-scale cotton spinning firms, both foreign and domestically owned, chose more capital-intensive technologies "*than what was actually needed for profit maximization*" (Santikarn, 1988). She suggests *satisficing* motivation may explain these choices. Similar results were found in other industries in Thailand by Lecraw and by Bell & Scott-Kemmis (1987). Secondly, James' study (1987) showed consistently inappropriate technology choice by parastatals in Tanzania and Kenya, despite the existence of more appropriate technologies, and (in Tanzania) government-declared objectives of promoting equality, which should have been supportive of appropriate technologies. James explained these choices with reference to bureaucratic objectives which, he hypothesised, are to extend investment and expand output; these objectives lead to use of foreign finance, and therefore foreign technology. Aid agencies formed a third category whose objectives did not appear to favour appropriate technologies. There were a number of examples of aid-finance for inappropriate technologies - e.g. for the integrated rice plant in the Philippines and for their tractorisation programme, and for the capital-intensive sugar technology chosen in Kenya. While there were a few cases where aid had favoured more appropriate technologies - e.g. aid support for some of the Mostis - the balance of aid decisions appeared inappropriate. The objectives of aid donors - to maximise aid flows while minimising bureaucratic costs, as well as to tie aid to supplies provided by the donor country - seem to be largely responsible.

Policies affecting objectives include those directly impinging on enterprises' decision-making, e.g. reforms of parastatals and aid agencies, and those which affect the envi-

ronment, for example by introducing more competition, thereby making it more difficult for firms to adopt satisficing objectives and survive.

b. Resources

The major policies influencing the price and availability of resources facing the micro enterprise are credit policies, which determine the quantity and price of credit available to different enterprises, subsidies and taxes on investments, tariffs and exchange rate policies which affect the relative price of different types of good, and wages and other labour policies, which affect the price of labour. There were numerous examples of the impact of policies towards resources on the choice of technology. For example, in Kenyan sugar processing, the government policy of permitting complete write-off of capital costs by large firms artificially cheapened the capital-intensive technology so its costs fell below those of the small-scale alternative. In Thailand and the Philippines, exchange rate and promotion policies favoured capital-intensive technologies, (see Bautista, 1988, and Santikarn, 1988). In many countries, the modern sector receives subsidized credit, while the informal sector has to pay rates up to 25 times as high (Liedholm & Mead, 1987). More detailed examples will be considered when we come to discuss the individual policies.

c. Markets

Markets are important in influencing the type of products produced and the scale of production. Both help determine the technologies used. More sophisticated products for high-income markets tend to require capital-intensive technologies. In a number of cases the desire to achieve 'high' standards for domestic elites or exports was used to justify capital-intensive choices. For example, James (1987) showed that parastatals in Kenya and Tanzania justified some of their technology choices in this way. The same justification was used for the more sophisticated maize milling techniques in Tanzania and for rice hulling in the Philippines (Bagachwa, 1988, and Ranis & Stewart, 1987).

Policies favouring markets encompass trade, income distribution, and products policies.

d. Technology

The range of technology known and available to a firm limits its possible technology choice. This range depends on levels and direction of government research and development and information services, and enterprises' research and development (R&D) and access to information. Two examples illustrate the significance of R&D for the development of efficient small-scale technologies. In the case of the open pan sulphitation sugar technology, R&D in India increased productivity so that the previously inefficient technology became competitive with the vacuum pan sulphitation technology (Kaplinsky, 1987). Secondly, the axial flow paddy thresher, developed for small farmers by the International Rice Research Institute, was rapidly taken up in the Philippines and Thailand, being produced by 70 firms in the Philippines and over 20 in Thailand

by 1985. Cumulative sales were 55,000 units in 1984, extending to Egypt, Honduras, Ivory Coast, Ghana, Colombia and Mexico (Duff, 1987). The very low productivity of traditional technologies – illustrated earlier in the case of the Dhenki and the Mosti – also emphasises the importance of R&D to upgrade the productivity of traditional technologies. Dissemination is also important, with very weak dissemination channels for rural non-agricultural technology being a major obstacle to technology upgrading.

Policies favouring technology include policies towards government financed R&D and dissemination, tax and subsidy policies, and patents policies.

e. Institutions and organization

Appropriate institutions are an important feature of policies that favour the small-scale sector and appropriate technology. The studies showed that some types of institution were much more favourable to appropriate technologies than others. The need for institutional reforms extended to many of the areas already mentioned. For example, many research and development institutions produce few useful results, and where they do they are often mainly directed towards capital-intensive technologies. There is little R&D devoted to upgrading rural technologies. New types of R&D institutions, and new incentive systems are needed.

Similarly, reforms are required in technology dissemination institutions. Institutional reform is an important aspect of getting credit to producers with few or no assets, as shown in the very successful case of the Grameen Bank. Institutional change is also needed in the structure of government with more decentralization of control over expenditure, and greater use of NGOs for monitoring. Institutional changes are needed in the structure of parastatals if they are to take more appropriate decisions.

In the private sector, subcontracting from large to small-scale firms can permit efficient and dynamic small-scale enterprises, working in tandem with the large-scale sector, as in industrial development in Japan. Studies in Bangladesh and a number of Latin American countries emphasised the importance of producer organizations, among small and micro enterprises, partly to permit sharing of technology and marketing, but more significantly to strengthen the bargaining power of the producers and their influence over government decisions. In Bangladesh, for example, small-farmers associations were of critical importance for securing appropriate irrigation. In Costa Rica, cooperatives of coffee producers eased access to technology and markets for small producers.

f. Rural linkages

Rural linkages represent the linkages between agriculture and non-agricultural activities in the rural areas. Where agricultural activity is flourishing and rural linkages are strong, rural industrialization develops rapidly. In the early stages of development, especially, strong development of rural industrial activities also promotes agricultural

growth, by improving incentives for such growth and stimulating technology change and accumulation in the rural areas. The study of rural linkages in the Philippines and Taiwan showed the importance of rural linkages for appropriate technologies. Rural non-agricultural employment was shown to rise rapidly with expansion in agricultural output because of production and consumption linkages. The extent of rural linkages depends not only on the growth of agricultural output, but also the agricultural strategy. Very dualistic or bimodal agricultural development leads to weaker linkages than more egalitarian agriculture because if incomes are better spread consumption of locally produced goods is greater, and small farmers use more local inputs and local processing (see Ranis & Stewart, 1987, and Ranis, 1988).

Policies towards rural linkages include promotion of egalitarian agricultural development, the creation of rural infrastructure and the dissemination of appropriate technology in the rural areas.

3.2. *Effects of Macro and Meso Policies on Technology Choice and Change*

The previous section provided an overview and broad categorization of the ways in which macro and meso policies affect technology. This section presents a more detailed analysis of how the policies identified in the overview have affected technology choice and change. In general prevalent policies have been hostile to the small-scale sector and to appropriate technologies.

The policies will be grouped into policies favouring taxes and investment promotion schemes; credit policies; policies favouring international trade and foreign exchange; labour market policies; products policies; policies favouring science and technology and dissemination; policies favouring rural linkages; aid; parastatals.

a. *Taxation and Investment Promotion*

Many governments have introduced schemes, to promote industrial investment, with tax relief in the form of special depreciation provisions, being the most important element. These schemes almost invariably discriminate in favour of the use of capital, and of large-scale producers.

Two examples will be discussed: Thailand and the Philippines. These cases are typical of many more.

Thailand: Investment incentives were introduced by the Board of Investment in 1960, with benefits including protection (import bans and surcharges against foreign competition, and tariff relief on imports) and tax incentives (exemption from corporate income tax and other taxes). Requirements on minimum size and capital investment meant that small firms were not eligible for these privileges; the larger the firm the longer the tax holiday. "Consequently, many small agro-processing firms in industrial industries such as rice mills, tapioca processing plants are not promoted" (Santikarn,

1988). The overall cost reduction of the promotion policies were 34.6% for the intermediate technology and 38.7% for the semi-advanced. Non-promoted firms, which included almost all small firms were thereby heavily penalised (Santikarn, 1988).

Philippines: Two Acts of 1967 and of 1970 gave a package of fiscal incentives to manufacturing enterprises registered with the Board of Investments. Nearly all the incentives had the effect of cheapening capital. They included

- tax exemption on imported capital acquired within 7 years from the date of registration of the company. This reduced the cost of imported equipment by 10 to 20%.
- tax credit on domestic capital equipment equivalent to 100% of customs duties.
- tax deduction of expansion reinvestment.

There were also some incentives favouring labour use, including tax deduction of half the expenses of labour training and a wage subsidy for exporters.

Analysis of the overall effects of these incentives showed that the user cost of capital was reduced by 49 to 71% while labour cost declined by 3.5% for non-exporting firms and 22% for exporting firms. The estimated effects⁷ were reduction of 35.6% in employment for non-exporting firms and 6.9% for exporting firms (Bautista, 1988).

b. Policies Towards Credit

Many governments have provided low priced credit for selected enterprises as a means of promoting investment. For the most part this credit has been secured by large enterprises, while most small and micro enterprises have had to finance their investment from their own savings, or by borrowing at very high cost from the informal sector. The allocation of subsidized credit has thus tended to favour large-scale enterprises while the cheapening of capital involved has favoured the choice of more capital-intensive technologies by recipient enterprises. The private banking system has also tended to favour large-scale and established firms because of the relatively low risks associated with lending to them.

In the Philippines the firms registered with the Board of Investment for fiscal privileges (see above) also have preferential access to low-interest credit, which reduces the cost of capital by 9 to 35%. Limited access to low price credit by small enterprises reduced the proportion of investible resources controlled by small firms, as did the government's eleven large projects, all highly capital-intensive, which together were estimated to cost US\$ four billion or 10% of one year's GNP. Subsidized credit was also provided for a tractorisation programme in a joint World Bank/Government Programme.

⁷ These estimates depend on rather arbitrary assumptions of the life of the project, the discount rate and the elasticity of substitution.

In the manufacturing sector in Thailand *promoted firms* receive credit at 9% interest, which, as shown earlier, had a significant cost-reducing and capital-cheapening effect for promoted firms.

In Tanzania, "*the domestic capital market has been heavily subsidised by the high rates of domestic inflation and low interest rates*" (Wangwe & Bagachwa, 1988). The real cost of institutional borrowing has been negative since 1978. Official low priced credit is allocated administratively through the Central Bank of Tanzania. This mechanism has led "*to the bulk of loanable funds being allocated to the large-scale public sector which are both the most politically and economically adept of the eligible recipients*" (Wangwe & Bagachwa, 1988). The small-scale sector has been excluded from the institutional market for credit on grounds of higher risks and administrative costs of lending.

In both Bangladesh and Zimbabwe, the small-scale sector has also been largely excluded from borrowing from the established financial institutions at relatively low interest rates. In Bangladesh, Ahmad showed that rural entrepreneurs have extremely limited access to institutional credit - a 1979 survey showed only 6% of rural enterprises received any credit, and of this only one-fifth got institutional credit. This is attributed to lack of collateral, lack of knowledge about sources of credit, intricate official formalities which have to be fulfilled to get institutional credit, the need for bribes, a long gestation period (sometimes 5 months or more), and a substantial cost in time (12 to 20 days) in pursuing the credit allocation (Ahmad, 1988).

In Zimbabwe, "*almost all private sector lending by financial institutions goes to well established firms*" (Ndela, 1988). This is attributed to the fact that the banks make their lending decisions on the basis of prior earnings, credit history and balance sheets, all of which operate against new and small firms, and those with little collateral.

Surveys of sources of credit for small firms elsewhere have shown that less than 1% come from formal sources (Liedholm & Mead, 1987). Small and micro enterprises either finance their investment from their own savings or from the informal money market.

According to a 1975 survey, in two-thirds of countries formal sector nominal interest rates were 10% or less (World Bank, 1975). Rates of interest in the informal sector in contrast often exceed 100%. The huge differences in rates are shown in table 7.

It should be emphasised that the situation is by no means only a result of government provision of subsidized credit. Even in the absence of such action, the small-scale sector would receive a relatively small share of total credit from formal sector institutions because of requirements for collateral, and bureaucratic procedures. A purely market (i.e. no government intervention) solution would not, therefore, be sufficient to

Table 7: Formal and Informal Nominal and Real Interest Rates in Selected Economies

	Informal Rates (%)		Formal Rates (%)	
	Nominal	Real ^a	Nominal	Real ^a
<i>Africa</i>				
Ethiopia ^a	70	66	12	8
Ghana ^a	70	64	6	0
Ivory Coast ^a	150	145	10	6
Nigeria	200	192	6	-2
Sudan ^a	120	120	7	7
Sierra Leone ^b	75	60	12	-3
<i>Asia</i>				
Afghanistan ^a	33	n.a.	9	n.a.
India ^b	25	15	9	-1
Indonesia ^a	40	29	14	3
Jordan ^a	20	15	7	2
Malaysia ^a	60	58	18	16
Pakistan ^a	30	27	7	4
Philippines	30	24	12	6
Republic of Korea ^a	60	49	6	5
Sri Lanka ^c	26	20	5	-1
Thailand ^b	29	27	9	7
Vietnam ^a	48	20	30	2
<i>Latin America</i>				
Bolivia ^a	100	96	9	5
Brazil ^a	60	38	15	-7
Chile ^a	82	52	14	-16
Colombia ^b	48	40	24	16
Costa Rica ^a	24	20	8	4
El Salvador ^a	25	23	10	8
Haiti ^b	140	122	15	-3
Honduras ^a	40	37	9	6
Mexico ^a	60	57	10	7

In: Haggblade et al., 1986

Sources:

- World Bank, 1975. Formal rates are average of those charged on various types of loans by agricultural credit institutions. Informal rates are from various credit studies in the reporting countries. Both sets of figures cover the period from 1967-1970.
- Chuta & Liedholm, 1979. Data are from the period 1970-1975.
- Wai, 1977.
- Real rates were obtained by subtracting from nominal rates the average annual rate of increase in the consumer price index for 1967-1970 for World Bank countries or 1972-1975 for Liedholm-Chuta countries.

get credit to the small-scale sector. Institutional innovation is also needed, to overcome the obstacles faced by small enterprises.

c. *Policies Towards International Trade*

Exchange rates

Many countries, following an import-substituting industrialization policy, maintained high exchange rates, accompanied by heavy tariffs (and/or quotas) on consumer goods with reduced (or zero) tariffs on capital goods.

This was the case, for example, in the Philippines in the 1950s and 1960s, in Costa Rica and Colombia in the 1960s and 1970s, and in Zimbabwe and Tanzania.

The combination of overvalued exchange rate and low tariffs on capital goods artificially lowered the price of capital, thus encouraging substitution of capital for labour. In addition, the foreign exchange regime discriminated against exports in favour of production of import-substitutes for the domestic market. As a result, growth of labour-intensive exports was inhibited.

The overvalued exchange rate also discriminated against agriculture, as widely documented by most of the studies of Latin America, as well as the Philippines, Thailand and Tanzania, thereby reducing agricultural growth and potential rural linkages.

Trade restrictions and exchange rate overvaluation were estimated to have reduced domestic agricultural prices relative to non-agricultural goods by over 100% in the 1950s in the Philippines, by 45% in the 1960s and around 20% in the 1970s (Bautista, 1988). In Thailand, the exchange rate was estimated to have been significantly overvalued between 1960 and 1984. The combined effects of this, the tariff policy, and policies towards agricultural prices was for a large (but declining) outflow of resources from agricultural to the urban sector (Siamwalla & Setboongsarng, 1987). In Tanzania, the exchange rate became increasingly overvalued during the 1970s and 1980s, with an estimated real appreciation of 56% between 1970-1978, and 120% between 1979-1985 (Wangwe & Bagachwa, 1988). The effect of the overvaluation was to reduce agricultural prices and agricultural output stagnated (see Stewart, 1986).

Estimates of currency overvaluation in 28 countries are shown in table 8. In recent years, however, many countries have devalued (usually as part of their IMF programme) and there has been a major real exchange rate among developing countries of around 30% over the three years 1984-1987, thus much reducing the extent of currency overvaluation.⁸

8. I.M.F., *World Economic Outlook*, April 1988. It must be noted that any estimates of the extent of overvaluation are arbitrary, since they imply that we know what the "correct" rate is. We do not – some considerations argue for a degree of overvaluation compared with a free market rate, especially for primary producers. But there are also strong arguments for avoiding excessive overvaluation and protection from many points of view, including those of promoting appropriate technology.

Table 8: *Degree of Currency Overvaluation (Percentage)*

	Year	Indications of Degree of Currency Overvalued
<i>Africa</i>		
Botswana	1983 (a)	10%
Cameroon	1979 (b)	0%
Ghana	1983 (a)	228%
Egypt	1983 (a)	66%
Ivory Coast	1979 (b)	10%
Kenya	1983 (a)	17%
Malawi	1983 (a)	60%
Nigeria	1983 (a)	45%
Senegal	1979 (b)	40%
Sierra Leone	1983 (a)	37%
Sierra Leone	1976 (b)	15%
Tunisia	1983 (a)	12%
Zambia	1983 (a)	27%
<i>Asia</i>		
Bangladesh	1983 (a)	42%
Hong Kong	1983 (a)	0%
India	1983 (a)	28%
Indonesia	1983 (a)	0%
Malaysia	1965 (c)	4%
Malaysia	1983 (a)	1%
Pakistan	1963 (c)	50%
Pakistan	1983 (a)	30%
Philippines	1963 (c)	15%
Philippines	1983 (a)	50%
South Korea	1983 (a)	8%
Taiwan	1965 (c)	20%
Taiwan	1983 (a)	6%
<i>Latin America</i>		
Argentina	1958 (c)	100%
Argentina	1983 (a)	11%
Brazil	1966 (c)	50%
Brazil	1983 (a)	37%
Chile	1966 (c)	68%
Chile	1983 (a)	17%
Colombia	1968 (c)	22%
Colombia	1983 (a)	21%
Jamaica	1983 (a)	14%
Honduras	1983 (a)	43%
Mexico	1960 (c)	15%
Mexico	1983 (a)	20%

In: Haggblade et al., 1986

Sources: (a) World Currency Yearbook (1984); black market premiums as on December 31, 1983. (b) Jansen (1980). (c) Healey (1972); cites Little et al. (1970) and Balassa (1971).

Tariff structure

The tariff structure also typically discriminates against small-scale investors, as many of the machines used by the small-scale sector are classified as consumer goods and subject to a high rate of tariff, in contrast to the low or zero tariffs on large-scale imports of capital goods. For example, in Sierra Leone sewing machines and outboard motors were classified as consumer goods, subject to tariffs of 35%; in Burkina Faso, import duties on handtools were 72%, and on sewing machines were 41% (Haggblade et al., 1986). In many countries, duty free imports were permitted to the large-scale investors as part of the investment promotion policy; e.g. in the Philippines tractors were subject to a zero duty, while power tillers were taxed at 19% (Bautista, 1988). In Sierra Leone it was estimated that duty free capital imports of the large-scale investors amounted to a subsidy to them of around 25% (Haggblade et al., 1986). Effective tariff protection for large-scale clothing producers was estimated to be 430%, while small firms received an effective rate of protection of 29% (Haggblade et al., 1986). The structure of protection in Tanzania *"has also tended to overprotect ... the large-scale inefficient firms at the expense of small-scale efficient firms"* (Wangwe & Bagachwa, 1988). A World Bank study showed that *"while a small-scale firm employing less than 25 workers has an effective rate of protection below 10%, the large enterprise employing over 250 workers enjoys a rate of protection well over 2,000%"* (Wangwe & Bagachwa, 1988; World Bank, 1986).

Administrative Mechanisms for Allocating Foreign Exchange

Foreign exchange of countries following import-substituting strategies, especially when subject to acute foreign exchange shortages, has often been allocated through administrative channels - i.e. by controls. In both Tanzania and Zimbabwe, the controls tended to favour the large-scale producers, at the expense of small-scale producers.

In Tanzania, the system of administrative allocation and import licensing has been *"vulnerable to the lobbying strength of the applicant, the crisis nature of the application and overall foreign exchange available and other political considerations. Because of their political and economic power, parastatal enterprises have been receiving a disproportionate share of allocations of foreign exchange ..."* (Wangwe & Bagachwa, 1988).

In Zimbabwe, foreign exchange is allocated by the government in a way that strongly favours existing firms (Ndela, 1988). The appropriateness of the technology is not a criterion. Both bureaucratic procedures and allocation criteria tend to favour large and established firms and discriminate against the small-scale sector (Ndela, 1988).

Evidence of how administrative allocation of foreign exchange is biased against small-scale producers was also shown in Bhagwati's nine-country study, which suggested that even in countries which believe they favoured the smaller applicants "ex

post outcomes appear to have been disturbingly concentrated on the large-scale applicants" (Bhagwati, 1987). The bias was attributed to similar factors to those found to be significant in Tanzania and Zimbabwe: bureaucratic procedures which favour the large scale; and a bias in favour of known and established producers.

While administrative procedures thus do not help small-scale producers, market solutions - especially in contexts of severe disequilibrium - do not appear to do so either. In Zambia, administrative allocation of foreign exchange was replaced by allocation through auction in 1985. The result was that the small producers (and the agricultural sector) secured almost no foreign exchange, as they lacked the resources to put in a competitive bid. The main beneficiaries were the multinational companies and the parastatals (Ncube, 1987).

Policies to support the small-scale sector will not only need to eliminate government-imposed distortions, but also to introduce some special mechanisms to ensure adequate access to foreign exchange by small-scale producers, during the transitional period.

d. Labour Market Policies

Labour market policies form another "distortion" that tend to bias technology choice towards capital-intensive technologies. These are policies such as minimum wage laws, social security requirements, and restrictions on work hours etc, which raise the cost of labour in the formal sector and thus tend to reduce employment in the formal sector.

These laws do not extend to the informal sector, where the cost of labour tends to be much lower. But since they raise costs in the formal sector, they increase the competitive edge of the informal sector and may thereby increase total employment (see Stewart & Weeks, 1975). The labour market policies are typically not effective in reducing poverty, since while they raise incomes in the formal sector they contribute to depressing them in the rest of the economy, where poverty is usually worse.

In the Philippines, minimum wage legislation and supplementary allowances for workers raise the price of labour, but these are partly offset by a subsidy on labour among promoted firms (Bautista, 1988). In contrast, in Tanzania wages policy has been used to reduce differentials among workers and between urban and rural sectors. Real urban wages have fallen sharply since the late 1970s. But policies restricting employers' authority to lay off workers have encouraged capital-intensive technology choices (Wangwe & Bagachwa, 1988).

While most evidence shows a large wage gap between large and medium or small enterprises, much of this is not due to labour market policies, but to differences in skills, and large firms' desire to reduce labour turnover, as shown by the fact that many large

firms pay wages above the legislated minimum. The increase in formal sector labour costs was estimated to range from 15 to 27% in selected African and Latin American countries in the early 1970s (Haggblade et al., 1986).

Most observers, however, found these labour market policies to have had only minor effects (see e.g. Berry & Sabot, 1978). Large reductions in real wages in the 1980s, with the debt crisis, will have further diminished the significance of these effects.

Aggregate effects of policies towards labour and capital

On balance government policies have acted to cheapen capital to the formal sector through tax and promotional policies, credit policies and exchange rate and tariff policies, while allocation of credit and of foreign exchange has favoured the large-scale formal sector and discriminated against the small-scale sector. However, in a number of areas it is not only government policies that have had these effects, but also the institutional arrangements. Thus market solutions (e.g. to credit and foreign exchange allocation) need to be supplemented by other policies to secure sufficient allocation of resources for the small-scale sector - to bring about what we shall call a "structured market".

e. Products Policies

The appropriateness of products is itself a very significant aspect of appropriate technology; in addition choice of technique is closely related to choice of product, with certain product standard requirements leading to capital-intensive and large-scale production methods.

While governments do not normally have a set of policies they define as "products policies", many policies affect product choice, directly or indirectly. The studies suggested that the most important direct product policies were government regulations, and parastatal decisions regarding product standards. Policies towards product development and information dissemination are also potentially important. Significant indirect policies include the whole nexus of policies towards income distribution which determine patterns of consumption demand.

A number of studies showed the close relationship between product standards and choice of technique, with the "higher" standard products more in demand among high-income consumers, being associated with more capital-intensive and large-scale technologies. This was true, for example, of the products of the roller mills, in contrast to the hammer mills, in Tanzania; sugar processing in India; and pineapple processing in the Philippines. James found that the objective of achieving "international" product standards led to a large-scale and capital-intensive technology in the cases of shoe production and laundry detergent in Tanzania. Other examples in Tanzania were bread, oil processing, printing ink, cement and beer (Wangwe & Bagachwa, 1988).

In the case of shoe production in Tanzania, and also rice milling in the Philippines, the need to maintain standards was justified as being necessary for production for export.⁹ The argument that exports require “high” quality and therefore choice of capital-intensive technology is often regarded as decisive. Yet deeper examination suggests the argument can often be misplaced. In the first place, the export argument is often used when in fact exports do not materialise at all, or only in very small quantities. This occurred in both the projects cited here. Secondly, successful exporting does not necessarily require very high quality. There are no unique “international” standards - the international market is made up of many markets of varying income levels, sophistication and quality requirements.

This was clearly illustrated in the pineapple case where the “lower” quality Taiwanese product was successfully exported to a lower-income segment of the market. South-South markets and exports to low-income Northern consumers offer a potential for trade in more appropriate products. Low price can normally compensate for low quality in international markets. In some countries, as in the Philippines and Tanzania at this time, high product quality was expected to offset the high costs of production resulting from inappropriate macro policies, especially overvalued exchange rates. In practice, this rarely happens, and when it does the exports may not be worth promoting, since they require expensive imported machinery and use little local labour. For labour surplus countries, labour-intensive manufactured exports are more appropriate, and these can best be secured by appropriate macro policies, not by artificially upgrading product quality.

Product quality was also used as a justification for capital-intensive technology in industries intended exclusively for the domestic market, where tastes for such products among the elite had been developed initially through imports, while the import substitution strategy aimed to replicate the same product standards. Most of the cases cited above – including the maize milling and the laundry detergent – were of this type. In this case inappropriate consumption standards stem partly from unequal income distribution, which means that even in a poor society there is demand for western style products among the elite, while the mass of the people, for whom different products would be appropriate, lack purchasing power. In this context *indirect* policies, designed to improve income distribution (through taxes, subsidies, asset redistribution) would be necessary to achieve a radical change in product choices. Nonetheless, a considerable amount can be achieved by *direct* product policies, which currently often favour inappropriate products.

9. The World Bank Appraisal Report of this project stated that “*One fairly modern shoe factory presently produces leather and canvas shoes for the internal market. The output is of acceptable quality within Tanzania, but does not meet international standards. The new shoe factory ... would produce about 4 million pairs of shoes to international standards, primarily for export, but it is expected that a small part of the production will be sold internally*”. World Bank (1977), quoted in James (1987).

First, parastatal choices favour inappropriate product standards – e.g. in Tanzania in maize milling and laundry detergent, where more appropriate products and technologies could have been chosen, and would have readily found a market.

Secondly, governments frequently influence the nature of private sector investment decisions, when they process technology transfer agreements, license investors to use foreign exchange or borrow, or provide special tariff protection. In all these cases, the appropriateness of the product (and technology) should be taken into account in the decision-making criteria.

Thirdly, government determined product standards and regulations mostly require inappropriate products and technologies; for example, standards of hygiene in food processing lead to excessive standards for a small segment of the population (Green quoted in Wangwe & Bagachwa, 1988), while the majority of the people are unaffected since their food is produced in unregulated conditions. Building standards – including standards for brick and cement manufacture – also tend favour capital-intensive choices. These standards were devised for the multistory buildings used in large cities, and are quite unnecessary for the one or two story buildings prevalent in many developing countries. Appropriate standards and regulations are needed which contain standards of relevance to conditions and levels of living in poor societies.

Other policies influencing product choice are indirect taxes and subsidies, policies towards advertising and information dissemination, and policies towards product development.

f. Science, Technology and Dissemination

The studies showed few attempts to develop technology in an appropriate direction and for the small-scale sector. However, where such efforts were made they succeeded in creating competitive technology.

In sugar processing, development efforts in India improved the extraction rate of the open-pan sulphitation technique so that it became competitive with the large vacuum pan technique developed in the advanced countries (Kaplinsky, 1987). In Costa Rica, technology development of traditional lime production permitted cement to be replaced by lime (Pacheco Carranza, 1988). In Guatemala, applied research improved the productivity of wool production by small producers by improving genetic material (Gutierrez, 1988). In Kenya, development of improved cooking stoves (liner stoves), led to production by small private workshops. Production started in 1983 and by mid-1988 about 200,000 stoves had been sold (Hyman, 1988). The success of the IRRRI developed axial thresher has been mentioned earlier, with production of over 55,000 by 1984¹⁰ (Duff, 1987). These efforts were partially or entirely aid-funded. However,

¹⁰ .In the case of the axial flow thresher, it appeared that while it was an appropriate technology in Thailand, in the Philippines it displaced labour and worsened income distribution.

Berry & Sabot (1978) showed a high rate of innovation among small firms in Colombia, unassisted by public support.

These examples all indicate the potential of R&D for increasing productivity of small enterprises. But the examples are rather unusual. More typically, R&D efforts are concentrated in large firms, or on inappropriate technologies in public sector research institutions (see e.g. Beranek & Ranis, 1978; Crane, 1977). Thus Rudra (1987) indicated that R&D in agriculture in India had been mainly focused on rather high cost, input-intensive technologies.

In Bangladesh, despite the fact that *"upgrading the technological base of the economy has been a recurring theme in the successive five year plans.....little progress has so far been achieved"*, while the *"issue of technology for rural industry has been given a rather low priority....there is not and never has been a clear-cut policy stance in favour of appropriate technology for rural industries"* (Ahmad, 1988).

In general, in the countries covered, technology policies do not systematically support appropriate technologies. Appropriate technologies tend to emerge only as a result of special efforts, usually inspired by outside funding bodies. This is partly due to the institutional and reward structure of the science and technology organizations, partly to the political economy pressures to which they, like other bodies, are subject, and partly reflects the general environment favouring the development and use of inappropriate technology.

The legal system also appears either not to promote local technological development at all, or to be supportive of only the more sophisticated technologies. In Kenya, for example, patents are still registered in London, which would only occur for the more sophisticated technologies – generally only those developed by multinational corporations. None of the countries studied in this project had the "utility" system adopted in Japan, which gives legal protection to simple technologies.

Technology dissemination also presents an obstacle to the transfer of appropriate technology to producers. Rural enterprises, especially, have very limited access to technological information.

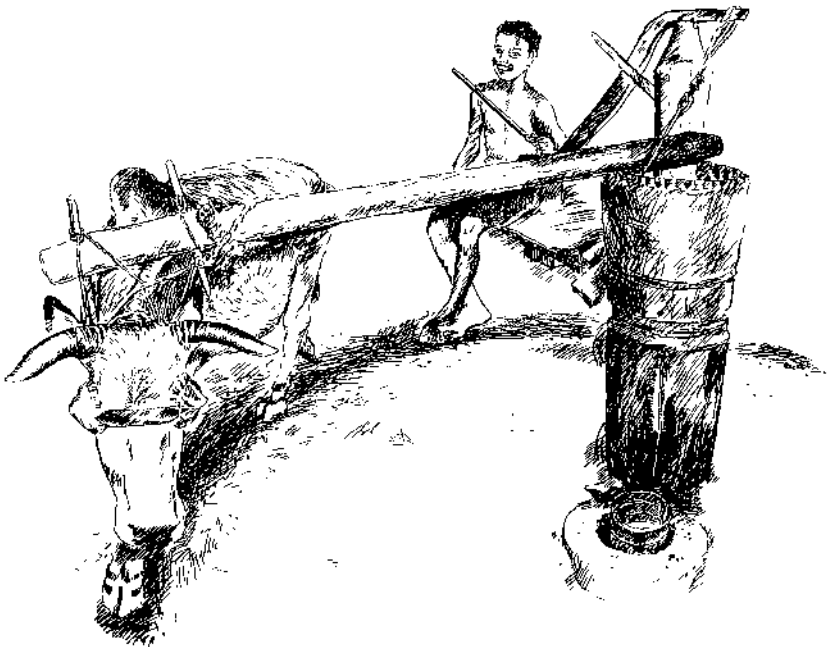
g. Rural Linkages

The comparison between Taiwan and the Philippines indicated the type of policies likely to favour rural linkages (Ranis & Stewart, 1987). While both countries exhibited significant rural linkages, Taiwanese rural industry grew much faster than that of the Philippines. The first requirement for a dynamic rural sector is a sustained growth in agricultural output. Consequently, policies which favour agricultural growth - including both macro and sectoral policies - are likely to promote rural linkages. The Latin American case studies revealed many instances where the agricultural sector had

suffered from discriminatory macro policies, especially overvalued exchange rates. In some cases – e.g. Mexico – these had been partially offset by favourable sectoral policies (subsidies to fertilizers, subsidised credit), but for the most part these tended to promote mechanization and support large farmers the most. The linkage studies showed that the nature of agricultural growth was also relevant to the size and nature of rural linkages; more labour-intensive farming tended to involve larger local consumption linkages; smaller farms – as in Taiwan – used simpler machines which were more often produced locally in small enterprises. Consequently, policies such as land reform and credit reform, which favour small farms, would tend to promote rural linkages. The institutional environment facing rural enterprises was also found to be important. In Taiwan, rural infrastructure – roads, electricity, and water – is much more abundant than in the Philippines, while rural credit institutions ensure access to credit for small enterprises. For example, in 1975, 26.5% of rural households in the Philippines had electricity compared with almost total coverage of Taiwanese rural households.

h. Parastatals

Parastatals were shown to take inappropriate technology decisions in almost all their investment decisions in Kenya and Tanzania (see James, 1987). As noted above, James attributed this to their bureaucratic objectives. The non-competitive environ-



The nature of agricultural growth is relevant to rural linkages.

ment in which they operated plus the government's willingness to finance their deficits indefinitely made it possible for them to take what were mostly uneconomic decisions. Reform of the operations of parastatals could therefore be an important element in a policy for appropriate technology.

i. *Aid*

Most of the evidence showed aid donors financing inappropriate technologies - large-scale and capital-intensive. Examples include a rice mill and tractorisation programme in the Philippines, sugar processing in Kenya, inappropriate agricultural investments in India, irrigation investment in Bangladesh and a textile mill in Tanzania. While there were exceptions – for example, UNICEF helped finance some of the Mostis and ATI financed a number of small-scale projects in Latin America – the balance was clearly towards inappropriate technologies. According to Wangwe & Bagachwa (1988): “*Foreign assistance has encouraged the parastatal sector to continue to invest in new large-scale, capital and import intensive plants and machinery, despite prevalence of excess capacity in existing plants*”.

The reasons for this bias in aid include bureaucratic procedures in the aid agencies which make it easier to disburse large amounts of money in a few large projects than many small projects, the practice of tying aid to capital costs and to donor industries, and the use of donor consultants, which almost invariably recommend technology from their own country.

j. *Administrative Procedures*

Centralised forms of government appeared to work against appropriate technology, favouring the large-scale and the urban, as we have seen in terms of allocation of credit and of foreign exchange, and also in the allocation of infrastructural investment. Decentralization of the government machine, especially in relation to expenditure decisions, would assist in the development of rural enterprise, particularly if NGOs were involved to help in administration and monitoring.

4. Macro and Meso Policies for Appropriate Technology

4.1. *Macro and Meso Policies*

Many of the macro and meso policies in effect have tended to favour inappropriate technology, as indicated in the previous section. Drawing on that discussion, this section will briefly summarise the changes needed to eliminate this bias, outlining the nature of macro and meso policies that would be supportive of the small-scale sector and appropriate technology.

a. *Taxation and Investment Promotion*

Schemes for the special promotion of investment, involving subsidies, special credit allocations, and tax allowances to a few large firms should be abolished.

b. Credit

Subsidised credit to a limited number of large or small-scale firms should be stopped. Rural credit institutions should be established to ensure physical access to credit in the rural areas. New credit procedures should be introduced for collateral and monitoring (as in the Grameen Bank, where groups of villagers act as collateral for one another) so as to help small enterprises, which lack conventional collateral, to get access to loans at reasonable rates of interest. It may be desirable to require the major financial institutions to reserve a proportion of their loans for small enterprises. This may be needed as a transitional measure while new procedures for lending successfully to the small-scale sector are developed and tried out. The proportion should be fixed in the light of the circumstances of the particular country.

c. International Trade

Exchange rates should be brought nearer to a market determined level, so as to avoid excessive discrimination against the agricultural sector and against exports. Tariffs should be reformed so that capital goods do not receive specially favourable treatment. Capital goods for the small-scale sector and for the large-scale sector should be taxed at the same rate. Systems of allocating foreign exchange by administrative means should be reformed to ensure that the small-scale sector receives an adequate share of the foreign exchange. This may be achieved by a move to a market system of allocating foreign exchange, combined with a requirement that a certain proportion of the foreign exchange is received by the small-scale sector.

d. Labour Markets

Policies which raise wages and restrict hours in the formal sector, while leaving working conditions untouched in the rest of the economy should be avoided. Policies towards labour market conditions should be devised which could reasonably be applied and enforced throughout the economy, and which do not excessively increase the price of labour.

e. Products Policies

First, the idea of 'appropriate' products needs to be accepted as an important element in any technology policy, and development and promotion of appropriate products should then form part of science, technology and dissemination policies, investment appraisal among the parastatals, and in any vetting of multinational investments. Government standards should be designed to incorporate local needs, taking into account their technological implications, and not simply copied from advanced countries. Information services about appropriate products should be supported, and a tax on advertising be considered. Policies (taxes, employment policies, asset redistribution) which make income distribution more egalitarian will also assist by extending the market for appropriate products.

f. Science, Technology, Dissemination

Government financed science and technology institutions should be reformed so as to devote more of their resources to developing appropriate products and techniques. This would be promoted by

- making the development of appropriate products and techniques a specific requirement;
- promoting special institutions to develop small-scale and rural technologies;
- changing the system whereby R&D institutions are financed, so that more of their activities are supported by contracts with local firms;
- the encouragement of producer organizations among small enterprises which can exert pressure on research organizations, and possibly finance research.

A dissemination network for appropriate technologies needs to be established (see Reddy in Bhalla, 1979). Reform of the legal system is required to encourage local innovation in appropriate directions. This involves the establishment of a system of protecting 'utility' models.

g. Rural Linkages

Macro and sectoral policies to promote egalitarian agricultural growth include policies towards agricultural pricing, extension and infrastructure and land reform; development of rural infrastructure and institutions to support rural credit and technology dissemination.

h. Parastatals

Change the environment in which parastatals operate to a more competitive one (through greater competition, externally or domestically) so that they have to be more efficient in order to survive; reducing their special financial privileges; improving appraisal techniques and making appropriate technology an explicit element in appraisal; reducing the influence of Western finance on their decisions, by seeking alternative sources of finance including their own savings and other donors; generating new forms of public enterprise more likely to take appropriate decisions, e.g. more decentralised small firms and cooperatives.

i. Aid

Reduced aid tying; reduced tying to capital costs of projects; reduced project aid and greater sectoral aid; the use of local intermediary institutions to help dispense funds to small firms with less administrative cost; appropriate technology to be incorporated explicitly into project appraisal; use of developing country's consultancy firms; changing auditing and paperwork requirements to ease the problems of small disbursements to small firms.

j. Administration

More decentralization of the administrative machinery, especially with respect to

expenditure, where block grants to local authorities could replace centrally made project decisions.

k. *Education*

Development of facilities to provide simple technical, administrative and management skills needed for small-scale enterprises.

4.2. *Political Economy of Policies and Appropriate Technology*

One fundamental reason why these policies are not being adopted, lies in the political economy of the changes proposed. To a very large extent, policies that favour appropriate technology and small and micro enterprise tend to favour the low-income and relatively deprived (e.g. small farmers and the landless, the informal sector and the unemployed). Yet the policies which favour inappropriate technology tend to benefit the "haves" of society – the big businessmen, the bureaucrats, foreign technology suppliers, large farmers. Detailed investigation of the beneficiaries and losers from alternative policies showed that this was the case in almost every example – in the Philippines, in Bangladesh, in India, in Kenya, and Tanzania¹¹. Similar forces seemed to prevail, leading to the adoption of similar policies favouring inappropriate technology, in countries which were apparently very different: for example, socialist Tanzania and more capitalist Kenya; or aid dependent Bangladesh and more self-reliant India. Thus the forces of political economy are likely to present a very serious obstacle to the types of reforms identified above.

However, total pessimism regarding the possibility of adopting better policies is not warranted. In the first place, some elements of the policies were to be found in a number of countries. For example, in Bangladesh the Grameen Bank has succeeded in lending to those without assets, with a very low default rate. The Self-Employed Women's Association has also been successful in India. The degree of exchange rate overvaluation has differed sharply among countries, and also in the same country over time. For example, the Philippines greatly reduced the degree of overvaluation in the 1970s and Tanzania has done so in the 1980s. These examples show that the possibility of policy reform cannot be ruled out because of forces of political economy.

Secondly, careful analyses of the gainers and losers from different elements in the policy package show that the type of political obstacles to be faced are likely to differ according to the policy instrument. An example is presented for rural linkages in the Philippines (table 9). While some policies are highly confrontational, with the gainers making their gains at the direct expense of other (usually powerful) groups, other policies can confer gains for some without severe losses for others. Land redistribution is an example of the first, when in the short run all gains for the landless are likely to be

11. See the studies in Stewart, 1987, and section 3, for evidence.

Table 9: An example of a matrix of losers and gainers

Policy change	Policies within agriculture						Rural infra-structure	Forward Linkages
	Promote agriculture Prices/credit	Investment	Land reform	Credit/Mechanization	Crop competitiveness	Electricity/Transport		
Large landowners/farmers	++	++	---	--	0	++	0	
Small farmers	++	+++	++	++	++	++	0	
Landless labourers	++	++	+++	++	++	++	0	
Rural industrialists	++	++	++	++	++	+++	+++	++
Elite/cronies	-	-	--	-	0	0	--	
Urban workers	---	-	0	0	0	0	0	
Urban u/e, informal	---	-	0	0	0	0	0	
Aid donors	++	++	0	--	0	--	--	--
Foreign customers	0	0	--	--	0	0	--	--

+: small gain
 ++: medium gain
 +++: large gain
 -: small loss
 --: medium loss
 ---: large loss
 0: neutral

at the expense of the large landowners. Technology development is an example of the second. The development of a new efficient and appropriate technology can raise incomes for the poor without reducing incomes of the better off, even in the short run, and in the medium term both groups may gain.¹²

Thirdly, the balance of forces of political economy in a society may be changed. New organizations may empower the small producers, as they have in some of the Latin American cases cited. As time proceeds, economic success also breeds political power, so that a shift which initially helps the small-scale sector a little may generate cumulative political forces in its favour. Outside intervention can also influence decisions – e.g. through conditionality – but there has been a mixed record in terms of lasting achievements. However, foreign aid can be used to diminish or ease the short run costs of otherwise unpopular policies.¹³

Three main conclusions follow from the analysis of political economy. First, the policy package to be promoted should be selected in the light of the political situation and potential in the particular country, with less confrontational policies being promoted in contexts where other policies do not seem feasible. Secondly, there is a lot that can be done to increase the power of the impoverished – by organization and education. Thirdly, aid can be used to ease the short run costs of policy changes.

Conclusions

The major conclusion of this chapter is that effective support for the small-scale sector and for appropriate technology requires the formulation, introduction and implementation of macro and meso policies to create an environment which favours small-scale producers and the choice of appropriate technologies. In most developing countries many of the prevailing policies in fact do the opposite – leading to inappropriate decisions.

Changing the policy environment to favour appropriate technology should not only affect the choice of technology but also the direction of technical change. The latter is of critical importance because technical change determines the parameters of future choice. The relative efficiency of future small-scale technologies could be greatly increased if efforts to create new and improved technologies were systematically directed to this end, while the current backwardness of some small-scale and traditional technologies is largely a reflection of their neglect in research efforts. Such a

12. Specifically for them, but this type of hypothetical loss will be much less strongly than a direct loss of land or other assets.

13. One example was the use of generous US aid to ease the macro-policy transition in South Korea and Taiwan in the 1960s. Another was the use of British aid to finance land reform in Kenya after independence.

change in direction requires not only national action, which has been dealt with in this chapter, but also cooperative international efforts.

In many countries, there are specific policies to support small-scale industry - providing special credit and technology for a few small-scale firms. Such policies were in effect, for example, in Tanzania and in Zimbabwe. These policies have had very limited effects: they cover only few firms, and those that are specially supported in this way often turn out to be high cost and inefficient. This type of small-scale industry support policy is not likely to be effective so long as the macro and meso policy environment is generally hostile to the small-scale sector. It makes no sense to favour a few small firms with specially subsidised credit, while at the same time favouring the large-scale sector in terms of overall credit and foreign exchange allocation and government regulations. It needs to be recognised that policy to the small-scale sector must be formulated together with policy towards the large scale sector. In most countries, removing privileges enjoyed by the large scale would do much more for the small scale than the special schemes and regulations currently adopted.

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VI. The impact of classification on policy

by Michael Farbman and Alan Lessik¹

In the past ten years, as we have worked in the field of small-scale and micro enterprise development, all of us have spent a significant amount of time arguing over definitions in our work. How do you measure the size of an enterprise? By number of employees, assets, sales, location of workplace, or participation of family labour? Of what importance is it if a firm is in manufacturing, commerce, transport or other sectors? After all of the discussions that have taken place, we still find ourselves without any universal answers to our questions. Each person or organization has developed its own concept of small enterprise and works accordingly. It appears that despite the definitional differences, however, most of us still can recognize a small-scale enterprise when we see one. What then is the problem?

Obviously, there is differentiation in the field. Each enterprise has characteristics that make it different from its neighbour. Yet the human mind has a need to make order out of chaos. This need arises from the desire to understand and react to phenomena and eventually to influence them. We classify in order to simplify the multitude of choices; then, for analytical purposes, we use these classifications or models, rather than the existing, unordered reality.

However, our classifying of reality is not static. It changes as we gain further experience and understanding of the limitations of the models that we have constructed. As new data is accumulated, we are forced to alter our models or build new ones. For those of us involved in the field of economic development, our thinking has changed significantly over the past two decades as we looked at small-scale enterprises.

Originally (in the dark ages before the ILO studies in the 1960s and 1970s), with the exception of Staley and Morse and very few others, we saw nothing but an undifferentiated mass. When we discussed the major economic activities of developing countries, small-scale enterprise was relegated to the inconsequential activities of the poor. As time has passed, the activities that the poor have engaged in have not changed as

¹. The views and interpretations expressed in this paper are those of the authors and should not be attributed to the U.S. Agency for International Development.

much as our perception of those activities. Through the major research efforts of these past decades - such as the ILO/World Employment Programme, Michigan State University, and RSIE report - we have gained an increasingly broad and systematic understanding of the full dimensions and of the heterogeneity of this sector, and of its impacts on the economies of developing countries. The process of our intellectual development in this area in many ways has been one of using research and demonstration projects to enlighten ourselves in what was at least intuitively an interesting area for inquiry, gradually revealing an ever more complex landscape with far broader and deeper linkages into national economies, household survival strategies, and genuine broad-based economic growth than we had ever begun to imagine.

1. Classifying Approaches to Small and Micro Enterprise Development

These introductory comments are intended to point out that we venture into this discussion of classification with humility and a realistic appreciation for the usefulness and limitations of constructing models of the reality we are trying to study, and as donors, ultimately to affect. For whatever categories we may choose to use for analysing small and micro enterprises, we are bound to come up with exceptions. Moreover, with the acquisition of future knowledge we know we will wish just as certainly to repudiate whatever generalities we think we are "discovering" today.

The urgency of the need for a framework within which to classify and order our thinking about small- and micro-scale enterprise (SME) development derives from the diversity in the origins of our current interest in the subject. James Boomgard (1989) captures this diversity nicely:

"In the 1970s, while searching for alternative strategies to 'trickle-down' development with greater prospects for employment generation and far more equitable distribution of benefits, the experts began looking seriously at the potential of small-scale, labour intensive enterprises in both rural and urban areas. Small enterprise began to attract a growing amount of attention through a variety of approaches and with a variety of names: cottage industry, household industry, the informal sector, Z-goods, the intermediate sector, appropriate technology and technological choice, and rural non-farm employment to name but a few. The approaches were similar when compared to the orthodoxy of development economics at the time. They shared a common interest in equity, but differed in their emphasis on growth versus employment and on what could or should be done to realize their implied objectives. Nevertheless, all were affected by the fact that there was little concrete evidence to document either the development importance of small- and micro enterprises or the options for improving their performance through policies or programs".

A reflection of this diversity in the *why* of SME is the heterogeneity of the *what* of the SME sector, in terms of e.g. size, sub-sector, industry, location, technology level, linkages, or entrepreneurial content. As different as SMEs are from one another in all these respects, so must our approaches to promoting them - directly or indirectly - be differentiated.

In this chapter our goal is to outline a system of classification that will be useful for analysing and determining direct interventions and policy support for SME. The model we shall use, which breaks down micro- and small-scale enterprises into three categories, is based on ideas developed by Teszler (1989), as well as some new conceptual work being done under contract for USAID to generate a holistic profile of AID's worldwide small-scale and micro enterprise development programme (Boomgard et al., 1989).

In view of the diversity found in the SME sector described above, it is not surprising that donors have settled on a variety of approaches to promoting SMEs, have chosen to work with differing targets and subgroups, and have adopted numerous objectives for these projects. Collectively, the list of assistance options includes provision of:

- services to SMEs such as training or technical assistance;
- resources such as credit;
- capacity building among institutions that retail these services and resources;
- policy and administrative reform initiatives at both the sectoral and macro levels.

A particular project, however, attempts to deal with a narrower focus, responding to unique business needs and a particular resource and policy environment. The framework described below classifies three general approaches to SME development, differentiated essentially among only two criteria: developmental goals and target population. It is based on categorizing SMEs along a continuum of three categories:

- survival activities of the poorest;
- micro enterprises;
- small-scale enterprises.

Each will be discussed below, followed by the implications that they hold for direct interventions and policy support.

1.1. *Survival Activities of the Poorest*

The first category comprises persons commonly referred to as the poorest of the poor. These are people that are engaged in economic activities that provide the barest means of survival. They participate in very few productive activities, other than providing for some minimal means to keep themselves and their families alive. They occupy the extreme lower echelon of the informal sector where in many cases the only barrier to entry to this category is the marginality of the economic return for their efforts that would keep anyone with other choices from choosing this option. The income that



Pre-entrepreneurial, although involved in some form of economic activity.

they may earn is clearly not enough to provide for any investment in their families (human capital), homes or economic activities. This group might be called pre-entrepreneurial, although it is important to note that they are involved in some form of economic activity. Since few developing countries have social security systems that will provide a safety net of last resort under these people, they have to engage in some form of income-generating activities to survive. The under-employed, overly abundant hawkers and vendors of most developing countries, subsistence farmers and many women's household activities would fit in this category.

These people are kept out of the micro enterprise or otherwise more economically substantial sectors by a number of barriers to entry. These include: lack of skills, lack of experience or opportunity to gain experience, lack of financial resources, cultural or social barriers and norms, and lack of access to markets. In addition, this is the category in which will be concentrated a number of other people that Malcolm Harper (1988) noted are often excluded from the economic mainstream in a given country, including, e.g., refugees, the disabled, ex-offenders, women in some societies (simply because they are female, apart from other economic characteristics), or minority groups.

1.2. *Micro enterprises*

The micro enterprise group forms the next classification. For our purposes, micro enterprises have the following characteristics: They employ roughly 10 or fewer full-

time workers. According to the Michigan State University studies (Liedholm & Mead, 1987),² they represent the largest percentage of employment in manufacturing in developing countries, from 42 to 90%. The largest category of micro enterprises, from 42 to 68%, are the family-based firms with a single worker. The smaller workshops are usually located in the home. The technology used is often traditional, based on widely existing technical knowledge, existing labour skills and existing raw materials supplies. Markets served typically are local.

The activities in this sector often correspond with the ILO version (rather than the Hernando de Soto version; 1989) of the informal sector, although they are normally unregistered and seldom pay taxes or are regulated. Micro enterprises are found extensively in rural settings, accounting for over fifty percent of rural manufacturing employment in many developing countries. In urban areas micro enterprises are equally common, and frequently account for the majority of employment in the retailing, services and transportation sectors.

The threshold downward from micro enterprise to survival is very permeable to the smallest and least economically capable members of this category. Bad economic times, family illness and death, or business failure, may bring a household quickly back to the survival sector. The barrier to the small-scale enterprise category is more enduring. The barriers to entry here are the difficulties in amassing the particular resources necessary; human capital, financial capital, market access, technology and overall business experience, that are needed to operate a slightly larger, more dynamic business.

1.3. *Small-Scale Enterprises*

The final category for this discussion is that of small-scale enterprises (SSEs). SSEs are defined as businesses with roughly ten to fifty workers. Their contribution to employment in manufacturing is generally smaller than micro enterprises, from 1 to 26%. Since these are larger firms, they depend more on hired workers who labour in workshops located away from the owner's home. More often small enterprises use some non-traditional or 'modern' technology in some aspect of the transformation process. The products and services may range from simple to complex and similarly span a range of consumer types. The marketing patterns may be somewhat more complex, reflecting innovation in raw material procurement or in output sales.

Small-scale enterprises may be more economically efficient than micro enterprises. Liedholm & Mead (1987) report that a direct relationship exists in some manufacturing industries between firm size and efficiency when firms of under 50 workers are compared. Returns per hour are lowest for one person firms in selected industries in most countries they reported on. Within the small-scale enterprise sector, these returns consistently rise as the number of workers increases.

2. Data references elsewhere in this section are from the same source.

Small-scale enterprises are often viewed as being either formal or, more likely, on the margin of the formal sector. They may pay some taxes or be registered with the municipality. With increased size, they become more obvious, both to customers and suppliers and to government. Small-scale enterprises tend to be more urban-based than rural.

In the case of the small-scale enterprise category, the threshold between it and the micro enterprise category may be somewhat fluid, particularly once an entrepreneur gains experience. Downturns in the economy may cause reductions in firm size, growth and profitability, but since the entrepreneur is not perched as closely to the edge as those in the micro enterprise sector, the business is likely to have more resources to bounce back. Growth past the upper threshold requires an accumulation of resources as well as the appropriate incentives for business expansion. This point will be discussed in more detail later in this chapter.

The three disaggregated categories of the low end of the enterprise continuum described above of course will contain some overlaps. Similarly, this classification also oversimplifies reality to an extent, and other factors may play an important role in different settings. These include: rural or urban location, fundamental economic, institutional and cultural differences within and across countries, and sectoral or sub-sectoral differences. However, for the purposes of this chapter, these three categories possess sufficient precision and uniqueness to sustain the basic points we wish to make. The next sections discuss the different strategies one would use in direct interventions and policy support based on these categories.

2. Direct Interventions

The purposes for making direct interventions to SMEs may run the gamut from basic employment and income generation, to enhancing business access to markets and technologies, to improving overall business productivity and efficiency and contribution to economic growth and national development. Importantly, one often observes in donor projects the objective of helping enterprises graduate from one class to another.

While this objective may be a good one - it is arguably one of the bases on which to build a sustainable economic growth dynamic - in reality we are learning that systematically and willfully fostering graduation is much more difficult to accomplish than we first hoped. In fact the whole issue of limits to transition capability between the classes identified above will be seen to be the ultimate determinant and constraint on donor options for intervening in the SME development process.

Viewed separately, each of the three categories of enterprise activity suggests its own particular approach for intervention. Using Boomgard's terminology, the survival

sector may be assisted by a community development approach; the micro enterprise subset may profit most from a marginalist or incrementalist approach; and small-scale enterprise needs a proper business development approach. Differentiation into these three approaches will give us a means for clarifying much of the discussion that takes place regarding the right way to assist the various distinct categories comprising this sector, and, with luck, might even be useful for defining limits and providing direction for project and programme design.

2.1. *Community Development Approach*

The goal of the community development approach is poverty alleviation and community growth. It is concerned with issues of broad social and economic development, usually within a specific locale or class within a society. Given the survival level of the participants, income generation in general – rather than employment or productivity growth – is a key focus in dealing with this group's economic needs.

Generally, community development approaches comprise integrated programmes of social infrastructure development, credit, low-level technical assistance, and educational inputs (such as literacy and numeracy training). Much of the emphasis is on community projects that will benefit larger numbers of the population. Other components of these programmes may include efforts specifically addressed to meeting basic human need requirements.

The income generation aspects of the community development approach may take several forms. Since many of the participants are considered pre-entrepreneurial, they are often given specialized training in job skills. In addition, some form of cooperative or group enterprise formation is often part of the programme. However, as Jeffrey Ashe has pointed out, these types of enterprises are the most difficult to develop and the most costly to maintain in the long run (Ashe, 1985). They have grave implications for donors in terms of recurrent cost finance requirements.

Enterprise development in this context seems to be more natural when it is focused on the experiences and resources that exist in the community. Many successful targeted women's projects often start with animal raising or food processing activities. These projects build on the margin of existing experience of the participants. Since they are smaller and incremental they are less apt to run into marketing and coordination problems that larger cooperative projects often face. However, depending on the locale, even these projects sooner rather than later often begin to encounter diminishing returns as market access and raw materials become constrained or new entries compete away possible economic surpluses.

Community development programmes usually have high costs per participant and, if run by outside PVOs or NGOs are rarely self-sustaining. Some local grassroots approaches, such as the Sarvodaya movement in Sri Lanka, or the Bhoomi Sena in

India's hill country, have been able to show significant accomplishments at lower unit cost levels. The credit programme of the Grameen Bank of Bangladesh uses what they call a social development approach to their lending. They combine small initial loans (US\$ 1 to US\$ 10) with simple community development education (the so-called fifteen rules). In this way, they have reached women in the survival category quite effectively and in what appears to be a sustainable manner.

Graduation to running a micro enterprise in some of these interventions is often an unstated goal. In others, such as the Grameen Bank Programme, it is positively eschewed. However, given the costs involved in running a community development programme and given the often marginal human capital, market and natural resource environments where they tend to be required, few such enterprises are ever seen to develop. The results, while not insubstantial in social and economic terms for the participants, are often harder to detect in broader economic or business development terms.

2.2. *Marginalist/Incrementalist Approach*

The marginalist/incrementalist approach is more focused than the community development approach on the particular needs of the micro enterprises. The overall goals of such an approach are to increase incomes and maintain jobs in micro enterprises. In some cases there may be an expectation of increases in employment through new job creation, although this may be downplayed in some programmes in relation to job maintenance.

There has been a variety of approaches developed for micro enterprise assistance over the years. These approaches range from training and technical assistance alone on one end to credit alone on the other, with any number of combinations of the two (plus supporting institutional capacity-building) in between.

Owing to the costliness of technical assistance and training, and because of difficulties in demonstrating cost-effectiveness of such expenditures, much of the current thinking on micro enterprise development seems to favour the so-called *minimalist* approach. In a minimalist programme — such as the Indonesian BKK or Accion/AITEC's programmes throughout Latin America — the emphasis is predominantly on credit, both through group and individual loans. In these programmes, short-term working capital loans of US\$ 50 to US\$ 1500 are given at market interest rates. Since the problem for the micro entrepreneur is more often access to capital rather than cost of capital, the interest rates in these programmes are set at market rates or higher. This helps to guarantee the financial sustainability of the programme.

The Accion model uses group lending, solidarity groups and similar peer pressure mechanisms as the means to guarantee repayment of the loan funds. These peer groups develop their own working procedures, leadership and programmes. Group lending is

more common at the lower income end of the micro enterprise category and often incorporates some of the characteristics of the community development approach.

For businesses that are more well-developed and which employ other than family members or more than one or two employees, these projects frequently disburse credit to micro entrepreneurs on their own (i.e. outside a group context), usually on the strength of a character-based rather than collateralized guarantee. This characteristic, shared with the business development approach, concentrates efforts on individuals, and attempts to respond to the needs of the business, rather than to those of a class of people. However, unlike in the business development approach, most lending, even among more viable micro enterprises, is for working capital rather than lending for investment in fixed plant and equipment.

Graduation from micro enterprise status to the small enterprise level seldom is seen to occur as a result of project effort; rather it appears to result more out of natural selection. Nevertheless, within their own "incrementalist" terms of reference, many firms have been shepherded through a limited growth process, have developed an increased ability to handle larger and larger loan sizes, and have also shown a continued maintenance of jobs and some small increases in new jobs. Still, since comparative data are not kept on unassisted firms, and since some assisted firms (as may be expected) do not prosper along with the best performers, and most importantly, since graduation through the threshold into the dynamic small business category seems so rare, one must be circumspect in judging the overall cost-effectiveness of this approach.

2.3. Business Development Approach

The business development approach is perhaps the oldest one used in small enterprise development. Its goal is to increase employment generation and income growth through promoting businesses into a sustainable growth dynamic. On an individual basis, it hopes ultimately to graduate clients to the formal sector and the institutions that exist there.

More so than the micro enterprise approach, the business development approach provides its beneficiaries a concentrated, individualized package of technical assistance, training and credit resources. The national development foundation approach in Latin America and the Caribbean offers credit of up to US\$ 5,000 to US\$ 6,000 along with classroom training in business-related skills - accounting, marketing, technology assessment and business management. Oftentimes, individualized technical assistance is available to overcome particular problems of that enterprise or subsector of enterprises.

Credit is a more important component of business development programmes that deal with firms closer to the micro enterprise end of the scale. As the firms gain more experience with using larger amounts of credit and develop a credit history, many are

able to access commercial credit from the formal banking system. In Honduras, local banks with surplus liquidity in search of new business borrowers contacted the small business development organizations for referrals of potential customers. Once a business hits this size, it is often to its advantage to use commercial credit because the terms frequently are longer and interest rates lower.

The Carvajal Foundation offers only limited amounts of credit and instead focuses on a comprehensive thirteen-week training and follow-up technical assistance programme. In working with larger small and micro enterprises, their approach features training in business management skills as the key to creating successful enterprises. The follow-up, individualized technical assistance, helps the entrepreneur in the workplace and deals with the specific problems that he or she is confronting.

At the larger end of the small business development spectrum, programmes practice a greater degree of selectivity in choice of clients. Feasibility proposals and other types of studies and references often are prerequisites for obtaining loans. These programmes have greater costs per participant which often are justified by the potential of greater benefits. However, due to the high costs per beneficiary, ultimately fewer firms can be assisted in a given year and programme sustainability can be threatened by a relatively low number of defaults on the credit side.

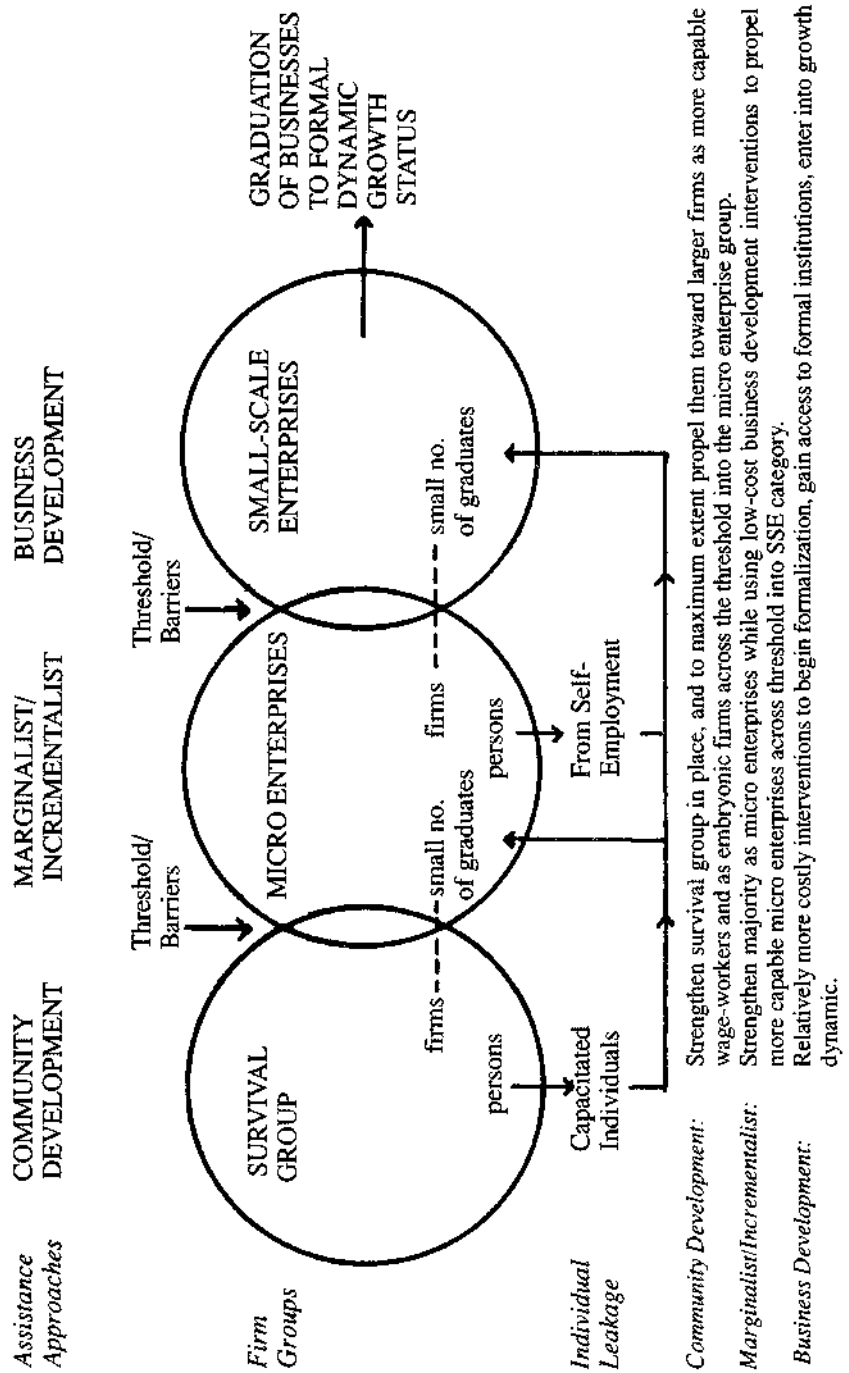
Like other SME development programmes, those business development programmes that focus on one or two objectives and attempt to use market forces rather than fight them off appear to be more successful. The industrial estates concept is one example of too comprehensive an approach which tends to have a high failure rate and is unsustainable in the long run. The Carvajal programme, which charges participants for the majority of the cost of the training and technical assistance that they receive, is more sustainable.

2.4. *Integration of the Framework*

Figure 1 illustrates the relationships among the above three size categories. The three small circles represent respectively the survival, the micro enterprise and the small-scale enterprise categories. What is most important to note is that while there exists some overlap at the margins of these three subgroups - as explained above - for the most part the boundaries of each circle where it intersects its neighbour represent thresholds which are protected by barriers to entry. Some project approaches are specifically designed to bridge these barriers, as in the case of attempting to make community or social investments among survival group members in order for them to develop into micro-entrepreneurs or to *leak* out of the system as skilled employees of larger businesses, or attempting to graduate SSEs into the dynamic, growth-oriented formal sector.

On the other hand, the marginalist approach seeks primarily to improve performance and efficiency of micro enterprises as micro enterprises, which leads to the often-seen

Figure 1: Classification of Enterprise Development Approaches



preference for sustaining assistance such as credit. Credit on its own can foster growth up to frontiers bounded by more expensive interventions such as new technology acquisition, professionalism of management and new market development - inputs for the most part best allocated to SSEs potentially possessing relatively more dynamism.

As indicated above, the boundaries/thresholds are generally only semi-permeable; it is much easier to fall back to a previous category than it is to grow out of any particular one. Especially given the precariousness of life in the survival and micro enterprise groups, one would expect to find more fluidity in these thresholds. As the enterprise grows and is more able to exist as an entity apart from the household economy, it gains further stability. Even so, all small-scale enterprises (as many larger firms) are dependent upon the entrepreneur or manager, and the fate and future of the enterprise rests upon the serendipity of this person's health, wisdom and commercial or market instincts.

Different types and combinations of institutions are called upon to deliver the different service and other support packages corresponding to these three approaches. Donor projects which provide resources, strengthen intermediary institutions concerned with these respective target groups, and address policy and other environmental constraints (see below) will likewise differ in accordance with the different objectives and group needs suggested by the framework.

3. Recent Findings on Growth and Barriers to Entry

Much of our knowledge about micro- and small-scale enterprise comes from static, cross-sectional studies of the sector. Although much valuable information has been gained from these studies, we know little about the crucial birth, transitional, and death processes of enterprises that define the dynamic dimensions of life in this sector. A recent study from Michigan State University, conducted by Liedholm & Parker (1988), has given us some first pieces of documentation and some new insights in this area.

Liedholm's survey and analytic work on non-farm small-scale manufacturing has covered the full spectrum of enterprise, from self-employed/family/cottage industry on up to traditional SSEs and occasionally medium-scale industries. In an analysis of historical micro-data on individual firm growth, which heretofore has not been explored in the Michigan State University survey data, Liedholm and Parker have determined that few enterprises naturally grew from micro to small to medium. For example, as table 10 indicates, the large majority of micro enterprises in African countries for which data are available remain in that size category. Relatively few are observed to graduate across the thresholds illustrated in figure 1. Similarly, the majority of small-scale and medium-sized firms do not grow out of a "seed-bed" of yet

Table 10: *Origins of Modern Small and Medium Private Manufacturing Firms (with 11 employees or more)*

Region/ Country	Year	No. of Firms in Sample	% Originated as Micro (< 10 employees)	% Beginning with 11 or > employees
<i>Africa</i>				
Nigeria	1965	64	43.7	56.3
Sierra Leone	1975	42	30.1	69.9
Rwanda	1987	28	10.7	89.3
Botswana	1982	20	20.0	80.0
<i>Asia</i>				
India	1979	244	65.6	34.4
Philippines	1978	47	48.9	51.1

Source: Adapted from Liedholm & Parker (1988).

smaller firms, but tend to *originate* as larger firms. On the other hand, in India, with its longer history of proactive support for small-scale enterprise development and with a far more robust and dynamic economy than is found in most African countries, graduation was seen to be a far more frequent phenomenon.

The likelihood of growth also varied according to locale. In Sierra Leone growth within class - not to mention across class-size thresholds - was observed to be distinctly less frequent in towns under 20,000 people than it was in towns greater than 20,000. This pattern of greater enterprise growth as one moves from rural to urban areas appears to be related to the possibilities each environment offers. Barriers to growth are most severe in rural areas and resources increasingly become somewhat more available in urban areas. Our observation that the survival category is generally located in rural areas, - while on the other end of the continuum, small-scale enterprises are found in urban areas - is reinforced by this finding.

Growth from micro- to small-scale enterprise also apparently depends on the type of business. Seventy percent of machine tools, printing and shoemaking firms in India that are presently small-scale grew from micro-sized firms. Other industries report smaller growth rates.

Finally, within the micro enterprise category, Liedholm and Parker report that in India, the larger micro enterprises (those with 6 to 10 workers) are more likely to grow than the smaller micro enterprises.



The majority of micro enterprises remain in the same size category.

4. Policy Support

Maximizing the enabling environment while minimizing elements of policy and administrative hostility to micro- and small-scale enterprise development have emerged over the past years as fundamental building blocks and indispensable complements to direct technical assistance for increasing growth and development options for the sector. However, the goals of policy support must be carefully crafted in order to assist those enterprises that need it without harming other enterprises. In short, leveling the playing field must be the objective while at the same time not introducing any equally ill-advised or counter-efficient preferences for SMEs.

Much is now known about biases that exist within the financial, economic, trade and regulatory frameworks that favour larger private and parastatal enterprises. However, in our enthusiasm for promoting SMEs we must be careful not to be instruments of the creation of new barriers to growth in other parts of the economy. In their assessment of the poor performance of the non-crony private sector in the Philippines, Biggs et al. (1987) talk about the phenomenon of the *missing middle*, i.e. the paucity of efficient, growth-oriented medium-scale enterprises. While there are many reasons for this distributional anomaly, some of the blame must be borne by policies that either favour small enterprises or otherwise inadvertently provide incentives to them to remain

small, even when other underlying economic forces and technical efficiency signals are militating in favour of growth.

This issue is explored widely throughout the modern literature on policies in relation to business development. For this chapter we wish to note at this point that the three small enterprise categories that we have been discussing each may have its own distinct policy set. As with the respective direct interventions that may be appropriate for the three categories, different policy regimes and approaches need to be developed to complement each. The next sections will discuss the policy implications that flow from the SME classification used in this chapter, focusing on aspects of the policy environment that are necessary for each, but which are also neutral with respect to the needs of the other sectors.

4.1. *Policies for the Survival Sector*

Policy options for the survival sector are broad-based and relatively non-specific. Essentially, those economic policies that encourage broad-based economic growth within a country are the policies that will affect this sector the most favourably. Only by increasing aggregate demand will the overall benefits be spread to this part of the economy.

Particularly in the rural areas, government policies that complement the community development approach will increase options. In most developing countries this will require policies that provide incentives to agriculture and which raise non-farm incomes and derivatively the demand for non-agricultural goods and services. Emphasis on policies that promote health care, education, infrastructure, transportation, and market development in rural areas are also likely to have positive results. Absent such a supportive economic and social environment, supply-side interventions directly focused on raising production or productivity in SMEs will be at best redistributive and more likely simply ineffective and non-sustainable.

In addition to general demand increases, urban-focused policies, such as shelter, transportation or decentralization, can similarly impact the urban survival sector, through opportunities for housing improvement, expanding markets for wage goods, and other *following* activities responding to the phenomena that accompany urbanization.

Finally, as a result of greater population demands, urban areas may experience scale or agglomeration economies which allow for lowering transactions costs in community economic development or pre-entrepreneurial assistance programmes. Upgrading of human resources complementary to generally supportive urban policy initiatives can create a *bootstrap* synergy which enables more opportunity for *graduation* into sustainable micro enterprises.

4.2. *Policies for Micro Enterprise Development*

According to Liedholm and Mead, expenditure elasticities of rural households for the products of small and micro enterprises are quite high. Thus, to the extent they in-

crease aggregate demand for products produced and available in rural markets, the policies that were discussed in the previous section will serve to increase incomes for micro entrepreneurs, their families and employees.

Trade policies also may have an important effect on this sector, mostly negative. Import duties and quotas are likely to distort internal demand. These policies often are put into place in order to protect certain large industries in a country with little regard for their effect on the smaller ones. In addition, import duties on consumer goods often penalize small producers which use such goods, purchased on dutiable secondary markets, while favouring larger businesses which import capital goods and raw materials duty-free for direct use.

Perhaps the greatest policy distortion that affects this group is overvaluation of currency. Overvaluation provides disincentives to domestic industries to produce because it makes foreign-produced goods cheaper. The negative impact at the margin on more fragile, and less import-intensive micro enterprises is relatively much greater than for larger businesses that have a means of offsetting this distortion. A floating exchange regime will eliminate this effect to the advantage of the more numerous smaller businesses which use fewer foreign capital goods or raw materials.

Another aspect of the policy and administrative environment that affects micro enterprises substantially, and which we have only recently begun to recognize fully, is the impact on all businesses - but particularly smaller ones - of registration requirements and other legal and property rights and procedures. Hernando de Soto (1989) has vividly documented for Perú the barriers placed in front of any business wishing to register and comply with the basic requirements of the law. In many (though not all) countries, regulations that permit the easier establishment of a business, that protect basic property rights and which deliver businesses from certain forms of governmentally-imposed insecurities would facilitate the entry, growth and maturation of even the smallest micro enterprises sustainable into the formal sector.

4.3. Policies for Small-Scale Enterprises

The policies that affect small-scale enterprises include many of those mentioned above plus others that more specifically relate to the growth dimension of SSEs. They generally fall into two groups: those policies that place penalties on, or inhibit graduation to the formal sector, and those policies that affect growth to medium-sized businesses.

Biggs, Grindle & Snodgrass (1988) note the preponderance of firms on the edge of small-scale formal status that appear not to grow. As reported in the previous section, Liedholm and Parker more recently noted that in many African countries one does not see the growth from micro- to small-scale that one sees in parts of Asia. Both sets of authors attribute the blame to "lumpy" penalties that prevent graduation to the formal sector. These penalties are the very high costs that constitute the barriers to entry of registration and legalization. These barriers may take the form of high marginal tax

rates and onerous registration requirements (*à la de Soto*), and the potentially dramatic financial impact of sudden adherence to minimum wage and labour laws. As long as the business was small and not recognized, it was not covered by the above constraints or it simply ignored them. For example, in the Philippines, the marginal tax rate for a small business that entered the formal sector for the first time was calculated to be at least 85% (Biggs, Grindle & Snodgrass, 1988).

The second category of policies of greatest concern to SSEs consists of those not necessarily related to the formal sector but which similarly affect the growth of businesses from small to medium size. Foremost are policies and laws designed to promote small enterprises by *favouring* them with special benefits and concessions such as tax exoneration, government procurement preferences, or exemption from export or import licensing. The penalty here, not just for the affected firms but for the economy as a whole, can be substantial, especially when firms perceive internal rewards for subordinating long-term vertical growth efficiencies to short-term pay-offs which accrue to them as a result of market distortions.

Finally, financial and economic policies that interfere with the performance of credit markets, otherwise misallocate scarce resources or provide interest rate subsidies, may adversely affect small-scale enterprises more than others. Since these enterprises must compete with larger, more powerful ones, policies that limit the availability of credit will affect them the most. Unlike micro enterprises whose needs are smaller and where formal credit plays a less important role, these firms cannot meet their credit needs through alternative means as easily. Therefore, when the crunch comes, they may be affected first.

Conclusions

The classification of small and micro-scale enterprises into the categories of survival, micro enterprise and small-scale enterprise has given us a method for differentiating key underlying characteristics which in turn suggest treatments appropriate for dealing with their needs, both through direct, supply-side interventions and indirectly through policy or regulatory reform. Division into these categories also implies that there are no right or wrong reasons for supporting a particular group. Rather there are merely different reasons for assisting each of these subgroups, and the objectives of the assistance must relate both to the real constraints experienced by businesses in these groups and the sustainability of the short-term benefits that donor resource transfers and other interventions often appear to stimulate.

The model that we have outlined also provides a means of differentiating those programmes which are designed to work within a category and those programmes designed to stimulate firms to cross the critical thresholds between categories. By utilizing this differentiation, donors have a greater analytical ability in matching their assistance strategies with the conditions in a particular time and place.

Given the appropriateness of matching strategies for assistance with needs and donor comparative advantage, this chapter has not prioritized between direct interventions and policy/environmental reform efforts. It is clear that the policies that are the most helpful are those macro-policies which raise overall levels of demand in the economy, and, at a sectoral level, those which serve to level the playing field, rather than creating new distortions which favour other particular groups. Policies of the latter type are particularly important when the objective is to assist small enterprises. These policies should not inadvertently preclude growth into larger, more efficient enterprises.

A final point that bears repeating is that graduation is difficult, particularly in countries with stagnant economies, and may occur rarely if firms are not assisted. Even then, sustainability of gains is not always assured. This finding sounds a cautious note concerning the prospects for our ability as donors to influence the growth and graduation rates of enterprises. At the least, more studies of small-scale enterprise dynamics are needed to confirm this conclusion as well as studies of the effectiveness of intervention programmes in helping to increase the natural success rates of enterprise growth across critical size thresholds.

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VII. Innovative financing systems

by Jacob Levitsky

The problem of how to provide finance for small enterprises has become a contentious issue, some argue against special credit lines as distorting the financial system and not really providing, in the long term, more finance for this sector. Others question whether access to credit from banks is really the biggest factor affecting the development of small enterprises. Of course, most small and micro enterprises, when asked, would say that shortage of finance is their major problem and the biggest constraint on development, but many studies have shown that this may not be the real situation. One is forced to ask if finance from formal institutions is really the major constraint to starting and expanding small enterprises that some have regarded. There is some evidence that management, technology and markets, may be at least as important as finance in many cases.

Certainly access to institutional finance is not a major constraint in "start-ups" of very small micro enterprises. In most developing countries, the capital needed to start such a micro business is not very large. In some African countries micro enterprises are started for less than US\$ 100, and US\$ 300-400 may be the maximum capital which in practice is generally used to start these entrepreneurial initiatives. Overwhelmingly, the entrepreneurs who start such a business with this small amount of capital are using funds obtained not from institutions, but from their own or family savings.

Even in more developed countries, studies have shown that most of the small enterprises with less than 2 workers were started with not more than US\$ 2000 to US\$ 3000 of capital, generally obtained from personal savings. A study in 1980 in Korea (Ho, 1980) found that of 1411 new enterprises started between 1971 and 1973 with only 5 to 9 workers, only 6% required more than US\$ 5000. Even in this middle income developing country, of 724 small enterprises that employed between 10 and 19 workers, only 3% needed more than US\$ 75,000. So that it is not surprising that even in larger small enterprises employing to 49 workers in Korea, only 8.8% had recourse to institutional finance of any sort when they were started.

The same situation seems to apply in most countries. Indeed, as table 11, referred to in the following subsections, shows, in 6 African countries studied in 1979, banks pro-

vided less than 1% of the initial investment, except for 10% in Ghana, which was the exception. In the table it is seen that own savings, or that of relatives, provided by far the largest proportion of the funds used. Question thus arises what the relative contribution is on formal financing systems in comparison to other types of financing.

1. Informal Credit Markets

Anand Chandavakar (1988) has studied the importance of informal credit markets in a number of countries and points out that these sources provided 24% of the total rural credit in Malaysia and about 37% in the Philippines as reported in 1972. By *informal credit markets*, Chandavakar includes money lenders, either professional or non-professional, some small unofficial private banking organizations, pawnshops and pawn brokers, and some merchants who may offer finance, sometimes together with another commercial function such as providing materials or selling the products of the borrower. Table 11 seems to show that in most *start-ups*, money lenders or informal credit markets do not play a major role although there is reason to believe that when these enterprises are in operation, there is often recourse to these sources for working capital.

It may be that these informal credit suppliers have tended to have been neglected by those who studied the problem of finance for small enterprises. Yet there is a rich diversity in these informal financial arrangements both in the type of service provided

Table 11: Sources of Finance for Initial Investments by Small Enterprises in Some African Countries
(Percentage of Initial Investment by Source)

	Nigeria		Ghana	Tanzania	Sierra Leone	Uganda
	Western	Ibadan Region				
Own Savings	97.7	59.0	-	78.0	60.2	77.5
Relatives	1.9	35.0	90.8	15.0	19.5	-
Banks	0.02	-	0.8	1.0	0.9	0.8
Government	-	2.0	-	1.0	-	-
Money Lenders	0.03	-	-	-	0.9	-
Other	-	4.0	-	6.0	18.3	21.7

Source: Cited in J. Page, *Small Enterprises in African Development: A Survey*, World Bank Working Paper, 1979.

and the terms and costs of their provision, which vary considerably from country to country.

There are, however, two basic characteristics of this group. The first, often forgotten, is that these informal financial intermediaries are tolerated and accepted locally, otherwise they would not be able to continue operating. Second, these services are outside of the control of the monetary authority of the banking system. This affords both strength and weakness to the informal credit markets; the freedom from regulation allows these informal money lenders to operate with greater flexibility, but on the other hand, they are denied legal recourse to enforce a loan contract. Many have tended to stress the darker side of the informal credit markets: the usurious nature of the money lenders and landlords who make these loans and their occasional recourse to violence to ensure repayment. Although such do exist, these features are probably less common than the situation where these informal lenders are well accepted in their communities. Individuals borrow and repay loans from these lenders primarily because they can obtain the funds quickly and without formalities, and because they see the prospect of having access to more finance from the same source in the future.

Those who borrow from the informal credit markets, usually small businesses or small-holders in agriculture, need short-term credit to cover immediate expenditures. They very often cannot provide the guarantee or collateral that would be required by an institution, and often they have neither the documentation, nor are prepared to devote the time to undergo the costs and inconvenience of a loan transaction with a formal financial institution. For this reason, the informal lender is an attractive source and although the relationship is basically one of trust, there is usually a binding commitment on the part of the lender and borrower to complete the transaction satisfactorily.

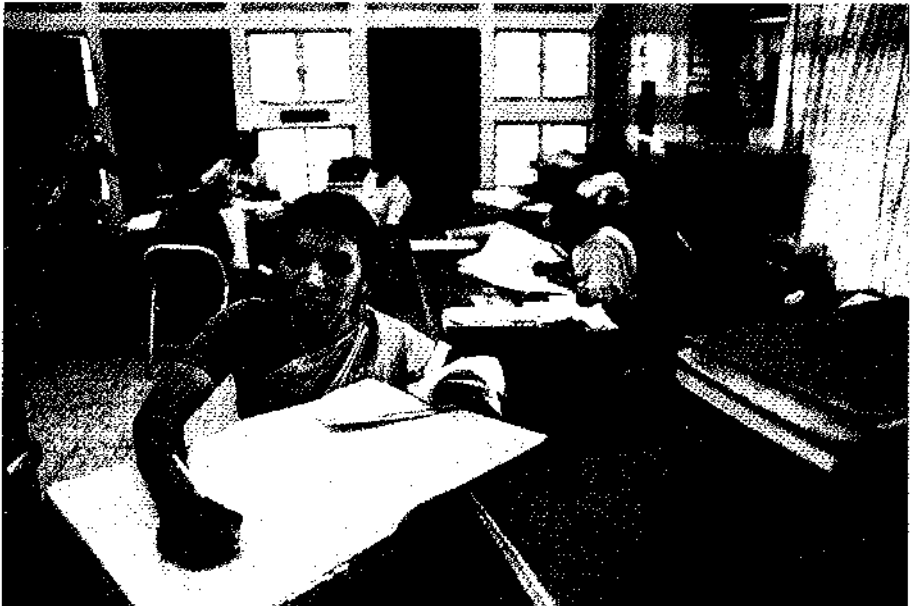
Of course not all informal lenders operate purely on trust. The pawn broker, as an example, does take some assets which, if the loan is not repaid, can be used to recover part, or all, of his loss. Most informal moneylenders use their own funds and most of this lending is done to long-term clients. Interest rates on such loans are often high, sometimes attacked as extortionate, but on the other hand, the loans are disbursed with little delay or demand for documentation and the transaction costs are low both for the lender and the borrower. As these transactions are usually short-term, the total amount of interest does not appear so high to the borrower who may feel he is making up the interest payment by having access to the money quickly.

2. Informal Savings and Credit Groups

Not all types of informal credit markets depend on the individual lender: some involve associations. Group savings associations are in reality informal groups that aim to

conduct a form of financial intermediation for their members, and they usually operate both as savings and credit institutions. Such informal associations are widespread in developing countries, especially in Africa (Seibel, 1988). A well known form of such informal credit groups is the Rotating Savings and Credit Association (ROSCA), wherein members agree to pool resources by making periodic payments into a fund which then rotates among members and the total is paid out to each member in turn. The form of pay-out to individual members for ROSCA may differ and, in some situations, those who have an immediate need for money may be given preference. Transaction costs in these types of services are low and these ROSCAs are able to reduce risk by only selecting members who have confidence in each other since in the final analysis all of the members are really guaranteeing each other.

ROSCAs really exist as a way to stimulate savings among group members. In most cases the amounts saved and disbursed in ROSCAs are not large, and most of the credit is short-term. More and more it has been found that most organizations that have been successful in offering microcredits on a larger scale - Grameen bank in Bangladesh, SEWA bank in India, KUPEDES in Indonesia - have combined mobilizing savings with providing credits. The credits so provided may be used for consumer items but they can and have been used for business development. The ROSCA is an example of an informal credit institution which may offer possibilities for some link-



Most successful organizations have combined savings with credit.

age with the formal financial system. The combining of savings and credit has the attraction of giving to borrowers a stake in seeing that loans are recovered and also provides a way for lending organizations to become less dependent on external donor sources.

The informal credit markets cannot, of course, meet all the financial needs of the micro enterprise sector, let alone the requirements of businesses that become larger and more formalized, and especially not for term lending for fixed asset investments. In practice, it is difficult to assess what part these informal credit services really play in meeting the short-term needs for finance of the small enterprise or micro enterprise groups. However rejecting all these types of intermediaries in favour of credit programmes through formal finance institutions or through NGOs, may mean that those who make policies have denied themselves the benefit of the experience of these groups in providing financial services.

3. Transaction Costs

As has been stated, the financial needs of most small enterprises in the early stages of operation, and sometimes for even longer, are not usually met from the formal financial system, primarily because, as is well known, the commercial banks are highly reluctant to lend to this group of borrowers. Lending to small enterprises is perceived as risky, but probably most important of all, the transaction costs of such lending are very high in relation to the amounts lent.

Transaction costs are high when a small enterprise borrows, not only for the lender but also for the borrowers. These transaction costs for the borrower may include direct cash payments charged for a loan application, the costs of travelling to and from the bank, expenses that may be incurred in preparing documentation, feasibility studies, obtaining copies of land titles, mortgage documents, as well as the not insignificant opportunity costs of time that the borrower must devote to these activities. It would be more correct therefore to regard the total cost of a loan for a small and micro borrower as not just the effective interest rate, but also take into account all these additional transaction costs.

There are, of course, considerable transaction costs for the lender incurred primarily in the screening process and the assessment of the risk involved in deciding upon a loan to this type of borrower.

The lenders have to devote a significant amount of time in obtaining whatever rudimentary information and data they can on the operations of the borrower, to say nothing of the time involved in obtaining and assessing the type of guarantees or collateral - for example obtaining information on titles to land and property - that may

be offered. Collateral requirements are taken largely by lenders to reduce risk, but they also raise the transaction costs of giving such loans. It is not surprising that even where commercial banks are prepared to lend to small enterprises, they aim to cover the high transaction costs through special payments for loan applications, additional commissions, compensating deposits, collection of interest in advance, all of which is more of a way to raise the effective rate of interest to cover high transactions cost, than to cover the higher risk perceived in such lending.

4. Formal Institution Lending¹

Much has been said and written about the reluctance of commercial banks to lend to small enterprises. There are real risks in lending to smaller enterprises, not because the borrowers are inherently dishonest, but because of the instability and high mortality of small businesses, mostly due to factors beyond the control of the entrepreneur-manager. Despite this situation, in a number of countries commercial banks have been prepared to become involved in credit lines for small enterprises such as those financed by the World Bank. Banks are motivated to do this by seeking a new clientele rather than by the profitability envisaged in these operations. It has been shown in several instances that where commercial banks have become involved in lending to small enterprises, even though in a cautious and prudent fashion, and usually through advantageous refinancing arrangements that do not require the use of their own resources but rather funds made available at relatively low cost, they do not expect to obtain the same financial returns on these loans as in lending to larger enterprises. Rather, they hope to obtain new clients who, if they prosper and grow, may become important borrowers and users of the bank's services in the future.

It would be well to remember, however, that although commercial banks have many distinct advantages as intermediaries for small enterprise lending, they inevitably will have a greater concern for maximizing profitability than possibly development banks or promotional agencies, and they cannot be expected to be over-concerned with the development aspects of the borrower and the loans given out.²

As long as the loans are repaid there is little concern by these commercial banks in the use of the funds borrowed, although effective controls can be introduced to ensure that the loans are used only for borrowers and projects considered eligible, but the limita-

1. For a more complete review of commercial and development bank lending to small enterprises, see J. Levitsky (1988), *Financing of Small and Medium Scale Enterprises*, UNIDO, Vienna.

2. For this reason it has been found that development banks, despite their poor performances generally as lenders to small-scale enterprises, should be encouraged to participate to a limited extent in refinancing schemes because of their greater concern for the contribution to national economic goals of the projects financed.

tion of commercial banks as promoters of small industries development should still be recognized.

In the final analysis, it may be that commercial banks can never really become major lenders for individual smaller enterprises, even less for micro enterprises, because they base lending decisions on documentation, such as balance sheets, income statements and feasibility studies, and they require documented physical assets that can be used as collateral, all of which many small enterprises and certainly micro enterprises do not have.

5. Interest Rates

Informal lenders base their lending decisions not on documentation but on personal and social interactions not directly related to the loan itself but rather to the person borrowing. It is argued that to become more involved in lending to the smaller borrowers formal lending institutions will have to change the way in which they make lending decisions and to decide more as informal lenders do, on the creditworthiness and character of the borrower. They will therefore have to be prepared to take a higher risk in making such loans. If they do so, this would mean that they would have to charge higher interest rates to cover both the higher risk and the high transaction costs.

In many developing countries, governments limit the interest rate that can be charged to borrowers and although some commercial banks can find ways of overcoming these restrictions through the innovative forms mentioned, this inability to charge higher interest rates threatens the profitability of the loan transaction. Even where it can be shown that allowing banks to charge a higher interest rate in loans might actually increase lending to this sector, political and social factors in developing countries present a higher interest rate to be charged on loans made to small borrowers, who are considered in general to be the poorer section of the population, than to larger enterprises, importers, and merchants. There are, however, some cases where this has happened and become generally accepted.³ Unfortunately in many cases, the desires of politicians who appear to favour the poor leads to the imposition of credit lines to be lent at less than the prevailing interest rate, generally leading to distortions, misuse of funds and poor loan recovery. Subsidized credit finds its way to the rich and well connected, rather than to the poor.

3. MIDAS, an NGO in Bangladesh lends to its small borrowers at above prevailing commercial rates and BKK and KUPEDDES, organizations that give out large numbers of very small loans to micro enterprises in Java, charge higher interest rates than the banks in Indonesia. In both cases, loan demand was high and the government has acquiesced in this situation.

Many of the special government subsidized credit programmes introduced in developing countries to provide greater access to loans for smaller enterprises are unlikely to achieve this objective. Most evidence shows that only a relatively small number ever receive the credits made available through these programmes, and these are not always the most deserving.

6. Mandated Lending

Some countries have tried to overcome the reluctance of commercial banks to lend to smaller enterprises by issuing directives obliging these banks to allot a specified minimum proportion of their lending to this type of borrower.⁴ Such directives, or mandated quotas, for commercial bank lending for small enterprises have been common in India and Pakistan for a number of years. One might say that this is the *stick* approach of imposing from above, a lending pattern on the bank, as distinct from the *carrot* of offering higher margins, opportunities to lend at higher interest rates and some form of risk sharing through credit guarantee or insurance all to make lending to small and micro enterprises more attractive.

Mandatory quotas have been criticized in that they are difficult to enforce and depend to a great extent on the reports of the banks on their portfolios to the central bank. Policing regulations and enforceable penalties have proved difficult, if not impossible, as the banks are usually able to manipulate the reports on their lending to show that small and micro enterprise borrowing is higher than it really is, often by reclassifying certain types of loans to individuals as borrowing from small businesses. Furthermore, this type of government direction of commercial bank lending means, in practice, that the overall cost of bank lending will rise and this will ultimately have to be borne by depositors through lower interest rates, and by other borrowers through higher interest rates on their loans. While the use of quotas in India has diverted some lending from the larger borrowers to small and micro enterprises, it has been questioned whether this has really been of overall benefit to the economy, bearing in mind the undesirable distortions resulting in the working of the financial sector and the costs of enforcing such regulations.

Even so government action to monitor lending to the small and micro enterprise sector and pressure on the banks to lend more to this sector can have some effect, if accompanied with a suitable set of incentives.

4. See J. Levitsky (1988). *Financing of Small and Medium Scale Enterprises*, UNIDO, Vienna, for more on mandated lending to small-scale enterprises.

7. Lending Through NGOs⁵

In addition to the informal credit intermediaries already referred to, credit programmes for small enterprises, or more generally micro enterprises, have been developed in a number of countries by promotional agencies and by Non-Governmental Organizations (NGOs). These programmes usually began because of the failure of the formal institutions or commercial banks to meet the needs of the microenterprise sector. The promotional agencies and NGOs stepped in by developing credit programmes consisting, at least initially of small amounts in short-term credits principally for working capital.

Such NGO credit programmes are now widespread in several Latin American and Asian countries, and also in a few African countries. Most of these NGOs benefit from funds made available by Private Voluntary Organizations (PVOs), often supported by donor agencies in developed countries.⁶

Although in many cases these credit programmes were initiated primarily, more as transitional programmes to provide the borrowers with some funds until they could develop and grow to the stage that they would be able to enter the mainstream of the financial sector and borrow from the formal commercial banks, in practice there has been a tendency for these programmes to become self-perpetuating and to grow in size and volume without ever achieving the goal of graduating micro enterprise borrowers into the formal financial system. In fact, many of these programmes put rather stringent, somewhat artificial limitations on the amount of a single loan, so that it is difficult to imagine that the micro enterprise could, with the help of such loans, be able to graduate into the formal financial markets.

Some of these NGOs have however resisted transforming themselves into full-fledged financial intermediaries and becoming involved in loan disbursement and collection. They have assumed the risk in lending to micro enterprise borrowers, have taken on the screening of borrowers and have helped those who are recommended for loans with advice and training but have left it to a commercial bank or other formal financial institution to disburse and collect the loans for a prescribed fee. This arrangement for instance exists between most of the Foundations helping micro enterprises operating in cities of Colombia with various banks and institutions.

5. For a wider treatment of micro enterprise credit programs of NGOs, see Summary Report of the World Conference of Micro enterprises, June 1988, Washington D.C. The full proceedings of the Conference are expected to be published in May 1989.

6. Although most NGO credit schemes are funded domestically or bilaterally, the Interamerican Development Bank has provided soft loans of about US\$ 500,000 each through its Small Credit Schemes to several such credit programs in Latin America, and the United Nations Capital Development Fund has also provided funds for such schemes in the least developed countries.

It is hoped that gradually after managing such programmes for a time, the commercial banks would begin to recognize that these borrowers are reliable bankable clientele and so would gradually begin to make loans directly from their own resources to these borrowers. So far, this has taken place, if at all, only on a very small scale. In India however, the Syndicate Bank and the Bank of Baroda, today have active lending programmes to small and micro enterprises but it is reported they began in this field by managing loan programmes without, in the first stages, actually undertaking the risk themselves.

8. Links Between Formal and Informal Intermediaries

One way for expanding lending to small enterprises may be through generating links between the informal financial intermediaries and the formal financial institutions. Two principal ways have been suggested for this. One suggested by Henry Jackelen (1988a) is by converting an NGO, promotional agency or informal lender into what he calls a *specialized intermediary*. The term specialized intermediary is used to describe *all those persons or agents who bring services to market segments not attractive to general providers of these services*. Jackelen suggests that some of the NGOs and promotional agencies could act as specialized intermediaries between the formal commercial banks and the enterprise borrowers. In his concept, the formal financial institutions would simply be the administrators of the lending programme, but would not become involved in the screening of borrowers or assessing their debt servicing capacity or their qualifications for a loan.

This approach really attempts to graduate not individuals, who have proved themselves successful borrowers able to repay their loans in special micro enterprise programmes operated by promotional agencies or NGOs, but rather to "graduate" a whole programme. This would have the attraction of offering a larger number of borrowers and a volume of lending with a proven high recovery rate as a more attractive client to a bank provided the risks and administration costs are deemed to be reasonable. This brings an important new group of clients to a bank without their having to incur the high development and transactional costs involved in building up the knowledge and information on this new client group. In this case the specialized intermediary would do all the selection, appraisal, approval, monitoring and supervision work on these clients at no cost to the bank and would be rewarded with a suitable, agreed service fee which, it is suggested, may be charged to the client as a fixed percentage of the loans.

Jackelen's proposal goes further than merely relieving the formal lending institution of the onus and costs of processing and supervising the loan through its various stages.

He also suggests a process of sharing the risk of the loan defaulting by offering in the first year a 100% iron clad guarantee on the principal and interest due from the

borrower, selected and approved by the specialized intermediary. This guarantee would be provided on the basis of a long-term agreement based on mutually agreed levels of performance. The available guarantee funds would leverage at least 10 times by bank lending over a time period of 5-6 years and that the guarantee coverage in agreement with the bank would be lowered over the years to 80% and ultimately dispensed with if it were shown that the performance of the borrowers reached an agreed level of performance in repayment. In order to make the arrangement even more attractive to the bank, it is suggested that the bank would be free at any time to withdraw at any time from the programme.

Jackelen sees the main problem as that of administration and suggests that efforts be made to computerize the loan portfolios of the banks for these lending arrangements to ensure that there is close monitoring of repayment performance. However, others may say that the arrangement of providing 100% guarantees has the danger of leaving the banks without any real stake in the loans made to these micro enterprises, giving little incentive to pursue debt collection. This would also put an undue amount of responsibility on the special intermediary, i.e. the respective NGO or promotional agency to select only those able to repay. It might be possible, or perhaps preferential, to work out arrangements whereby the guarantee never goes above 80%, but this of course raises the questions as to whether the banks would be prepared to enter such a scheme even if required to bear only 20% of the lending risk. However irrespective of whether the guarantee is for 100%, 80%, or 70%, the system has certain merits in providing a relationship between informal financial intermediaries and formal financial institutions. Although this may be confined in the first stages to organized NGOs or promotional agencies, it can also be expanded, and enlarged in the course of time to cover ROSCAs, credit unions, savings and credit cooperatives, or other informal lenders, all of whom could enter into this relationship provided there is an overall coverage of the programme from a guarantee fund which, presumably in the first stages, would need to be financed by an external donor or by the government. One assumes that if a volume of lending can be built up the intermediation charges earned by the specialized intermediary would be sufficient to cover its own administration costs.

The second proposed way of linking informal and formal intermediaries would consist of an NGO or *informal credit intermediary* borrowing in bulk from a financial institution or commercial bank and then using the money to lend-on at a suitable rate to micro enterprise borrowers. This would of course be possible only where the NGO concerned had good financial standing or individuals in its management who were able to guarantee the loan made from the commercial bank. There are some examples from Latin America of such arrangements⁷ whereby commercial banks lent to micro enterprises through such an informal intermediary who was prepared to undertake the financial risk. This arrangement might particularly apply to credit union and coopera-

7. ADEMI in Dominican Republic already does this.

tives who on the basis of their own deposits and savings, might be able to reach agreements with commercial banks to obtain larger loans, to be broken down and lent on as business loans to credit unions or cooperative members.

This arrangement would also be attractive to a commercial bank in that they would avoid both the high transactional cost in dealing with a large number of individual, very small borrowers and also the problem of loan security. Both of the proposals mentioned have the advantage of involving commercial banks as a source of finance for small-scale borrowers through a two-tiered arrangement, but in the second arrangement there would be no need for a guarantee scheme.

9. Guarantee Schemes

The first of the two arrangements above, depends on a guarantee to the commercial bank for the loans put out to the micro enterprise borrowers. Credit guarantee, or credit insurance schemes⁸, which covers a fixed percentage of the risk, can provide an inducement to a commercial bank to lend to small enterprises, if at the same time one can find a way of reducing the high transaction costs. There are some situations where commercial banks are ready to reduce collateral requirements when convinced that they are dealing with a credit-worthy client with a viable project, but commercial banks generally feel they have a responsibility to their shareholders and owners to obtain security coverage for any loans made. While the proposal above speaks of 100% guarantee which has been used in some developed countries including Japan and France, most believe that in developing countries, where such schemes have not as yet generally proved effective, the guarantee should not cover the whole of the loan but rather only 50 to 80% and even then not automatically. There is the unfortunate record of the credit insurance scheme in Indonesia, ASKRINDO, which guaranteed 75% of all loans automatically under the KIK/KMKP⁹ programme for small borrowers. The Indonesian government was required to pay out the equivalent of hundreds of millions of dollars to meet the claims of non-payment from this lending programme. It is felt that the proposals of 100% automatic guarantee (i.e. guarantees without screening) in granting of guarantees should be avoided.

The disappointing experience of guarantee schemes in developing countries until now has been that most of these schemes have not been able to cover the costs incurred in administration and claims, and encountered great difficulty in attaining the confidence of the commercial banks. However, credit guarantee or risk sharing schemes, if

8. For a wider treatment of credit guarantee schemes, see J. Levitsky & R. Prasad (1987), *Credit Guarantee Schemes for Small and Medium Enterprises*, Industry and Finance Series, World Bank

9. See description of KIK/KMKP program in RSIE (1988), *Development of Rural Small Industrial Enterprise, Lessons from Experience*, UNDP, Government of the Netherlands, ILO, UNIDO, Vienna.

properly designed and implemented, could help convince commercial banks to become involved in lending to small enterprises.

Credit guarantees have in the last years been started, or are planned, in many developing countries in Latin America, Asia, and Africa – sometimes with donor help. Two donors, USAID and German Technical Assistance, have been particularly active in supporting such schemes. The record has been disappointing, but this may be due more to the fact that some of these schemes were inadequately funded and poorly administered.

Some of these schemes point proudly to the fact that after two to three years they have not had to pay out on any claims, which raises doubt whether the scheme resulted in any additional lending and tended to indicate that the lending institutions were continuing to demand collateral and to adopt an extremely cautious approach in approving loans, presumably having little confidence in the scheme. Despite this experience, if one wants to involve commercial banks in lending to the small, and in particular, to micro enterprises, then some form of guarantee arrangement will almost certainly have to be introduced. In fact in the developed countries in Western Europe, North America, or Japan, such guarantee schemes have been an essential element in fostering lending to small enterprises.

10. Incentives for Banks

To sum up there are basically three forms of incentives that can be used to induce commercial banks to lend to small enterprises. There are:

- (i) Help in reducing the transaction costs by having small enterprise clients screened, appraised, and supervised by another agency acting as an intermediary, and if possible lending to these borrowers as groups with some intermediary agency taking the risk and also reducing the intermediation costs.
- (ii) Increasing the margin for the lending banks, either by allowing onlending at a higher interest rate or making available lower cost funds for this purpose, possibly through refinancing arrangements.
- (iii) Reducing the risk of loss from loan defaults through credit guarantees or insurance.

It has been shown that with the above incentives in place and suitable training for bank managers and staff, commercial banks can be induced to participate in lending schemes for small and micro enterprises and even for micro enterprises to a limited extent. Clearly small and micro enterprise lending cannot be expected to grow above a limited percentage of a bank's portfolio to allow for some element of *cross-subsidization* of higher profits on the other loans and services to cover the lower return on lending to small enterprises. In general, one may expect specialized banks such as

savings banks, peoples' banks, (or banques populaires), or cooperative banks -i.e. institutions that have as a major objective to provide banking services to members or to specific groups as a service rather than just to maximize profits - to be more ready to lend to small enterprises. This is indeed the case in the examples of the Caja Social y Ahorro (Savings bank) in Colombia, Peoples' Bank in Sri Lanka and BCP (Banque Centrale Populaire) in Morocco. In some countries, state-owned banks are also more prepared to lend to small and micro enterprises under pressure from the government, but this is not uniformly the case.

11. Alternative Financing: Leasing and Venture Capital

11.1. Leasing

Where capital is scarce, as is usually the case in financing small enterprise development, leasing may provide a convenient arrangement. In leasing, a capital asset, usually a building or a piece of equipment, is made available by an institution or a leasing company over a period of time for a regular rental payment. The asset remains the property of the *lessor*, that is the party making available the use of the asset. The asset can be repossessed if there is default in the rental payment. Very often after a number of years of leasing as asset, it may be purchased by the *lessee* (the user) for a nominal amount thus converting the arrangement to a type of hire purchase.

Leasing may be an attractive alternative to purchasing a piece of equipment especially in the case of a small-scale entrepreneur who cannot raise the finance to pay for the purchase and has not enough collateral to raise a loan. Leasing also has tax advantages and can be beneficial to the cash flow situation of an enterprise that needs its limited funds for working capital. Sometimes special leasing arrangements can be made where payments are adjusted to the use of the machine leased and the earnings so generated. Leasing may also be combined with technical assistance and supervision including maintenance, quality control and advice (as in the case of computer leasing). In some situations commercial banks set up leasing subsidiaries where there are stringent controls on credits, although leasing is still quite rare in most developing countries.

11.2. Venture capital

Few entrepreneurs are able to develop an enterprise solely on the basis of loans and debt. At best most institutions and credit schemes will not, and should not, finance more than about 70% of an investment. The rest has to come from the entrepreneur's own resources or from some source of equity or venture capital.

Support for venture capital in developing countries is still relatively new and the few such sources that exist have generally invested in larger medium-scale enterprises. Also there exists strong resistance by entrepreneurs to sharing ownership of their

business with either public or private partners. Still there have been attempts at providing equity for small-scale entrepreneurs in some countries. An interesting example is the case of Micropar, a venture capital company established by ACCION International in Bahia, Brazil in the late 1970s, where basically small and micro industries were screened and approved for equity investments. Practically none of the investments were made since the legal process for registration was extremely cumbersome and, probably more importantly, entrepreneurs feared the repercussions (labour laws, tax implications) of being legalized (Jackelen, 1988b).

In Africa in particular, entrepreneurs are sometimes unable to mobilize even the very small amounts of equity needed to start a new small enterprise. Some West African countries have therefore created small funds, *Fonds de Participation*, in which small equity contributions are made to enable an individual entrepreneur who has the skills and a viable business plan, but cannot raise the minimum capital needed to start his business.

It has been suggested that a type of *quasi-equity* might be used. This would be a type of a loan in which an investor would have no legal rights of ownership, but would accept to subordinate his claim on the borrower's assets and might accept a variable payment based on earnings. This type of financial assistance to small and micro enterprises deserves to be explored as a possible way of overcoming the lack of risk capital for new start-ups of small and micro enterprises and to reduce overburdensome debt servicing beyond the capacity of such borrowers.

12. Debt/Equity Conversions

The debt crisis in Latin America and other developing countries has given rise to proposals to reduce debt through debt/equity conversions. This refers to *buying* debt at a discount from private lenders and *selling* debt to developing countries' governments for local currency at the full paper value. This would then be used for local investments. Some of this debt is being offered at a high discount for investment in Bolivia for example, where foreign loans are offered at 10% of value. Thus an investor with dollars can, by purchasing some debt, obtain considerably greater value in local currency.

This may offer a new source of funds for small enterprise financing, but is a new and rather complex field with legal difficulties and uncertainty as to how local authorities would react. It also would prevent developing country governments from having access to new foreign exchange if donors were to convert debt in this way. Nevertheless there may be cases where this source of local funding could be considered as a supplement to external donor credit lines made available for small and micro enterprise development.

Conclusion

None of the suggestions made could of itself answer all the financing needs of small or micro enterprises in all the developing countries. The situation varies substantially from country to country, depending on the banking system, whether state-owned, local private or foreign-owned, and on the workings of the financial sector and the types of financial institutions. There is now need for more innovative thinking on the subject to make better use of the informal financial markets and finding ways of offering new financing help through leasing arrangements and equity capital provisions as well as ways of stimulating the formal financial system to become more involved in lending to small enterprises.

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VIII. Women and entrepreneurship; new approaches from India

by Marty Chen

Over the past two decades, largely in response to the UN Decade for Women (1975-1985), the various small and micro enterprise (SME) programmes funded by bilateral and multilateral donor organizations have placed increasing emphasis on women entrepreneurs. In their SME programmes for women entrepreneurs, donors have favoured projects which provide direct assistance, usually in the form of credit, training, technology, or marketing services. As a result, the donor community dialogue about SME programmes for women has centred on whether a minimal or a more comprehensive set of services is required and on how best to deliver the acceptable number and range of services.

Given this emphasis on project deliverables, the SME projects for women have generally reached a limited number of beneficiaries, have generally paid limited attention to the structural constraints faced by women entrepreneurs, and have generally had a limited impact on the policy environment which affects women's enterprises. In contrast to this general pattern, several women's organizations in India have deliberately and effectively addressed the structural and policy constraints faced by women entrepreneurs and have successfully organized and supported large numbers of women.

Drawing on lessons learned from these projects, this chapter argues that certain concepts about SME programming for women need to be re-examined and that SME projects should attempt to build an enabling environment for women entrepreneurs, not simply provide direct assistance.¹ The first section of the chapter discusses the Indian approach in support of women entrepreneurs. The second section of the chapter presents some lessons from the Indian experience which challenge the standard assumptions and objectives of SME programmes for women. The concluding section suggests several options available to donors seeking to remove policy barriers to the SME activities of women.

1. The term *enabling environment* has been borrowed from Van der Wees & Romijn (1987) and is used here to refer to both the local work environment and the broader policy environment.

1. Promoting Women Entrepreneurs: The Indian Experience

In the early-1970s, three significant organizations for women entrepreneurs in three major cities of India were established. One of these, the Annapurna Mahila Mandal (AMM) in Bombay, has organized over 15,000 women engaged in one single occupation: catering low-cost meals for industrial workers. The other two organizations, the Working Women's Forum (WWF) in Madras and the Self-Employed Women's Association (SEWA) in Ahmedabad, have organized over 25,000 and 35,000 women respectively from a wide range of occupations, including:

- *petty vendors and hawkers*, who sell goods such as vegetables, fruits, fish, eggs, snack foods, household utensils, and used garments;
- *home-based producers*, who are self-employed or work as piece rate workers, making such products as cigarettes, incense sticks, snack foods, garments, brooms, and handicrafts; and
- *labourers*, who sell various services such as cleaning, cooking, and laundering or provide manual labour for construction, transportation, or other activities.

This chapter is not intended as a comparative analysis of SEWA, WWF, and AMM but as an analysis of certain common elements in their approach to women entrepreneurs. The founders of all three organizations had prior grass-roots organizing experience: the founder of SEWA in trade union organizing; the founders of WWF and AMM in political party organizing. Given their prior experience, the founders shared an in depth familiarity with women entrepreneurs, with the local environment in which women work, and with the broader political and economic context which affects how women work. When they began their respective organizations, therefore, the founders did so from a common set of assumptions:

- that most poor women work;
- that most poor women work at micro enterprises which provide self-employment to themselves and some family members;²
- that women work in a wide variety of enterprises: as producers, sellers, and labourers;
- that the constraints to women's full productivity are often specific to the particular enterprise or trade group in which they are engaged;
- that there are significant financial, managerial, marketing, and leadership skills among the women entrepreneurs;
- that government officers and planners (at the municipal, state, and national levels) are generally either indifferent or hostile to women entrepreneurs; but
- that it is important to work closely with government in order to leverage support and to advocate change on behalf of women entrepreneurs.

2. It is important to remember throughout this discussion that women in developing countries are predominantly engaged in micro-scale enterprises (less than five workers).



Women work in a wide variety of enterprises.

Given these assumptions, each organization started working with women in selected trades in which large numbers of poor women were already concentrated. They began by analysing women's work within these trades and by identifying the main constraint or need specific to each trade: in most trades, the need for credit; in some trades, the need to reduce harassment by the police, middlemen, or merchants. Although they began with one entry point intervention, all three organizations evolved into complex programmes carrying out multiple interventions. These interventions have been adopted, sometimes with modifications, from other development strategies: credit or banking services; technical extension, training, and other input services; welfare or social services; cooperative organizing; trade union organizing; and legal or political lobbying.

As adopted and implemented by the Indian women's organizations, these multiple interventions can be grouped into two broad categories of objectives: one set which is designed to leverage or deliver certain services for women; another set which is designed to influence or change the working environment for women. The first set, which SEWA refers to as the development aspect of its work, includes many of the standard interventions of SME programmes: credit, training, marketing services, and cooperative organizing. The second set, which SEWA refers to as the "struggle" aspect of its work, includes many of the standard methodologies of trade union work:

organizing workers by trade, establishing complaints cells, legal counselling, and organizing strikes, pickets, or campaigns as needed.

These two sets of interventions are at once complimentary (especially in terms of short-term objectives) and fundamentally different (especially in terms of long-term objectives). Whereas the main objectives behind the first set are the actual delivery of credit, training, and other services to a targeted number of women, the objectives behind the second set are not deliverable but require advocacy and negotiation: that is, visibility, legitimacy, a representative voice, and supportive policies for women entrepreneurs. These differences in objectives are reflected in the two approaches to organizing adopted by SEWA.

Borrowing strategies from the trade union movement, SEWA organizes women primarily into trade groups which negotiate, bargain, and lobby for fair prices, wages, and working conditions. Unlike standard trade union workers, however, the women entrepreneurs organized by SEWA cannot negotiate and bargain with an employer, as they are self-employed. Rather, they negotiate and bargain with merchants, middlemen, the police, municipal authorities and government: all of whom in various ways influence the terms and conditions under which women work. As and when necessary (for example, if women within a trade group are being victimized by merchants from whom they obtain raw materials or to whom they supply finished goods), SEWA also organizes women into cooperatives to receive training and marketing services and to develop autonomous markets for their goods and services.

Table 12 presents the range of interventions developed by the three women's organizations in India: categorized by the two sets of objectives described above and by the standard areas of SME programme intervention. It is important to note that all three programmes carry out many of the standard SME programme interventions. They have continued, that is, to deliver certain services while lobbying for an enabling environment. It is also important to note that the programmes have deliberately and systematically built linkages: horizontal linkages between their women members and with other women's groups to develop a representative movement and vertical linkages with formal financial institutions and government departments and ministries both to leverage services and to institute change. Finally, it is important to note that the programmes chose and modified interventions to address the specific structural constraints and strategic needs of the various trades or subsectors.

By building linkages and by aiming for structural change, these women's organizations have not only, as ORU (1988) and Teszler (1989) have correctly observed, actively supported women's enterprises but have also organized women to become effective pressure groups at the local, national, and international levels. These pressure groups have lobbied effectively for women as legitimate clients of the nationalized banks; for women's legitimate space in municipal markets; for women as suppli-

Table 12: *Two Sets of Interventions*

AREA	DIRECT ASSISTANCE	POLICY INFLUENCE
R&D	Feasibility studies	Diagnoses of structural constraints
	Market demand studies	Sectoral analyses of dynamics & constraints
Credit	Credit delivery	Leveraging credit from bank Specialized development banks
Training	Technical skills Managerial skills	Lobbying skills Organizing skills
Raw materials	Procurement and supply	Lobbying for: - quotas - fair prices
Work place	Providing production and storage space	Lobbying for fixed point of sale
Technology	Providing tools and equipment	Lobbying against technological displacement
Management	Collective production Cooperative leadership	Representative organization Trade union leadership
Markets	Product markets Market information Cost pricing	Labour and factor markets Market structure Wage and price policies
Organizing	Cooperatives: - production - marketing Strategies: - cooperative	Cooperatives: - supply - service Strategies: - trade union
Services	Social and welfare: child care	Legal and trade union: - complaints section - legal counselling - insurance schemes: * maternity benefit * life * occupational health
Advocacy	Financial institutions Business institutions	Government institutions Policy-making institutions Planning institutions Research institutions Media institutions Trade unions: - national - international Women's movement: - national - international

Table 13: *Policy Influencing Efforts by SEWA*³

LEVEL	POLICY ISSUE
Municipality level	<ul style="list-style-type: none"> - Supreme Court ruling mandating space be allotted in new municipal market to women vegetable vendors. - Cooperatives of women to supply various goods and services to public sector schemes or departments. - Identification badges for self-employed women and municipality sanction of informal sector activities.
State level	<ul style="list-style-type: none"> - Adoption of various insurance schemes for self-employed women workers: Maternity Benefit, Life Insurance, Occupational Health Insurance. - Public sector purchasing scheme to purchase certain goods and services for women.
National level	<ul style="list-style-type: none"> - Sections of informal sector and women entrepreneurs in recent Five Year Plans of Government of India. - Report of the Commission on Self-Employed Women Workers submitted in time for recommendations to be considered for Eighth Five Year Plan.
International level	<ul style="list-style-type: none"> - Resolution on home-based workers adopted by international association of trade unions. - Invitation by ILO for representative of self-employed workers to join tripartite consultations (of employers, formal sector workers, and government).

ers of various goods and services required by government programmes; for the application of formal sector labour laws and benefits to informal sector workers; for maternity, life, and occupational insurance schemes for women; against cases of harassment or exploitation of women workers; and for other measures of public recognition, support, and protection of women entrepreneurs. Perhaps most significantly and fundamentally, SEWA has effectively lobbied for the legitimacy and representation of self-employed workers in the international trade union movement. Table 13 presents the various steps SEWA has taken to successfully influence public policy in support of self-employed women workers.

Despite the range of interventions tested and the significant impact of public policy

3. This table is based on information from *SEWA in 1988*. Full information can be obtained from SEWA.

achieved, there are several weaknesses which can be ascribed to the Indian experience. First, because these programmes have deliberately built on women's traditional economic roles, the occupational structure for women entrepreneurs has not been altered significantly and the majority of women have not moved out of the lowest level occupations. Whereas earnings have increased for some women and wage or price rates have been increased for certain trade, earnings and wages remain low for most women. However, if one compares the pre-intervention earnings in many occupations with post-intervention earnings, the increase in earnings in relative terms is significant.⁴

Secondly, and a related point, only limited attempts have been made to help women enter higher-priced product markets or the formal sector of labour. To help women gain access to the formal sector, skills training for women in electronics and other high-growth industries should be increased. Similarly, attempts should be made to help women expand their enterprises or enter higher-priced product markets and to train women in new skills so they can compete for jobs in emerging or expanding sectors. However, it is not clear, given the limited absorption to date of surplus labour generally, how many women will actually be absorbed into the formal economy.⁵

Limited short-term success in the areas noted here may actually lead to long-term success. There are potential trade-offs in terms of scale and impact when projects aim to capture higher margins of profit or different product and labour markets for women. Experience from projects that have been able to move women out of the lowest level occupations or to maximize earnings for women indicates that the process tends to benefit only a few women. The projects referred to in this chapter explicitly aim for marginal increases in income but substantial increases in the bargaining power and visibility of large numbers of women. What in the short term may appear to be marginal change has the potential to lead to macro-structural change if the bargaining power of significant numbers of women is strengthened and if the centrality of their enterprises in the critical sectors of the economy is recognized and translated into national policies.

2. Lessons Learned From the Indian Approach

The Indian experience offers several critical insights both about women's enterprises and about how best to support women's enterprises. The Indian programmes identified characteristics specific to women's enterprises which confirm evidence about women's enterprises from other settings (ORU, 1988):

4. Woman artisans working as piece-rate workers, making bags, lace, or bangles, earn as little as two rupees (about 16 US cents) a day. Where projects have been able to unionize these women to demand higher piece rates, they have begun to earn three to five rupees (25-40 US cents) per day.
5. SEWA estimates that in India the formal sector absorbs only 11% of total labour; the remaining 89% work in the informal sector.

- The *smaller* the enterprise, the more likely it is to be a woman's enterprise. Women are more likely to be entrepreneurs in micro enterprises, particularly those which provide self-employment to themselves or family members, and are more likely to be employees in larger enterprises.
- The more *invisible* the enterprise, the more likely it is to be a woman's enterprise. Women's enterprises are often not recognized, counted, or valued. Hence, women's contribution to the economy is still undervalued.
- The *lower the returns* to an enterprise, the more likely it is to be a woman's enterprise. There are legal and customary barriers to women owning assets or land and institutional barriers that limit women's access to mainstream support services (credit, training, information). These factors restrict women to low productivity sectors.

The Indian experience also suggests several ways in which the standard concepts about SME might be broadened to better promote women's enterprises and SMEs in general:

- The narrow definition of enterprise (i.e. as industry or manufacturing) might be more broadly defined to include commerce and services. The Indian experience points to the importance, if a programme is designed to promote all types of women's enterprises, of including all areas of entrepreneurship: from home-based production to petty vending and hawking to selling labour services in a wide variety of sectors (not just those typed as female).
- The debate which focuses on the size and significance of SMEs (growth issues) might recognize the centrality of micro enterprise to the economies of poor households, both those which are net suppliers and those which are net consumers of SME goods and services (equity issues). The Indian experience points to two major issues in regard to the equity side of the SME debate. First, that the enterprises of poor women are critical to the welfare of their households and that poor women can seldom exercise choice as to whether or not to become entrepreneurs. Second, and this point is often overlooked, that SME supply goods and services at low prices to poor customers and that these low-priced goods and services often subsidize capitalist growth. For example, the women caterers supported and organized by AMM offer low-cost meals to industrial workers. If this catering service were not as low-cost or as large-scale as it is, the industries would be forced to pay higher wages to their workers.
- Programmes which aim to promote women's enterprises, and SMEs generally, might shift their emphasis from promoting targeted projects to influencing policies. The Indian experience points to the significance and potential of moving beyond credit, technical assistance, and other project deliverables to focus on structural change and political advocacy. So long as programmes maintain a narrow project focus they are likely to benefit relatively few entrepreneurs and to do so only for the duration of the project. If programmes begin to address structural constraints to SMEs and to advocate policy changes in support of SMEs they are

more likely to achieve significant benefits in terms of scale and systematic change.

- The Indian experience in promoting urban women entrepreneurs can be characterized as a sectoral approach and can be applied to rural sectors as well. The Indian experience with urban women entrepreneurs can be characterized as a sectoral approach in that strategies or interventions were designed to address constraints specific to various sectors or subsectors of the economy and were designed to introduce change at all levels of any given sector, from the immediate work environment at the local level to the policy environment at the national level. As developed in the urban programmes described above, the sectoral approach involves, initially, analysis of women's work within any given sector. Through such analysis, intervening structural constraints or strategic needs, specific to women's roles within the sector, can be identified and addressed. Further, because government programmes are typically developed along sectoral lines, women can be linked to existing support systems and infrastructure services. Finally, and perhaps most fundamentally, women's work and needs can be translated into broader policy issues relating to sectoral development. Given the success of the sectoral approach in the urban context, several programmes in India have begun to replicate the approach in various rural sectors, notably in the dairying, sericulture, and forestry sectors.⁶

3. Implications for Donor Assistance

The Indian experience would suggest that it is useful for donors to foster a dialogue between non-governmental (NGO) projects and relevant professional or government institutions. Cross-institution coordination could make good use of the particular strengths of each institution: NGOs would benefit from the technical expertise and direct linkages with the government or professional institution; the government or professional institution would benefit from the project experience and gender and poverty perspective of the NGOs; and, most importantly, the women entrepreneurs would benefit from the widest possible range of interventions and support.

The Indian experience suggests several options available to donors seeking to remove structural barriers and to improve the policy environment that affects the micro enterprises of women: options for research activities, project intervention, and influencing policy. For each of the options listed below, donors also have the choice of whether to carry out the option directly (through their own staff or consultants) or whether to carry out the option through host country institutions (non-government, professional, or government).

6. Refer to Chen (1989) for a detailed discussion of the sectoral approach to promoting women's work in India.

a. *Research*

- Collecting data and conducting research on SMEs to promote a policy dialogue.
- Conducting policy studies on SMEs to promote a policy dialogue.
- Documenting how SMEs have responded to specific policies and how policies may promote SME growth.
- Building national capacity for policy analysis and research.
- Developing national research capacity to collect, analyse, and disseminate information on topics relevant to SMEs.
- Conducting research on growth sectors and factors that influence access or entry to and product development or diversification within these sectors.
- Researching the consistency of growth-led policies with establishing or protecting SMEs.
- Conducting a series of sector specific analyses of SMEs, employing both a gender and a class framework.
- Conducting a series of case studies of pilot projects in support of SMEs in specific sectors or subsectors.
- Preparing country and sector specific guidebooks on SMEs for use by planners and practitioners.
- Sharing this research information with host country planners and practitioners and with the international donor community.

b. *Project Interventions*

- Supporting demonstration projects that can influence the intended policy audience.
- Supporting demonstration projects designed to mainstream women into the major sectoral plans and programmes of government.
- Supporting sector specific strategic planning exercises or specialized training sessions.
- Promoting mechanisms for SMEs (and SME programmes) to engage in policy dialogue.
- Supporting efforts to build representative institutions for SMEs to address structural constraints and to represent SMEs before government planners and policy-makers.
- Coordinating with other donors and policy-makers on SME policy issues.
- Strengthening NGO or other institutional capability to lobby for policy reforms.
- Promoting technological improvements for sectors or subsectors (e.g. the service sector) where women predominate.
- Promoting institutional changes that would increase SME access to banks, cooperatives and other enterprise-related organizations.

c. *Policy Measures*

- Raising SME policy issues in the context of host country or donor community dialogues about structural adjustment, growth strategies, poverty alleviation strategies or other relevant topics.

- Supporting government efforts to develop national strategies to address SME problems.
- Advocating policies that would generate demand for small-scale production and avoid subsidization of competing large-scale enterprises.
- Advocating policies for promoting labour-intensive, small and micro enterprises.
- Advocating supportive policies in the areas of credit, interest rates, taxation, licensing, and investment privileges.
- Advocating SME specific marketing policies: such as the government purchasing scheme adopted by India that limited the public sector purchase of specific goods and services to SME-suppliers.
- Advocating legislative and municipal reforms that would sanction informal sector work.
- Advocating policies for maternity benefit, child care, life insurance, and occupational insurance schemes for women entrepreneurs.

Conclusion

In conclusion, it should be emphasized that programmes in support of SMEs, particularly those in support of women's enterprises, have the potential of producing both equity (in that the poor, particularly poor women, are concentrated in SMEs) and growth (in that SMEs constitute a large and, in some contexts, increasing share of national economies).

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IX. Creative donor interventions

by Marilyn Carr

Although the majority of people in developing countries depend on agricultural production for their livelihood, the non-farm sector has just as important a part to play in support of agriculture and, increasingly, as a direct source of income for masses of poor people.

In the past, development strategies have tended to emphasize large-scale, capital-intensive, urban industries based on imported technologies and skills, promoting goods which can be afforded only by small elite and creating few employment opportunities. Many such industries have proved to be 'white elephants', depending on government subsidies and foreign equipment and expertise for their continued existence. Few have had any major impact in terms of contributing to sustained development.

By focusing only on agricultural production at one end of the spectrum and large-scale urban industry at the other, an important sector of economic activity has been overlooked. This is the small and micro enterprise sector which comprises millions of artisanal units in the urban areas and many more millions of household units in the rural areas, as well as a substantial number of small modern factories.

Increasingly, it is recognized that this sector, which is sparing in its use of capital and foreign exchange, draws heavily on local skills and resources, and produces basic goods and services demanded by the bulk of the population, holds the key to a development process in which the majority of people can participate and from which the majority can benefit.

Many developing country governments, donors and international agencies (although far from all) are now anxious to channel increased resources into the promotion of small and micro enterprise. As support for this sector grows and as more experimentation takes place, the evidence is increasing as to how difficult it is to have any significant impact in terms of contributing to sustained development.

In particular, three points have come to light. First, not only is the sector huge, it is also very diverse; and fuzzy thinking, which has failed to differentiate between the characteristics and needs of modern small industry, urban informal units, rural enter-

prises, and rural non-farm activities, has led to much confusion when trying to design support programmes and formulate policies.

Second, many of the early attempts at small enterprise promotion, usually channelled through governmental small enterprise organizations, have tended to benefit the better-off, larger and more urban small and micro entrepreneurs. The bulk of the people in the sector, the so-called microentrepreneurs in the urban informal and rural areas - many of whom are women - have not benefited at all from such interventions.

Third, while some of the more recent small enterprise programmes have focused specifically on the smallest entrepreneurs and on disadvantaged groups such as women, they have managed to reach only a handful of the people involved. Thus, although such programmes highlight the benefits of assisting these enterprising people to help themselves, the question remains as to how this can be done effectively on a widespread and sustainable basis. It is this question which forms the basis for discussion in the following pages.

The chapter commences with a brief review of experience in small enterprise development to date. It then looks at how donors and international agencies could reorient their thinking, policies and programmes in a way which promotes the small enterprise sector more effectively. A final section highlights some key issues for discussion.

1. Assisting Small Enterprises: Experience to Date

1.1. The SMIDA Approach

The traditional and commonly thought-of channel of support for small enterprise are the Small Industry Development Agencies (SMIDAs) which have been set up in many countries in the last two or three decades to provide a comprehensive range of support services. These are normally public institutions and they include the SIDOs (Small Industries Development Organizations) in Tanzania and Zambia, the SEDCOs (Small Enterprise Development Corporations) in Zimbabwe and Swaziland, Small Industry Corporations and Boards in Pakistan, and Small Industry Services Institutes and District Industry Centres in India.

For the main part, the impact of these schemes has been disappointing. First, many of the agencies have failed to promote a significant number of enterprises. For example, SIDO in Tanzania established only 0.5 small industrial enterprises per staff member per annum between 1978 and 1983 that are still operating (RSIE, 1988).

Second, even those SMIDAs which have managed to establish large numbers of new enterprises and to reach out to large numbers of entrepreneurs have tended to make contact only with the wealthier, urban tip of the iceberg. The bulk of entrepreneurs in

the urban informal and rural sectors have normally not been able to benefit from their services. Women in particular have had difficulty in making use of SMIDA services.

Third, there has been a tendency for SMIDAs to become dependant on external sources of funds for their existence, and even worse, many of the industries they have helped to establish are also dependant on continued external support because of excessive use of imported equipment and inputs (RSIE, 1988). This reliance on import-intensive techniques, combined with the fact that the entrepreneur is not usually involved in the early but crucial stages of product design and technology selection, have been found to stifle the development of indigenous entrepreneurship in countries such as Tanzania (Wangwe & Bagachwa, 1988).

Fourth, SMIDAs have concentrated almost totally on the supply of services to small entrepreneurs and played an insignificant part in undertaking research into and influencing the economic and legal environment within which small enterprises operate. Not all SMIDAs have such a function within their terms of reference, but given the importance now being attributed to getting the environment right (RSIE, 1988) this would seem to be an important issue for government-related small enterprise bodies to address. As things stand at the moment, SMIDAs may even have a negative effect on the overall environment for small enterprise since governments which have established such agencies can point to this as their contribution to the sector and then ignore more important policy issues.

This is analogous to the situation concerning the use of appropriate technology where many governments (and donors) put relatively small sums of money into appropriate technology centres or units and then proceed to choose inappropriate technologies in their overall programmes.

Despite their apparent weaknesses and failings, SMIDAs continue to receive the lion's share of donor assistance for small enterprise development in the Third World. Some of this relates to correcting deficiencies noted above. For example, donor assistance is being offered to several SMIDAs to increase their capacity to assist women entrepreneurs. For the main part, however, it is difficult to see how such centralized, rigid institutions could ever reach and effectively assist the bulk of small entrepreneurs in the urban informal sector and in the rural areas.

1.2. *The Informal Sector*

It is estimated that approximately half of the urban population in the Third World depends directly or indirectly on the informal sector for its livelihood (ILO, 1986). In addition, over 20% of the rural labour force now participates in off-farm activities. A very high percentage of entrepreneurs and workers in the informal sector are women. In Sierra Leone, over 80% of owners of tie-dye establishments are women. Women in the rural industries of Bangladesh constitute over 34% of the workforce. In Honduras,

women own about 61% of all small enterprises and employ nearly 50 per cent of all workers. And in rural Guatemala, women contribute 50% of the workforce in textiles, 47% in food processing and baking, and 65% in commercial services (ILO, 1986). Women's involvement in enterprises is particularly high in rural areas (ORU, 1988).

The dependency for their livelihoods of the very poor, and particularly of poor women, on informal sector activities has become a strong argument in favour of its promotion. There are, however, a number of issues and problems facing those who seek to promote it.

First, there are those who query whether the informal sector entrepreneurs need assistance at all. For example, Harper (1988) states that the sector is "*self-contained and balanced in that there are informal mechanisms for providing finance, for marketing and supply, for premises and for training. They may not be ideal, but they do exist and expand or contract in response to demand.*"

Many attempts at helping this sector have, he feels, resulted in a waste of resources and, in some cases, had a negative impact on intended beneficiaries. He does, however, accept that training and technical assistance may be useful for micro entrepreneurs wishing to 'graduate' into the formal sector, and for disadvantaged groups such



Dependency of the very poor on informal sector activities.

as women and refugees who do not have automatic access to the 'network of services' available within the informal sector.

Second, while many agree that the entrepreneurs in the informal sector must be assisted, consensus soon ends over the issue of how. Some argue that all the entrepreneurs in the sector need is an end to harassment of their activities by the authorities and legalization of their position. Others feel that provision of credit at commercial but non-exorbitant rates is the most important form of assistance. Still others argue for provision of technical assistance and training either with or without credit.

The evidence is mixed, but it does seem that the less entrepreneurial individuals (e.g. women) need a greater input of services than others in the sector. Many studies have concluded that assistance programmes become more expensive and more complex in situations where latent entrepreneurship has to be uncovered and where special barriers to entry have to be overcome. To concentrate only on the simpler and least costly programmes (e.g. the Kaolack scheme in Senegal) may result in reaching larger numbers of entrepreneurs in a cost-effective way, but it means that the group of people most in need of assistance will be left out altogether.

Third, although they are on the increase, there is still a lack of local agencies through which external assistance can be channelled to the informal and rural enterprise sectors. For the main part, the agencies involved are indigenous and international NGOs and associations of small entrepreneurs. In some countries, various government departments involved in rural development are also active in encouraging rural enterprises. Such agencies have the advantage of holding the trust of the entrepreneurs they seek to serve. They also normally have a participatory approach to development which leads to successful projects. In total, however, they would have difficulty in extending comprehensive services to more than a small fraction of the poor household involved in productive activities. In addition, some of these agencies have a welfare orientation which diminishes their value as a channel of improved business methods. Women's organizations and NGOs, and extension officers who work with rural women seem to be particularly prone to this approach, and the result has been proliferation of non-viable projects which do little to raise women's incomes or status.

Fourth, the lack of competent partners in developing countries has resulted in

- overloading of the few good agencies which do exist;
- attempts to increase institutional capacity;
- giving direct assistance to small entrepreneurs without going through an intermediary.

Good agencies can cease to be effective if they take on more work than they can handle. Small agencies which are working well at a local level may not perform so well if they greatly expand their operations with a massive influx of donor funds. And

direct assistance to entrepreneurs is not a sustainable option (although it may be useful for demonstration purposes as in the Kaolack experiment in Senegal).

Fifth, because donor interest in small enterprise promotion is so great at the moment, there is a tendency for donors and agencies to duplicate each others activities. A current example of this comes from Malawi where UNDP has recorded a total of eight projects which propose to increase women's access to income-generating activities through running business training courses for extension workers or increasing women's access to existing business advisory services. Without some attempt at coordination on the part of UNDP, these eight projects would undoubtedly duplicate efforts in respect of development of training materials. Worse still, they could train the same set of trainers (and rural women) in differing and conflicting ways.

In summary, although enthusiasm for working with the informal and rural enterprise sector is running high, success stories are as yet few in number, and obviously there are some major obstacles to be overcome if more is to be achieved. Approaches which donors and international agencies might take in seeking to overcome these obstacles are explored in the following section.

2. Filling the Gap: the Role of Donors and Agencies

2.1. Demand or Supply?

One of the major concerns of those involved in small enterprise development is that to date, only a tiny proportion of potential and existing entrepreneurs have benefited from assistance measures. This is largely a consequence of the almost total concentration on programmes which aim at the direct supply of services. For the main part, the demand-side of the equation has been ignored.

Where issues of demand have been addressed in the past, this has normally been at the sectoral level, with attempts being made to redress the discriminatory effects which industry policy (which has normally favoured large-scale industry) has had on the small and micro sector. A review of the development plans of 41 developing countries (Sinha, 1983) found that the vast majority stated an interest in encouraging small-scale, often decentralized industries, and most specified a number of policy instruments which should be implemented to enable small industries to compete on equal terms with large industries, or even to enable them to operate in a protected environment. However, policy pronouncements do not always lead to implementation of policy measures and, even when measures are implemented they do not always result in a positive impact on intended beneficiaries. The 1983 review found little evidence of impact on small firms, but it would be interesting to update this exercise to see what has happened six years on. Even if effective, however, such measures have relevance mainly for the small modern industry sector: they would be unlikely to be of help to

the bulk of the entrepreneurs who operate outside of this. Recent studies and trends indicate that these enterprises - the bulk of which are in rural areas and small market towns - can best be helped through demand-side policies which result in an increase in rural incomes and a consequent increase in demand for the products and services of micro enterprises. Such demand-side macro policies include (RSIE, 1988):

- investments in infrastructure and social services in rural areas;
- price policies to ensure favourable terms on trade for the farmer;
- wide distribution of benefits in rural areas so as to generate sufficient effective demands;
- agricultural investments in irrigation extension and research and provision of credit to farmers.

It is now argued that, in the absence of a favourable economic environment which stimulates demand for the basic goods and services provided by small enterprises, supply-side measures will have a limited effect and may even fall flat on their face. Thus, donors are being urged to ensure that favourable policies are in place before providing supply-side assistance to small enterprise, and in those cases where the environment is unfavourable, to channel assistance towards changing the situation.

This represents a radical departure from normal donor and agency practice in this sector and it is not surprising to find that, as yet, while several donors express a theoretical preference for the macro policy approach, external assistance rarely takes the form of policy assistance, and support for small enterprise is rarely a consideration in policy leverage situations.

As far as policy leverage and conditionality is concerned, one study (Haggblade et al., 1986) concludes that

"this approach has met with some success in case of stabilization policies, particularly during the course of foreign exchange crises. We have found less evidence of successful leveraging aimed at developmental policies concerned with enterprise or employment questions. It may be unrealistic to expect leveraging to work in these areas, given the non-crisis and wide-ranging nature of the policy changes required, the analytically and politically controversial nature of such changes, and the limited amounts of funds likely to be available for conditional assistance for these types of changes."

Of course, if external assistance is needed in the wake of an economic crisis, the opportunity could be used to include small enterprise-related policy in the adjustment programme. But as usually agencies such as IMF and the World Bank which are involved in structural adjustment programmes, to date, have shown no interest in including a small enterprise policy component.

Such programmes can and do benefit small enterprise indirectly. For example, the closure of modern factories in Niger following a structural adjustment programme led

to micro enterprises taking over the manufacture of agricultural implements, metal beds and jam (Van Dijk, 1988). The effects are not always beneficial, however, and donors who are interested in small enterprise promotion but who lack sufficient clout individually to engage in effective policy leverage should consider what options remain.

One suggestion is that individual donors could use their membership of agencies such as the World Bank to focus their attention on small enterprise promotion (Teszler, 1989). Another option is for donors to collectively exert leverage at the country level through the UNDP Resident Representative who shares responsibility with the host government for field coordination of donor and agency activities.

A longer term option, and probably one of the more important contributions donors can make, is assistance in building up indigenous capacities for policy analysis. This can involve

- strengthening the data base on which policy analysis rests;
- highlighting and disseminating information on successes and failures;
- supporting educational and research institutions where staff and graduates can influence policy formulation;
- supporting the formation or strengthening of policy making units;
- assisting policy makers (through training) to gain a better understanding of the complex ways in which policies affect different sectors of the economy.

In all of the above, an attempt should be made to build on the work already done on policy research and the building of indigenous policy analysis capacities in the field of appropriate technology choice.

2.2. *Balancing Supply and Demand*

While demand-side policies provide an important stimulus to small enterprise development, supply-side measures are often also needed to enable small enterprises to respond to the increased demand for their products and services. It has been pointed out that women and other disadvantaged groups in particular will be unlikely to be able to respond adequately to favourable demand situations without the implementation of measures aimed at improving distribution and access (ORU, 1988).

In this respect, a comparison can be made between the strategy needed for small enterprise development and the strategy used to promote agricultural development which has successfully mixed demand-side (price) policies and supply-side interventions (technology and infrastructure). A major difficulty in the case of small enterprise development is that the enterprises are more diverse and local in their inputs and markets than farming and, in the case of rural enterprises, they are also much thinner on the ground. They are, therefore, relatively more difficult to reach and to service effectively.

In most developing countries there is usually a fairly comprehensive network of agricultural extension agents who can reach the majority of farmers. Normally, there is also a network of community development workers whose job it is to organize and mobilize local people. By contrast, there are very few examples of rural industrial extension services at government level, and where they do exist (one example is the Rural Industry Officers in Botswana) they are insufficiently resourced to deal adequately with the task in hand. Finally, while extension staff in public small enterprise support agencies (such as SMIDAs) have been able to reach many urban-based small modern entrepreneurs, their outreach in the urban informal sector is very limited. To the limited extent they are able to, it are NGOs which have attempted to fill the gap.

It is to this issue of filling the gap in supply of inputs and assistance to small enterprises that donors and agencies have normally addressed themselves. To date, attention has been focused on supporting SMIDAs but as it has become increasingly clear that this often represents an expensive way of providing a few better-off entrepreneurs with a whole range of subsidized services which they could probably do without, these agencies have come in for much closer scrutiny.

There is no suggestion that external support should be withdrawn entirely from SMIDAs, however, as donors and agencies can play an important part in molding them into effective institutions. For example, they could be encouraged to curtail some of the least successful of their ventures such as management of industrial estates. Assistance could be given to set up more branch offices so as to reach entrepreneurs in smaller towns. And assistance could also be given to assist in the process of reaching greater numbers of women entrepreneurs. SIDA has been assisting SIDO in Tanzania in this respect and UNIFEM has made funds available to SEDCO Zimbabwe to host a meeting of all SMIDAs in the SADCC Region to discuss increased support for women entrepreneurs. SMIDAs might also be encouraged and assisted to play a role in advising on policy formulation in support of small enterprise development. Thought should be given, however, to the pros and cons of placing such a function in a SMIDA versus somewhere more in the mainstream of economic policy making.

Given the disappointing performance of the SMIDAs, however, donors and agencies have increasingly turned their attention to finding other channels through which the supply gap can be filled.

2.3. Partners in Development

a. Donors and NGOs

Given their impressive record in assisting the poorest entrepreneurs (albeit limited numbers of them) in the urban informal and rural areas, more and more external assistance has been channeled to NGOs.

A number of comments can be made about this relationship. Firstly, NGOs work in very different ways from donors and international agencies and cooperation between two parties which is not based on an adequate understanding of each other can be problematic. Donors should, therefore, make a greater attempt to get to know the NGOs they seek to work with to increase their understanding of how the 'grassroots' approach works. The example of the NGO Division of UNDP in training its field level staff in the NGO approach to development could be copied by other agencies.

Secondly, and related to the first point, donor and international agencies should not overlook the value of researching NGO experiences when designing assistance programmes. For example, the World Bank programme to assist with rural employment creation in Bangladesh through establishing Upazila Employment Resources Centres (UERCs) is based on a very thorough review of NGO experience with rural employment creation in the country.

Thirdly, even though most developing countries have a multitude of NGOs (including associations set up by small entrepreneurs themselves), donor attention is normally focused on only a few of the better known, and presumably more successful ones. One problem with this is that the better known NGOs can be persuaded to take on more work than they can handle or may be transformed from a workable small organization into a much expanded version which cannot duplicate the same results on a larger scale. Of course, there are examples of successful grading-up of pilot schemes - the Grameen Bank in Bangladesh and the Northeast Union of Assistance to Small Business (UNO) project in Brazil (Hunt, 1985) being two of the better known. However, other successful organizations have failed to survive the test, and donors need to dedicate a maximum of care to planning for such expansion.

In doing so, they should also bear in mind the need to be able to disperse assistance required by the NGO as quickly as possible if it is to be of maximum use. The example of bilateral assistance for the replication of the successful Intermediate Technology Transfer Unit scheme of the Technology Consultancy Centre in Ghana illustrates this point. In the case of one donor, a delay of five years was encountered between design of the proposal and commencement of the project. In the case of another donor an even longer delay of ten years was experienced because of excessive bureaucracy (Smillie, 1986). This does not lead to harmonious donor-NGO relationships, but is there a choice for NGOs which want large amounts of assistance to grow bigger? One suggested route is for donors to channel more of their funding to Third World NGOs through NGOs in the First World.

Another point of concern is that the many smaller and lesser known NGOs in developing countries often have no access to donor or international agency assistance, and it is these groups which often work with the poorest households in the most remote areas. How can donors effectively reach these groups? In some countries, a focal NGO can

act as a conduit between local NGOs and donors, as well as providing them with services such as training and information on technology. Dina Desa plays this role in Indonesia. In other cases, various types of 'umbrella' organizations exist which undertake similar functions on behalf of their NGO members. The Micro Industries Development Centre plays this role in the Philippines. Where such organizations do not exist donors could assist in their formation, or assist an existing NGO to do the job. Aid would be channelled to small organizations through the focal agency until such time as they are able to receive aid directly. The focal agency would then be able to turn to building the institutional capacity of other small NGOs (Ashe, 1985).

Fourthly, while most local NGOs have a good understanding of the communities in which they work and strong community programmes, many have a welfare orientation which limits their usefulness in small enterprise promotion programmes. There are serious doubts as to whether it is possible to transform the more typical small, welfare oriented NGO into an enterprise development organization capable of achieving significant scale (McKee, 1987). However, donors should examine ways and means of enabling such organizations to upgrade their knowledge and understanding of basic business skills since they are often the main source of assistance available to disadvantaged groups such as rural women. Even larger NGOs often start off with a welfare approach. In their case, however, there are several examples of donor assistance to set up business programmes (USAID assistance to NCKK in Kenya; Ford Foundation and ITDG assistance to BRAC in Bangladesh).

In conclusion, *systematic* channelling of external assistance through NGOs would seem to be a promising avenue for reaching targeted sector of small entrepreneurs (particularly marginal entrepreneurs, women or refugees).

b. *Donors and Government*

Experiences in channelling external assistance through SMIDAs have already been discussed, but are there other ways in which donors can try to assist the smallest enterprises through government institutions?

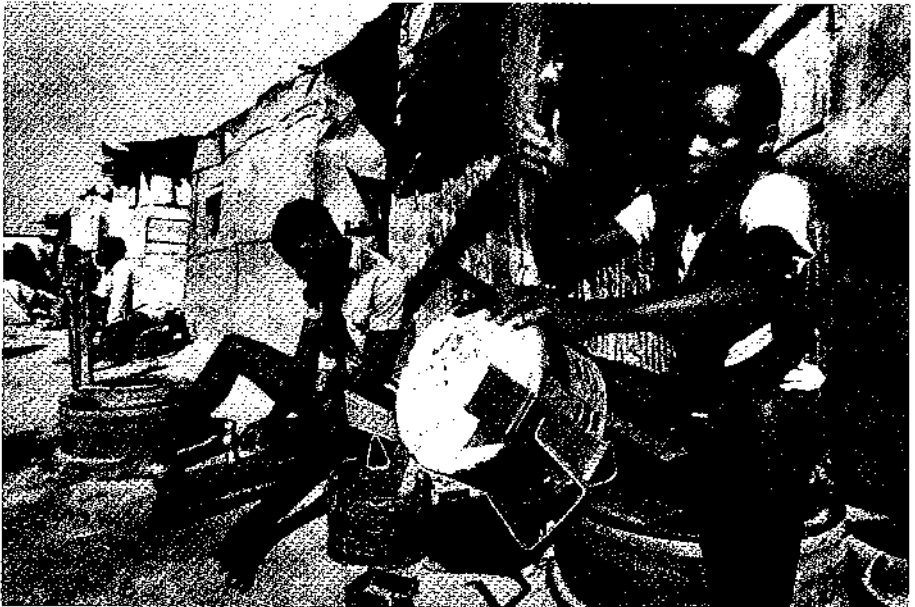
One area of interest relates to supporting business training for relevant extension workers such as home economics agents or community development workers who are often expected to help women set up income-generating activities but lack the skills to do this on a sound business basis. An international NGO, World Education Inc., has been training home extension workers in Swaziland in business skills (using Kenyan women entrepreneurs as trainers), and it plans to run similar training courses for community workers in Malawi. It remains to be seen whether this results in the establishment of viable businesses.

c. Donors and the Private Sector

Another channel through which donor assistance could be routed is the private commercial sector. Entrepreneurs and business people are often the best people to train or give advice and evidence suggests that entrepreneurs prefer getting advice from business people rather than from governmental officials.

At the level of small business, there are examples of successful experiments which could be copied and replicated by donors and agencies. The African Women's Task Force which was initiated by UNECA to enable small businesswomen to travel to other African countries to transfer their (technical) skills to other women could be expanded with increased assistance.

In Somalia, local business people were paid by an assistance project to train refugees in appropriate local skills. This not only ensured that the skills and the training were relevant to the local resources, but it also provided a means whereby the trainee-refugees could start to make contacts in the business where they were being trained, in preparation for starting their own (Harper, 1988). This could be tried in other countries with large refugee populations. In addition, ways and means should be explored of building up the capacity of the network of small traders in rural areas to deliver advice and information to the smallest and most vulnerable enterprises.



There are examples of successful experiments.

At the large business-level, donors could assist by exploring ways in which subcontracting relationships could be better developed with small enterprises as a way of expanding markets. While this sort of assistance is more likely to assist modern small enterprises, some of the traditional small enterprises may also benefit. Donors and agencies could also discuss cooperation with the large-scale industry sector in establishing some sort of rural industrial extension network which would lead to increased prosperity in the rural areas and ultimately lead to increased markets for the products of large industries.

The commercial banking sector is another avenue worth exploring. Recent experiments and studies reveal that a significant, unmet demand for credit exists at a price sufficiently high to cover the high transaction costs inherent in underserved rural markets. Donors might pursue further experimentation of this kind with a view to entering into a dialogue with the banks on measures needed to foster the commercial replication of successful approaches (Robert Nathan Associates, 1985). Attention should be paid to the fact that certain types of potential borrowers may not be able to benefit from such developments for reasons other than price. For example, women who have no collateral in their own name are normally rejected by commercial banks. In this respect, innovative guarantee schemes such as those introduced by Women's World Banking, UNIFEM and others should be further encouraged and assisted.

d. *Donors and Donors*

Finally, donors must, of course, work with each other both at the field level and at headquarters. At the field level, coordination of donor activities is in theory the responsibility of the Resident Representative of UNDP who reviews annual foreign assistance efforts. This exercise is voluntary and coordination is therefore difficult to achieve, particularly in an area which covers so many areas and has no specific focal point within the agency itself or its field offices. UNDP offices now have focal points for priority areas such as Women in Development and NGOs. These focal points are expected to assist with coordination of activities in these sectors and they receive training and other support from special units in headquarters. Donors and agencies could request UNDP to consider establishing a focal point for small enterprise development in each field office.

At headquarters level, coordination is assisted by an informal network of individuals responsible for small enterprise development in their agency. This network includes representatives from most of the major bilaterals involved in the sector as well as a number of multilateral agencies. Members meet annually in different host countries to review priority areas in small enterprise development and exchange views and information. Informal exchanges occur between meetings.

This is a useful coordinating device which deserves continued support from the agencies involved. A headquarters problem which it does not solve, however, is the lack of

sufficient in-house expertise on small enterprise development in most donor agencies. If effective donor policies and programmes towards small enterprise development are to be designed and implemented, this is a matter which needs urgent attention.

3. Do Special Groups Need Special Assistance?

While macro demand-side measures have the potential of making their impact felt on all entrepreneurs, it is unlikely that supply-side measures could ever reach the entire existing and potential small entrepreneurial population in a country - even if donor assistance successfully strengthens the outreach and delivery capacity of government, NGO and private commercial institutions.

In a situation where an entire sector cannot be covered, certain sub-sectors have to be targeted for assistance. There is considerable debate as to criteria for selection of these target groups. Some argue for limiting supply-side assistance to those small entrepreneurs who can absolutely not do without such assistance and who require a complex and expensive package of inputs. Others argue that assistance should be targeted at a level of entrepreneur who, although still very small and informal, has more substantial resources than those in the very poorest group. Much of this discussion revolves around the importance of making women a special focus for attention since at the very tiniest end of the enterprise-scale, it is women who predominate. Thus, the higher the cut-off point for assistance, the more likely it is that women's needs will be ignored.

A separate but related issue is whether women who have been targeted for assistance require special programmes. Evidence suggests that because of the special constraints which women face in the running of their enterprise, programmes designed to assist them will need to cover much more than training, technical assistance and credit related to business or income-generating activities. A recent study of women entrepreneurs (ORU, 1988) maintains strongly that a successful aid strategy addressing this group must also incorporate a minimum level of social provisions as a basis for further development and empowerment. Experiences to date with organizations such as SEWA and Grameen Bank tend to bear out this view.

Other special measures are often needed to effectively serve women entrepreneurs. A recent study of the Port Sudan Small-scale Enterprise Programme (Hall, 1988), concluded that reaching out to women (almost half of the Programme's clients) where they live and work is a very effective strategy to increase their participation in a loan scheme. Unlike so many other loan schemes, women can take part without having to gather up their courage to take the daring, often disapproved of step to go to a public office to ask for a loan. In addition, there is a great advantage in having women work with women (half of the staff are female). Both unsolicited and regular home visits are unremarkable and unobjectionable if they are made by women. Training is also of-

ferred in the home/work place at times which fit in conveniently with women's multitudinous daily tasks. Perhaps the point needing greatest stress is the overwhelming importance of recruiting adequate numbers of female extension workers in assistance programmes aimed at poor women.

UNIFEM has now had over 10 years experience in targeting assistance directly at the productive activities of women micro entrepreneurs and women's groups. A great deal of this activity has focused on the priority areas of food production and food processing - the latter being one of the few viable business activities that can be started in sparsely populated, low income rural areas experiencing no rapid growth in income (RSIE, 1988).

The experimental projects promoted by UNIFEM over the years bear out many of the above findings relating to targeting special groups. Assistance has normally taken the form of an integrated package of inputs comprising credit, training and technology, and they are normally preceded by careful research into women's priority needs and local socio-economic conditions. An important part of these technology-related projects has been identifying local technology agencies and private firms whose engineers are willing to work with intended women beneficiaries on the design and adaptation of technologies suited to their needs.

It has been found to be important to include men in most UNIFEM projects and they benefit too; directly as participants and indirectly as a result of women's increased incomes. The important thing is that women are never excluded (as is often the case in mainstream projects) and as a result, everyone is better off. As is the intention with UNIFEM projects, many of its successes at the pilot level have been taken up by bilateral donors for widespread replication.

Conclusion

There is now increased interest among donors and international agencies in supporting the small enterprise sector and a growing concern that existing forms of external assistance might be inappropriate to the task in hand. In particular, the conventional strategy of channelling assistance for the sector through centralized small industry development agencies can benefit the more urbanized, modern small but seems hopelessly inadequate in terms of helping the millions of smallest entrepreneurs in the urban informal sector and the rural areas. The major question being asked is how donors and international agencies can best channel their resources in order to assist this massive, diverse, scattered and difficult to reach group of people.

Debate seems to centre around two major issues:

- (i) *to what extent should donors devote more attention to demand-side policies affecting the economic environment for small enterprise development;*

(ii) *to what extent should donors move away from channelling supply-side assistance through centralized small industry support agencies and experiment with new delivery mechanisms.*

In both cases, there is also a need to debate how any desired shifts in emphasis can best be achieved.

a. *Demand versus supply*

Emphasis to date has been heavily focused on supply-side assistance measures and there is undoubtedly some scope for paying more attention to demand-side policies.

- *Is the evidence in support of the impact of macro policies on small enterprise development strong enough to warrant a substantial shift in emphasis?*
- *Do we know enough about the likely impact of various policy related measures to be able to decide where donors should place emphasis?*
- *To what extent can donors and international agencies have an impact individually, and to what extent is there a need for a coordinated approach?*

b. *Supply-side mechanisms*

Emphasis to date has been heavily focused on channelling supply-based assistance through centralized SMIDAs which have very little outreach in the informal sector and rural areas.

- *To what extent should future external assistance be focused on making SMIDAs more effective? Could such institutions help informal enterprises either directly or indirectly through advising on policy formulation?*
- *Should the major emphasis of future assistance be on experimenting with new delivery mechanisms?*
- *Is there enough evidence to show what the most appropriate mechanism for reaching informal enterprises might be?*
- *How can donors best work with and through NGOs, private companies and banks?*
- *Is the evidence in support of the importance of women in the small enterprise sector strong enough to warrant special attention being given to them? What types of assistance are best suited to women entrepreneurs and to what extent can donors make use of existing specialist agencies in channelling this support to them?*

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X. Intervention programmes still needed?

by Klaas Molenaar

Complementary to the afore mentioned issues a number of questions related to small and micro enterprise development were further discussed during the 1989 Workshop "Small Scale Enterprise Development, In Search of New Dutch Approaches". An holistic approach to the development prospects of the sector invites for further analysis of such issues as:

- *the role of technical assistance programmes;*
- *the role of technology;*
- *the role of non-governmental organizations;*
- *the role of research programmes.*

In an annex to this chapter some remarks are also presented about the capacity of Dutch organizations to implement new policies. This chapter is a summary of the discussions of the above-mentioned items during the workshop.

1. Technical Assistance

The RSIE report (1988) has revealed that SMIDAs to date have not generated the results originally anticipated. Notwithstanding the limitations of SMIDAs it would be incorrect to draw the conclusion that non-financial assistance would not be effective at all. Technical assistance will remain to be an important instrument in the programmes to promote and develop micro and small enterprises.

Two levels of assistance can be distinguished:

- (i) Direct assistance to the target group.
- (ii) Assistance to intermediaries (local and national).

The traditional types of intervention, such as management training or management advice and consultancy services, still need to play a role. These types of intervention, however, need further adaptation to prevailing conditions. While being considered relevant it has also become evident that new approaches are required. Such new functions requiring a massive input are:

- Participatory training and extension methods, which require guidance and linkage to other programmes but also a changing attitude of officials on high policy level.
- Promotion of small and micro enterprise associations, which is a very labour-intensive work since a lot of assistance is required in the formation and development of such associations.

As to the need to develop new methods for transfer of know-how to small and micro enterprises it is understood that research and development capacity is to be built up in developing countries. Universities and training institutes are to be supported further in order to ensure that they are in a position to develop new methodologies and concepts. At the same time it is believed that local expertise is to be mobilized further. In this field donors can play an important role as they could consider contracting local consultants more often for the execution of small and micro enterprise promotion and development programmes. Similarly, thought could be given to the idea to build up – and strengthen existing – networks of experts and institutions in developing countries involved in such new approaches as participatory training and extension.

With regard to the role of intermediaries a stronger involvement of local organizations (NGOs, PVOs) is considered to be important (see also section 3). However, taking into account the size of problems, other entities will also play an important role, such as national institutes, partly the more traditional small and micro enterprise development agencies, financing institutions, and other institutions at national level. In this way, through joint operations of both public and private organizations, achievements can be increased significantly, since NGOs alone lack sufficient capacity to do so.

However, such local intermediaries (e.g. NGOs, PVOs, church groups) need to build up institutional capacity and their staff have to be trained.

Thus, assistance is required by national institutions to back up activities of local institutions. These national institutions might either provide credit or give professional advice in specific subsectors.

In order to allow the national institutions to perform these new functions, due attention should be given to:

- Institutional development.
- New measures to make the institutions viable and sustainable in these functions.
- Policy development support, since often a deviation from tradition is needed.
- Staff training (e.g. the problem of loan officers for credit institutions).

Finally, the element of subsidy, which implicitly is always imbedded in technical assistance, should be compared with other activities. Especially in the agricultural sector, governmental support systems consume large amounts of money. The amount required for the small-scale industrial sector is relatively insignificant, and should not

necessarily cause much problems. Further assessment of the practices in the agricultural sector are recommended in order to learn from such experiences, especially as to the question of reaching large numbers of beneficiaries in a cost-effective way.

In general, one can conclude that technical assistance is still required in order to tackle the many new fields identified in the previous chapters.

2. The Role of Technology

In chapter V ample evidence has already been presented about the importance to create an environment favourable to the promotion of adequate technologies. Still due attention is also to be given to the promotion of technology at micro level. Small and micro enterprises can be assisted by the introduction of the right technology. To assess the impact of technology a number of questions have to be put forward such as:

- Why have certain developments taken place and others not?
- What are the success factors of programmes that promoted the use of certain types of technologies?
- What are the linkages between technology promotion programmes and other support programmes?

Within this context, lessons can be drawn from specific experiences.

- Firstly, lessons can be drawn from experiences gained in field projects introducing specific technologies. An example is shown in a GTZ sponsored project in Malawi aiming at the promotion of income-generating projects for women through the introduction of location and target group specific technologies.

In the field project in Malawi it became evident that the introduction and eventual adaptation of new technologies, was made possible by linking the technology component to a programme of technical assistance, training and development credit. Most important was the general understanding of all parties involved that the projects initiated (such as oilpressing, soap making, maize milling) should be sustainable in order to assure a continuous improvement of the living standards of female headed households.

- Secondly, in depth analysis of the impact of organizations dedicating to the transfer of technologies can throw more light on the relevance of technology in small and micro enterprises. An example may be the role of Appropriate Technology International (ATI), a Washington based non-profit organization that deals with both technology development and transfer of technology.

The experiences of Appropriate Technology International are used as lessons for the future when successful, sustainable projects become available. In the approach

one aims at a limited number of activities that are initiated, but special care is exercised to ensure that a great number of beneficiaries is reached.

ATI gives grants to specific projects ultimately aiming at a sustainable commercial activity. The development of self-reliance is considered to be of prime importance. From the start of a particular activity support is organized as much as possible on a risk sharing basis. Risks can be part of the technology; adaptation of equipment to local circumstances and quality improvement of the raw material are crucial factors.

The economic risk is appraised by means of a cost benefit analysis. If the outcome is positive, ATI supports the project in the start-up phase, which lasts about two years. Technical assistance and financial support for foreign components are given during this period.

After the start-up phase one decides upon continuation. In case of continuation, ATI plans gradual withdrawal from the project.

The experiments in Malawi and the activities supported by ATI are only examples of the various initiatives in the field of development and promotion of new technologies. Much has already been said and written about activities by others. The initiatives discussed here distinct themselves mainly because an attempt is made to link technology to business development and financing (Malawi) or research is carried out to commence with sustainable programmes that can be replicated eventually without external donor support (ATI's approach). Analyses of present technology development programmes and transfer of technology programmes lead to the believe that further attention is to be given to a number of issues such as:

- establishing linkages between technology development organizations;
- building up indigenous, local research and development capacity;
- introducing systems that can become sustainable;
- creating networks that are client oriented;
- setting up documentation systems and databases accessible to both field staff and researchers.

In as far as it can be assumed that there might be an ordered spectrum of technologies two questions have to be put forward

- whether there are areas of continuity between these technologies from more *traditional* to more *modern*, and
- which factors would influence such transitions.

Besides the above questions further attention is to be given to the South to South transfer of technology, in order to avoid continuous imitation of modern technologies only.

3. Role of Non-Governmental Organizations

Non-financial assistance for small and micro enterprises could very effectively be organized by local intermediaries.

Classification of NGOs is indeed regarded to be an important step towards further support. For example, distinction can be made between an economic and a non-economic approach. Services provided on the basis of the economic approach might have effects which are conflicting with the target group dominated approach. Since many people from the target group will not be able to pay fully for services, part of the target group might not be reached when applying fully the economic approach. On the other hand, grants create dependency and do not lead to sustainable development. Consequently suggestions made by USAID aiming at a local contribution of at least 20% of the costs involved and avoiding complete dependency on one donor, are believed to hit upon a viable compromise.

Several other classifications are possible, such as micro vs. small-scale enterprises, informal vs. formal, oppositional vs. accepted groups, all of which are considered relevant as long as these are in line with the objective of the specific analyses at a given time. These classifications refer to a continuum and not to a dichotomy. In general, classification is seen as relevant from the point of view of organizational development. Each type requires a specific approach.

Due care should be given that NGOs do not lose their specific characteristics by becoming fully involved in one or two intervention activities. Such can be the case when NGOs or PVOs are involved in channelling credit (as a supporting activity to their regular programmes) and subsequently become quasi-banks themselves with most of the available time of the staff devoted to collection and administration of funds proper; credit and financing institutions are still required to properly carry out such functions.

Strong emphasis should be put on the organizational development of NGOs, which is considered to be vital. Organizational development should be supported and this might even go as far as playing an active role in the creation of new organizations. On the other hand, great care should be taken to avoid *overkilling* NGOs, especially by overfunding (see also section 1).

Organizational development can be supported at three levels:

- (i) Target group level.
- (ii) Intermediate level.
- (iii) International non-governmental organizations.

A distinction can be made in support of organizational development between a project approach and an organizational approach. A project approach implies short-term inter-

ventions in combination with specific, short-term objectives. An organizational approach should contain an analysis of the organization, including that of financial data of past periods, discussion of objectives for future planning in relation to performance in the past, and an agreement on what should be done in the next three years, including financing.

In this context it is important for an organization to determine its ability to evolve along its own lines, not according to donor perception or major macro-economic issues.

4. The Role of Research Programmes

The starting point for any research programme supporting small and micro enterprise development must be the relevance of the research programme proper. Further, adequate attention must be given in research activities to the need of regional differentiation. Different research programmes are needed for the various small and micro enterprises support programmes reflecting the specific target groups the support programmes intend to serve.

Research programmes should preferably be divided into two main-streams:

- Action oriented research, which must be very specific, and will be more of a short-term nature, and
- Long-term research, which will cover a longer period and have a wider horizon supporting specifically (long-term) policy programmes.

On the basis of the prevailing understanding of the need for further support to ongoing and planned small and micro enterprise development programmes the following areas of major attention can be identified:

Action research

- evaluation of existing knowledge;
- analyse processes which affect people (e.g. monetarization, commercialization, technology change);
- new organizational forms and subcontracting;
- technology transfer.

Long-term research

- self-employment in a regional context;
- technical change, possibilities or stagnation for SME;
- where do entrepreneurs come from;
- impact of government policies.

Annex to chapter X

The Capacity in the Netherlands to Implement (New) Policies and Programmes

In assessing the capacity for assistance to implementation of small and micro enterprises development programmes both the demand and supply-sides should be considered.

With regard to the *demand*-side the following questions were raised:

- Should the Netherlands be involved in direct (or indirect) interventions or only aim at policy level interventions? If yes, at what level?
- What expertise is necessary and what quality of this expertise is desired?
- In which way should cooperation be sought with local expertise? Although experience in cooperation with local expertise appears to be limited, it is nevertheless believed that such cooperation be intensified.
- How will the situation be in about five years time?

Answers to such questions are at present difficult to provide as there is so far little attention paid to the development of a "communal memory" through a systematic learning process. Very little experience is publicized and, if publicized, it is often not easily available (because of the unavailability of reports).

With regard to the *supply*-side (from Dutch organizations) there appears to be a tendency to think that expertise is limited. This may, however, be caused by the fact that experience and manpower is extremely scattered over a large number of organizations.

In September 1988 a meeting was organized in Tilburg at the initiative of the Institute for Development Studies (IVO) and the Royal Tropical Institute (KIT) of people concerned with SME development. As a result of this meeting a small contact group of implementation oriented individuals was formed. That informal group initiated an attempt to make an inventory of available experiences and expertise in the Netherlands.

A draft report of this study, which has so far a very preliminary and probing character, was brought forward in 1989. Possibly the most surprising result was that about 150 persons (divided over 34 organizations/individuals) report to have experience and be active in small-scale enterprise development programmes (partially or fully).

The study can be seen as an interesting initiative which could serve as a starting point and a partial contribution for further systematic investigations to find answers to questions like:

- What type of expertise is available?
- What is the quality of this experience?
- How can the experience required in 5-10 years from now be formed?
- How can capacities of expertise in the recipient countries be assessed and mobilized?
- Which combinations between local, international and Dutch expertise are possible?

To support policy formulation, and to assess whether intended policy adjustments can be implemented, the question "How can demand and supply meet each other in the optimal way to serve the goal of SME development?" should be further explored.

XI. New directions identified

by Antoinette Gosses and Klaas Molenaar

From the analyses presented in the preceding chapters the general conclusion can be drawn that small enterprise development requires rethinking of the issues at hand, reordering of priorities, and indeed innovative ways of intervention. This is true for both donors, researchers, professionals and practitioners. The analysis of both the supply and demand-side interventions by donors (and supported by each professional in his or her respective field of competence) presents a strong case for not only reformulating the way small enterprises develop, but especially the mechanics of any intervention put forward.

The issues discussed by the various authors show a high degree of consistency and all indicate that major shifts are needed in our approaches.

At first sight the fundamental dilemmas for small and micro enterprise programmes appear to be to choose between direct intervention and policy changes or between institutional development and direct interventions. However, a more in depth analysis of the issues at hand shows that the fundamental question to address ourselves is related to the question whether we talk of small and micro enterprises in terms of their (in)direct and potential contribution to economic growth or whether we are supporting the poor masses in their efforts to survive and make a dignified living. In other words, are we using a definition in which development equals economic growth or are we talking about poverty alleviation and the uplifting of the underprivileged. Developing strategies that would bring the two approaches together appears to be the real challenge.

This challenge aims at finding ways to link the world of the underprivileged with the more formalized economy; it requires a basic understanding of the environmental context in which the poor masses operate: it requires an attitude to translate small developmental efforts into programmes serving a large number of people; it asks for linking formal and informal systems, without loosing sight of flexibility and accessibility.

Within this context the overall conclusion from the thematic evaluation on the development of Rural Small Industrial Enterprise (RSIE, 1988) must be taken seriously, i.e. that the supply-side approach, depending on the context and particular conditions,

has worked only to a limited extent. To put it bluntly, it has been a type of isolated support, reaching few people at relatively high costs. This argument was in favour of direct small and micro enterprise interventions only as a complement to general development programmes. In other words, small and micro enterprises are not a prime mover, but only enhance the development process (see also chapters II, III and IV).

1. Policy Environment

We are aiming at employment, income and growth as long-term objectives and small and micro enterprise development support is only one possible strategy. Strong arguments have been brought forward to think in terms of development strategies of which a small and micro enterprises strategy is only an element. Basically, the question whether small and micro enterprises policy should be an integral part of overall development policy, should be answered affirmatively.

One of the issues, immediately derived from the former point of the small and micro enterprise sector being an integral part of general development, is that policy changes can also bring about new distortions, favouring one group or sector over another. In other words, the question should be raised, what are the effects of policy changes on our development approach as a whole?

The RSIE report and chapter IV by Subrahmanyam Nanjundan give ample empirical evidence of the relevant success - and related implications - of macro policies in a selected number of countries. However further in depth analysis of such cases seems required in order to learn from such experiences further, as it is still difficult to arrive at uniform guidelines for overall policies. Policies remain to be defined in such a manner that they reflect the socio-cultural and economic conditions of the country concerned. While in one situation an export oriented policy as in the case of Korea may be the best choice, it is quite well possible that in other countries (China for instance) redistribution and rural based policies are better suited. Still the analyses in the RSIE study (1988) provided ample empirical evidence that macro policies should preferably favour growth of rural income, through the generation of agricultural surplus as a precondition for the stimulation of non-farming activities and henceforth of (rural) small and micro enterprises.

Donor programmes can be instrumental in introducing the pertinent changes and adjustments in overall policies and programmes of governments in the field of small and micro enterprises. But, there is reason to examine the existing programmes of industrial cooperation carefully, both in the multilateral and bilateral dimensions as a sound base for the search for new approaches and improvement of the involvement of international efforts in the area of small-scale labour oriented development.

Similarly, we have to take into account that there is a trade-off between growth policy and target group policy. There are no changes in policy that will be without any effect; if policy changes will favour one group this will undoubtedly affect others. Thus, if new policies for small and micro entrepreneurs strengthen their position, this could lead to negative reactions from other power groups. Support to small and micro entrepreneurs should not be seen in isolation from overall development policies, nor should it deny any prevailing political systems and structure.

Furthermore, we should also look at the vertical integration of economic activities, rather than treating them in an isolated way. The interrelationships between the various economic activities in the product column can not be overlooked. A simple economic activity at first sight might be classified as survival activity (such as the household activity of carpet weavers in Pakistan or India), but further analysis can reveal that it could form part of a wider range of entrepreneurial initiatives with merchants and agents involved in putting-out systems, trade and commercialization. The development of one element in the 'chain' can not be pursued in isolation from activities at other levels.

Consequently, a strong point has to be made on the strengthening of pressure groups both in terms of empowerment of the people concerned as well as to influence policy formulation on a macro-level. Such empowerment processes are long-term processes, with very little (quantifiable) results on the short run. Short-term measures to improve the life of the individual are indeed needed too. Hence, the challenge for the future is to find a balance between both strategies. Policy decisions should reflect this choice clearly in order to allow for its pertinent evaluation to measure achievements over time.

The discussion around structural adjustment policies should be assessed in this context too, rightly so because a lot of countries are confronted with them and the impact of such programmes is far-reaching. Through these adjustment programmes the small and micro enterprise sector is either victimized or conversely seen as the sector of last resort with dwindling support services. Pros and cons are being recognized but basically it must be acknowledged that the World Bank is still putting too much faith into the functioning of market economies only and has made little headway in interlinking the structural adjustment programmes with social development plans.

2. Efficiency of Small Enterprises

After studying chapter V by Frances Stewart – relating the arguments in this chapter also to the results of the studies carried out by the Michigan State University (Liedholm & Mead, 1987) - one may conclude that small enterprises indeed are

efficient; support to the sector of micro and small enterprises, and even selfemployment activities, deserves further attention from an economic perspective.

Particular care should be exercised when analysing the sector in macro-economic terms, taking into due consideration the fact that the vast majority of these enterprises generate products for low prices (and relatively low quality) for the poor masses at domestic markets. Too easily the sector can be placed in an international macro context, leading to wrong conclusions in cost benefit analyses. The shadow price for unemployment is not zero for the many operating small businesses but rather starvation or death. Individual small and micro enterprises will come and disappear, but the sector as a whole will remain, whether it be in a formal capacity or as informal activities, and people will continue to earn a living from it.

However, a major question remains to be answered, i.e. how to arrive at an environment comprising the required growth and development of the sector. Studies (Stewart, 1987) have proved that the sector still often operates in a hostile environment, whereby larger industries are favoured and have more scope for development.

Policy changes needed to eliminate this bias are in the field of:

- taxation and investment policy;
- access to credit;
- international trade (foreign exchange allocation, tariff structures);
- working conditions and legislation on the labour market;
- product policies;
- science, technology and their dissemination;
- rural linkages;
- efficient parastatals;
- transport, infrastructural development and decentralization.

A policy dialogue should be entered into by donors and recipients but it should be based on persuasion rather than on confrontation.

An addition to the above can be made. The policy environment is not only hostile to small and micro enterprises but also indifferent to small and micro enterprises. There are too few incentives for attitudinal changes of bureaucrats when dealing with small or micro entrepreneurs. In this light, careful assessment is also needed of theories applied and promoted by various training institutions and universities. It can be observed that in certain training institutions theories are advocated that ultimately would not benefit the small and micro enterprise sector. People graduating from such institutions are the policy-formulating officials of the future. If such a theory environment can be influenced the long-term benefits might be enormous.

Time and again questions are raised regarding the policy approach to be chosen. Are

we talking about poverty alleviation or about small and micro enterprises development? This basic choice needs to be made at some point in order to ask the right analytical questions. The answers to these questions are not only technical, they convey the necessity to make political choices. Furthermore, when searching for answers one has to be aware of the interrelation between economic policies and development needs. Creating an enabling environment is an economic strategy in itself and can only be successful if the prevailing political context makes such strategy feasible.

3. Target Groups and Policy

Similarly, the question is raised how to define the target group; in other words to determine the orientation of the development strategy. This subject has been very effectively and extensively tackled in the debate on classification. A clear analysis has been given (see chapter VI, Michael Farbman and Alan Lessik) of the choice of instruments, according to the different grouping of individuals involved in economic activities.

Classification is needed for analytical purposes. It helps linking the right instruments to the various groupings of economic activities. The actual choice which category of economic activities to support is of course a political decision. But again evidence is growing that it is quite impossible to support one target group without interrelating such programmes to the question of its impact on other target groups, not forgetting even the existing interrelationships and interdependence between the various target groups.

The classification has its limitations given the heterogeneity of the sector as well as the dynamic elements in society. Nevertheless, for analytical purposes it is an indispensable instrument for policy makers.

Also based on the results of research carried out in the past decade (USAID; PISCES) it is felt that classification along the following lines:

- survival activities;
- micro enterprises (mainly informal);
- small and micro enterprises (with growth potential);

would be a helpful one. Other, similar ones exist. The most important lesson to be learned from the past is the need to include the 'survival' economy in the classifications. Economic activities initiated and undertaken by the poor (even when purely of a survival nature) cannot be isolated from other economic activities.

This also means that community oriented development programmes should not deny the linkages that exist between social and economic development processes. One cannot go without the other.

For all categories, interventions and policies have been suggested, which seemed, broadly speaking, acceptable, also considering again the heterogeneity of the categories.

A very important lesson learned from empirical research is that graduation from one category (upward mobility) is very rare. On the contrary it more often occurs that people fall back from one category to a lower one, sometimes moving back and forth (see also the result of PMUR Colombia research).

When it comes to the policy decision which target group to aim at it appears of vital importance to be explicit in one's choice. If one target group is taken as a point of departure, certain intervention programmes seem to be more effective than others. But more importantly it is clear that the target group itself must be seen as an actor in the development process rather than as a subject of assistance proper.

The attitude and mobilization of the target group itself can be instrumental in arriving at the required policy changes. In this respect it is well understood that even people working at the lowest level of subsistence are hampered by the disfunctioning of institutions around them, such as the police, legislature, suppliers, distributors, and even their relatives. Further organization of the target groups at all levels is seen as a step forward to arrive at a situation where the required changes in environment can be arrived at by its transformation into an enabling rather than a hostile environment.

Approaches in terms of policy choice of target group are probably very dependent on the time frame allowed for intervention. Assessment of the functioning and even more the impact of organizations such as the Grameen Bank (Bangladesh), UNO (Brazil) or Dina Desa (Indonesia) demonstrate the need for a long-term perspective and strategy. The foundation of their present importance was laid more than ten years ago when these organizations commenced as a very minor social mobilization programme.

Just as was the case with the cooperative movement in Western Europe, it took considerable time before these grass roots organizations were accepted as a serious market partner, and obtained the influence they appear to have nowadays. Imitating these successes is hence very difficult, if not impossible; learning from their experiences is nevertheless very useful.

Subsequently we may conclude that if we allow ourselves enough time – which we should, considering the vastness of problems – empowerment should be one of our prime strategies; we should allow the target groups to organize themselves to play their role too in changing the enabling environment and enhancing the effectiveness of a number of interrelated interventions.

4. Intervention Strategies, the Role of Finance

The analyses presented in the previous chapters made it clear that supply-side policies have their limitations. Still there is a felt need for adequate and appropriate intervention programmes that are in line with the advocated demand based policies. Financing and credit programmes could continue to be an important instrument for small and micro enterprises support. It has even proved to become more and more important. Financing seems to be one of the few interventions that can be controlled or even owned by the target group (at all levels). The Roscas, Susus, or Tontins are examples of it, but also the credit and savings associations or the small enterprise finance institutions.

It has become clear that in future the informal money markets have to absorb also quite a significant part of the bulk of financial needs of the small and micro entrepreneurs. Moneylenders and informal credit associations are seen as important instruments performing major services.

Of paramount importance is the link between credit and savings, as shown by successful institutions. Whenever savings programmes are linked to credit facilities it has been demonstrated that the effectiveness of the finance operations has improved. Commitment of the borrowers is translated clearly in the willingness to save, but even more important is the understanding of the importance of saving.

Savings are a way to mobilize funds on the one hand, and as a means of social mobilization and social organization. On the other hand this can be channelled further into group-based savings and credit programmes (such as Grameen Bank-Bangladesh) or into group-based guarantee systems (such as the INSOTEC-Ecuador promoted programme). Group formation for the small borrowers plays a very important role and in many occasions is most appropriate given the prevailing socio-cultural context.

Numerous evaluations of formal finance systems have revealed the limitations of the latter to reach the underprivileged. Secondly, the informal systems lack to an extent the pertinent know-how and funds to give sufficient impetus to the sector to grow and develop further. Links should be found between the informal and formal financing systems.

When searching for ways to link formal and informal systems, it should be borne in mind that both systems operate with a set of acceptable standards that do not necessarily have to be modified. The informal systems are successful because of the accessibility, flexibility, very low degree of formalization or bureaucratization, and use of social pressure.

The formal system can only survive if it continues to adhere to existing banking principles such as risk avoidance, cost minimization and accountability. The linking of the two systems would occur with the introduction of methods that respect the characteristics of both systems. Thus, collateral requirements remain an issue for the formal system; a requirement that can be overcome through certain types of guarantee systems. Secondly, transaction costs are still to be covered, thus when NGOs and PVOs can take over some functions from the banks, it will reduce the burden of the latter but not eliminate the costs themselves. And when risks are high, this must be reflected in the interest rates.

The now widely accepted view is that there is generally not a shortage of funds. It is rather a matter of accessibility. Many banks have a good liquidity and would welcome the possibility of new profitable operations; hence a need to open channels to the banks as well. In this respect it must also be taken into account (see also chapter VII, Jacob Levitsky) that financing operations are best administered by specialized entities. Rather than again setting up new institutions, efforts should be deployed to strengthen existing ones. Jackelen (1988) rightly argues that NGOs and PVOs could become a vital instrument in linking formal and informal systems. But, organizations with a social mission such as NGOs or PVOs should not be lured into credit operations if their organization is not up to it. In such cases preference is to be given to linking the latter with financial entities proper. This again should be directly linked to the issue of sustainability and viability. Scattered credit operations undertaken by a vast number of organizations at a very limited scale prove to be very inefficient and with limited impact. Combining efforts enhances operations tremendously.

Two other elements deserve further attention in the years to come. Group formation may have a long-term positive effect on the credit and finance operations. Even though it is a costly operation on the short run, it seems to be instrumental in reducing risks and linking formal and informal systems (see also chapter VII).

Second, and in line with the findings of Farbman and Lessik (chapter VI), supporting technical assistance programmes have only a limited impact on the performance of borrowers. Once an enterprise reaches a certain stage (a more formalized one) individualized technical assistance might be of use; whether comprehensive technical assistance programmes have a positive contribution to the development of micro enterprises remains to be investigated. Whatever the outcome of such research, it is an accepted fact that such technical assistance remains to be treated as a subsidy to the sector, as it can never be launched on a cost recovery basis.

5. Group Specific Programmes

The analyses put forward by Marty Chen (chapter VIII) and the ORU study (1988) throw more light on the importance of group specific programmes in the small and micro enterprise sector. But even more important are the observations that programmes should be based on two mutually complementary strategies. To arrive at a balanced development policy, attention is to be paid to the following two strategies:

- the developmental strategy which is directly related to the tangible, visible environment, i.e. the potential for development of the business, and
- the policy intervention strategy, dealing with the conglomerate of invisible issues (i.e. the sets of laws, regulations). The latter should take into account pertinent policy changes at three levels; the micro level (the direct environment of the business), the meso level (district, municipality level) and the macro level (national policy level).

In order to arrive at a persuasive policy dialogue, the organization of the actors (entrepreneurs) at all levels has proved to be effective. Through such an organization the entrepreneurs can act as pressure groups that are in a position to put their views across, and they often succeed in obtaining the required policy adjustments.

When programmes are set up to assist women one should take into account the multiple roles of women entrepreneurs (thought should thus be given to the entrepreneur in her capacity as consumer, producer, housekeeper, and last but not least the social organizer).

Empirical evidence demonstrates that sectoral, or group specific approaches have positive effects, as long as they can be linked to programmes to change policy and environment.

Furthermore, it has become evident that group specific programmes can be successful if they are directed both to potential, new starters, and to existing business operators. Creating an environment conducive to establishing more new enterprises is important as well as safeguarding existing employment and sources of income.

6. New Donor Initiatives

During the past ten years or so more insight has been gained about the relative impact of the various intervention techniques and the short and long-term impact of adopted policies.

In the introductory comments of the editors of these proceedings reference has already been made to the numerous conferences and seminars held in the Netherlands, not disregarding the importance of the numerous studies carried out on the international scene.

Perhaps the most important studies in this field to refer to are the PISCES studies (Farbman, 1981), the research programme by the Michigan State University (Liedholm & Mead, 1987) and the RSIE study (1988). In chapter II these experiences have been analysed in their aggregate form. The basic questions to find an answer to are: Why have donor agencies for such a long period avoided to work out demand specific programmes? Why were those reached either the 'easy-to-reach' groups (the better off, more urban and more developed entrepreneurs), and in those rare cases where the weaker groups were reached (women, the self employed, refugees, handicapped, poor rural people), why so few? In summary: why have so many programmes, projects, seminars and workshops accomplished so little?

Analyses of the past have thrown more light on the many pitfalls to expect, the many difficulties for which no answers are readily available yet as has been rightly argued by Marilyn Carr (chapter IX). The first and foremost and gravest point to mention is whether outside intervention for small, micro or informal sector type of firms can produce any positive result at all, i.e. whether such interventions can lead to incremental growth and to combatting poverty. The next step then is to design interventions that comply with both economic criteria and development requirements. Calculations have been made of the interest rate required in Indonesia for small-scale lending schemes that would be completely recovering their costs, including bad debts. That interest rate would be around 50%, which by any standard would be at any political level unacceptable if inflation would be only 9%. Do we thus have to be a passive observer only? On the contrary, as proved by the analyses in the previous chapters.

Promotion of small and micro enterprises forms an integral part of overall development policy. The generation of jobs, income and growth is not only to be measured in macro-economic terms. The small and micro enterprises are also a vehicle for overall development, supporting other sectors (through processing, distribution and supply of goods and services), and being supported by other sectors too (i.e. surplus cash income from the agricultural sector stimulating the sector, or potentials generated by the modern sector for instance for the sector through hitech development).

Small and micro enterprises are there to stay and deserve continuous support. So the question at hand is not whether to do anything, but at what level of income, living standards, job security, and future perspectives for the generations to come to direct programmes.

Essential in this respect is first to learn from those programmes that were successful. Group specific programmes such as the ones set up for - and, more importantly, by - women have demonstrated the importance of setting up networks, group organizations and policy dialogues.

Secondly, initiatives deployed by Non-Governmental and Private Voluntary Organizations deserve further support and eventually replications. Thirdly, serious thought

should be given to the question why local programmes set up without external interventions such as the ROSCAs, sometimes have been successful.

It is thus essential to formulate a number of critical questions. Questions not to criticize present initiatives but formulated as a new step forward.

- Is it possible to design new monitoring and evaluation systems that generate more insight in the relevant impact of new and existing programmes?
- Is it possible to measure the incremental impact of small and micro enterprises?
- Is it possible to enhance existing supply-side programmes whenever the overall policy environment is indeed favourable for small and micro enterprises?
- Is it possible to support local initiatives of local self-help organizations, so that they initiate and stimulate further processes to change present conditions?
- Is it possible to extend the network of expertise by strengthening consultancy organizations in developing countries, and even more importantly, by strengthening local organizations, training local consultants and professionals?
- Is it possible to support government efforts to strengthen their planning capacity in such way that governments will be in a position to coordinate the various donor initiatives?
- Is it possible to establish linkages between formal development agencies, (or formal organizations) with local, more informal systems, while continuing to respect the characteristics of both systems?
- Is it possible to identify the subsidy elements in programmes for small and micro enterprise development and promotion, consequently facilitating the ultimate policy decision whether to support the sector or not, and on what grounds?
- Is it possible to identify specific government intervention mechanisms that will contribute to the creation of an enabling environment?
- Is it possible to design long-term intervention programmes that eventually will lead to a more favourable environment for the sector?
- And subsequently: Is it possible to identify local groups that eventually will be the key actors in such a policy dialogue, and is it possible to introduce a process of organizational development that will ultimately give such groups the pertinent capacity to undertake this task?

The various options need to be carefully investigated. Hence, to that end basic quality research is needed into the various processes and their intricacies. In general one can observe that further discussions are needed on the required policy influencing the sector both directly and indirectly. If we consider macro policies vital to enable the small and micro enterprises sector to develop further, coordination of donor intervention is needed. But there are a lot of inconsistencies as far as policy coordination is concerned too, particular if we take into account the range of vested interests. Thus, strengthening of policy advisory structures and training for policy makers is of paramount importance for the various countries.

Concluding remarks

Discussions on demand-side policy vs. supply-side policy have not yet matured to the full, probably because the differences between both policies are not always clear ones. Supply-side policy is still particularly viable where NGO support is concerned or where government extension and business advisory organization has been given an autonomous status and are operating at local or district level mainly.

Again, supply-side programmes are effective where certain vulnerable groups or sectors are supported and where it can have a demonstration function in order to influence policy. Intermediate institutions in general have failed to carry out the tasks originally assigned to them. Too much has been expected of them, too many programmes have been suggested, especially to the more successful ones, and too little freedom to design their own policies has been allocated to them. But their outreach capability is undisputed. Staff training could be strengthened to overcome part of those problems.

As has been argued before, group specific programmes continue to warrant (even increasing) attention and support; special approaches for specific target groups have proved to be effective. To get better insight into their programmes, more in depth and longitudinal research might be needed.

From the analyses made so far, one may conclude that new initiatives in the future should reflect the widely accepted view that small and micro enterprises are there to stay, that economic activities at a wide spectrum deserve further support, and that new programmes should incorporate both the economic and the social development objectives. Economic development for the poor and underprivileged will not be possible if the poor are left out.

Particularly programmes that promote and develop income-generating activities, as well as small and micro enterprises, will be instrumental in ensuring a balanced development process.

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ANNEX I

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ANNEX 3

ABBREVIATIONS

AEPRP	African Economic Policy Reform Programme
AMM	Annapurna Mahili Mandal (India)
APEMIPE	Asociación de Pequeñas y Medianas Industrias de Perú
ATI	Appropriate Technology International
BCP	Banque Centrale de Crédit Populaire (Marocco)
BINGO	Big International Non-Governmental Organization
BRAC	Bangladesh Rural Advancement Committee
CBE	Community and Brigade Enterprise (China)
CIDA	Canadian International Development Agency
EC	European Community
FAO	Food and Agriculture Organization
FENAPI	Federación Nacional de Asociaciones de Pequeñas Industrias
GDP	Gross Domestic Product
GNP	Gross National Product
ILO	International Labour Organisation
IMF	International Monetary Fund
ITDG	Intermediate Technology Development Group
KVIC	Khadi and Village Industries Commission (India)
LSE	Large-Scale Enterprise
NCKK	National Council of Churches of Kenya
NGO	Non-Governmental Organization
NIC	Newly Industrialized Country
ORU	Operations Review Unit (the Netherlands)
PVO	Private Voluntary Organization
R&D	Research and Development
ROSCA	Rotating Savings and Credit Association
SADCC	Southern African Development Coordination Conference
SEDCO	Small Enterprise Development Corporation (Zimbabwe, Swaziland)
SEWA	Self-Employed Women's Association (India)
SIDO	Small Industries Development Organization (Tanzania, Zambia)
SME	Small and Micro Enterprise
SMIDA	Small Industry Development Agency
SSE	Small-Scale Enterprise
SSI	Small-Scale Industry
UERC	Upazila Employment Resources Centre (Bangladesh)
UN	United Nations
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNICEF	United Nations Children Education Fund

UNIDO	United Nations Industrial Development Organization
UNIFEM	United Nations Development Fund for Women
USAID	United States Agency for International Development
WWF	Working Women's Forum (India)



