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# Financing the Development of Small Scale Industries.

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# Small Scale Industries

This research project was a collaborative effort of the International Bank for Reconstruction and Development and the Swedish International Development Authority. The research team consisted of David Kochav (Chief) and Nurit Wahl (IBRD consultants), Kathleen DiTullio (IBRD staff member), and Holger Bohlin and Ilmar Roostal (SIDA consultants). The fieldwork was conducted between November, 1973, and March, 1974.

Table of Contents

TABLE OF CONTENTS (Cont'd)

## PREFACE

With the increasing demand for the growth of more labor-intensive, employment-generating activities in developing countries, a great deal of attention is being given to the potential of small-scale enterprises. In the more advanced semi-industrialized and industrializing countries the concern is with the broadening of what is often still a top heavy industrial structure dominated by capital-intensive, large industries. In the countries still on the verge of industrialization, on the other hand, efforts are being made to find ways to create an indigenous pool of entrepreneurial skills and an industrial labor force. Overall, it is usually expected that a wide range of objectives might be served by increasing the resources available to assist small-scale manufacturing and business activity.

It is generally recognized that solutions to the problems of small enterprises have to be very country-specific, depending on inherited skills, socio-economic background, the stage of development, and past and current policies. There is a need nonetheless to try to distill the common elements of what is needed to succeed in the encouragement of small enterprises and, within this framework, the measures needed to provide effective financial support of such enterprises. This study was commissioned with this aim in mind. It is based on visits to eight countries - Colombia, Guyana, Iran, Korea, Singapore, Trinidad and Tobago, Tunisia, and Zambia -- and also draws on experience of a number of other developing countries including Bangladesh, India, Israel, Kenya, and Pakistan. The report summarizes the common financial problems that appear to be universally present in one form or another for smaller manufacturing enterprises and the kinds of solutions that warrant consideration by international development agencies that want to assist in the growth of small-scale enterprises.

The findings may be considered negative in that no successful experiences that could be held up as models were found. While governments and international development agencies have shown interest in small-scale industries, past efforts at providing assistance that could actually be used by a large number of small entrepreneurs have been, at best, half-hearted. This is an unsophisticated target group compared to modern medium and large enterprises; there is great reluctance to take the risk of lending to these small entrepreneurs and of supporting the spread of something less than "modern" techniques. Moreover, the information available on the role of small industries vis-a-vis other industries and the economy as a whole, and on the financial costs of lending to small firms and providing technical/managerial services to them is lamentably poor, even in institutions which have been operating in this field.

All of these constraints make it difficult to assess what might be a single best approach to promotion of small industries, and what the costs of such programs would be. The following findings thus do not present tested expertise for the effective financing of small industries in developing countries. Such expertise will only come as a result of increasing efforts of international and particularly by national development institutions.

This report provides an introduction to a difficult task, and suggests some options for the financing of small-scale industries on the basis of current knowledge and experience. Its views are those of the research team and not necessarily those of IBRD or SIDA.

xii. In most cases it would be preferable for a small enterprise to have all of its credit requirements -- medium- and long-term as well as short-term -- channeled through the same intermediary. If this is not feasible due to institutional constraints, it would be necessary to secure coordination between the different institutions providing credit to the same small enterprise.

xiii. There is not enough experience to indicate what spread is needed between the cost of funds to the financing institution and its lending rate to small enterprises. A few cases indicate that for specialized institutions lending to small- and medium-sized industries, a spread of 5 to 6 percentage points might be appropriate. In any event, the spread is likely to be higher in lending to small enterprises than to larger ones, and therefore the interest rate charged to small enterprises would be higher than that charged to larger enterprises. Such a difference is perhaps undesirable, but it would be tolerable if the main problem -- that of providing adequate credit to small enterprises -- can be overcome.

xiv. To reduce risks to the financing institution and to encourage lending to new entrepreneurs, a guarantee fund would under most circumstances be required. Most of the risks associated with such a fund would have to be underwritten by the government, but a minor part of the costs should be covered by participation of the borrowers themselves.

xv. Many small enterprises, particularly newly established ones, have insufficient equity. Given the difficulties of providing effective management participation or follow-up, it would probably be unrealistic to expect financial institutions in developing countries to provide equity capital for small industries on a significant scale. Where shortage of equity is a serious constraint, financing institutions could be encouraged to include in an overall financing package an element of long-term, low-interest credit, with a highly flexible amortization schedule, as a partial functional substitute for equity.

xvi. Flexibility in amortization schedules is needed in lending to small enterprises, which are often inexperienced in projecting future cash flows, and which almost always face considerable uncertainties in this respect. Financial intermediaries lending to small enterprises should adopt liberal amortization schedules, and should not themselves be overly dependent upon strict cash flow projections.

xvii. Leasing of equipment could be a useful technique of financing small enterprises, particularly in mitigating the problem of security for medium- and long-term loans. Leasing companies should be encouraged to provide their services to small enterprises in developing countries, and assisted in doing so.

xviii. Financial intermediaries lending to small enterprises should also provide their borrowers with assistance in basic financial management, such as bookkeeping, maintenance of adequate records, and debt collection.

Provision of Technical/Managerial Services

xix. Provision of financing to small industries without concurrent provision of basic technical and managerial know-how could be ineffective and sometimes even counterproductive. In the countries visited, existing technical services programs are too small to reach the vast number of small enterprises, and are generally not adapted to their particular requirements.

xx. At early stages of industrialization, technical/managerial services to small industries might concentrate upon extension-type services, employing "generalists" experienced and/or trained in problems of small-scale industry. At later stages of industrialization, emphasis upon specialist technical services able to provide specific assistance in particular sub-branches appear to be more useful.

xxi. It might be worthwhile to establish a few institutions providing both financing and technical services for small industries within the framework of intensive in-depth development programs, particularly in a sub-regional context. Realistically, however, this could be accomplished only gradually, and only in a limited number of small countries or sub-regions of larger ones. Alternatively, technical/managerial services could be administratively separate from financing institutions, yet closely coordinated with them in a two-way relationship. Small entrepreneurs could be required by the financing institution to obtain necessary assistance from the technical service institution; on the other hand, the technical service institution should be in a position to recommend provision of appropriate financing.

xxii. Costs of technical/managerial services are bound to be high, and would have to be covered mostly by government funds regardless of whether such services are separate from or combined with financing institutions.

Intensification of International Assistance for the Development of Small Industries

xxiii. International development agencies could help promote a more balanced industrial structure in developing countries by intensifying their assistance to small industries. Such assistance should be based upon an overall approach to the problems of small-scale industry in a given country, used as much as possible as a lever for institution building, and tied in with arrangements for providing suitable technical/managerial assistance.

xxiv. The main effort should be to reach, through intermediaries, small enterprises employing up to 20 workers, not only in manufacturing but also in related activities such as construction, transportation, and equipment repair. Handicrafts and/or cottage industries might also be eligible for assistance, depending upon specific conditions prevailing in particular countries. In fact, the numbers and kinds of small enterprises eligible for assistance from international donor agency sources might most appropriately be determined by the capability of domestic institutions to provide financing and technical/managerial services in an effective way, rather than by a priori eligibility limitations.

xxv. The crucial element in international agency financing is to assist in the establishment of effective institutional arrangements. The specific type of arrangement to be established in any given country must be formulated on the basis of conditions prevailing in that particular country. As stated above, the primary options are: (a) a specialized small industry financing institution; (b) a specialized small industry "window" in a development financing institution; and (c) a fund deposited with a central bank or another institution for relending to small industries through commercial banks. Another technique might be a "package loan" which in addition to the provision of credits would include complementary elements, such as industrial estate components specifically designed for small industries, technical services, and so on.

xxvi. Lending from international sources should cover medium- and long-term credit for fixed assets and permanent working capital. Short-term credits should preferably be made available from supplemental funds provided by domestic financing intermediaries. Most financing, particularly for the smallest enterprises, would have to be in the form of local currency loans. A substantial component of international agency financing should be allocated for technical/managerial services.

xxvii. Substantially increased international assistance for small-scale industry promotion would require specialized expertise, and staff requirements are bound to be considerable. Staffing considerations will of necessity play an important role in an agency's design of programs and they should also be reflected in the division of labor among donor development agencies on lines following comparative advantages in various types of assistance.

## SUMMARY AND CONCLUSIONS

i. The promotion of small-scale industries in developing countries is generally handicapped by a combination of two major factors: (1) the actual policy framework is generally insufficiently conducive to promotion of small enterprises and in practice tends to favor larger enterprises; and (2) institutions designed to provide financial or technical/managerial services to industrial enterprises do not provide sufficient assistance to small firms. In most cases, the smaller the enterprise, the greater the difficulties it faces under existing policy and institutional conditions.

ii. Discrimination against small industries, even if unintended, tends to weaken the overall industrial structure, and might impede rather than enhance the process of industrialization in developing countries.

iii. Surveys in countries visited, as well as in other countries, indicate that small industries make a very significant contribution to industrial development. Small industries employing up to 50 workers contribute 70% to 80% of industrial employment and 30% to 45% of manufacturing value added in the "industrializing" countries visited (Columbia, Tunisia, and Iran). In other countries visited, such as Korea, Singapore, and Israel, the share contributed by small-scale industry is considerably smaller, but even in these countries they provide at least 20% to 30% of industrial employment and 15% to 25% of value added. In addition to their quantitative contribution, small industries serve as an indispensable training ground for indigenous entrepreneurs, managers, and industrial workers.

iv. In most countries visited, stated governmental support for small-scale industry is not translated into effective action -- particularly in the case of the smallest enterprises -- either because the actual incentive structure implicitly favors large enterprises, or because small industry promotion programs (with few exceptions) have achieved little success. In several countries, small-scale industries have made progress despite, rather than because of, government policies and incentives.

v. Measures to correct policies which in effect discriminate against small industries have been suggested in "Small Enterprises in Manufacturing: The Emerging Issues." 1/ The removal of discriminatory policies is a necessary but not a sufficient condition. Effective promotion of small enterprises on a significant scale also requires a combination of programs, incentives, and institutional arrangements. The formulation and implementation of necessary policies, together with requisite program follow-up, necessitates a governmental unit concentrating solely on formulation of appropriate policies and programs for promoting small-scale industries.

vi. In selecting target groups within the wide range and variety of small-scale industries, enterprises employing up to 20 workers appear to require the major concentration of effort in promotion programs. Such enterprises represent an important segment of almost every developing economy, and

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1/ IBRD, Economics of Industry Division, June 1973.

at the same time have very limited access to regular financing and technical services institutions. Enterprises employing 20 to 50 workers should also be assisted; at the other end of the range, handicrafts and cottage industries employing less than 5 workers might be assisted when they appear to have potential for increased productivity.

Provision of Financing

vii. Shortage of finance is not the only obstacle to promotion of small-scale industries, but it is generally an important constraint. Surveys in the countries visited indicate that small enterprises face great difficulties in obtaining funds from regular financing institutions, because of higher lending costs, greater risks, and the difficulties which confront many small entrepreneurs in complying with bank procedures and requirements. The type of credit that small industries find it most difficult to obtain is medium- and long-term financing. The smaller and newer the enterprise, the greater are the obstacles generally encountered.

viii. In the countries visited, a variety of institutions or arrangements exist for providing credit to small-scale industries. Such arrangements have met with some limited success in terms of increased lending to small industries, although even specialized institutions have tended to lend to the larger and more established of the small enterprises. In any case, the impact of existing programs is still marginal; they reach only a fraction of the small enterprises, and many small industries still depend on "unofficial" lending sources, sometimes at exhorbitant interest rates.

ix. An effective program for financing of small-scale industries should incorporate the following common elements: (a) provision of all types of loans, including medium- and long-term financing, as well as short-term credits; (b) a branch network to reach small enterprises in widely dispersed locations; and (c) some basic financial management services. These program requirements can be met by a variety of institutional arrangements, some of which would require innovation.

x. Depending upon the particular conditions prevailing in a given country, financing for small-scale industries could be channeled through: (a) a specialized small industry financing institution; (b) a specialized small industry division in a development financing institution; or (c) a small industry promotion fund deposited with a central bank or in another appropriate institution.

xi. Except in a limited number of very small countries where a few branches of a small industry bank or development bank could directly reach small enterprises, commercial banks can serve as useful -- and often indispensable -- intermediaries, capable of reaching a great many small enterprises in widely scattered locations. In addition to relending on a medium- or long-term basis funds channeled to them by the major institution suggested in x, commercial banks might also be able to provide from their own sources complementary short-term loans for seasonal or peak-load working capital requirements.

# I. INTRODUCTION

1. The International Bank for Reconstruction and Development (IBRD) in collaboration with the Swedish International Development Authority (SIDA) commissioned a study of the principal issues that arise in lending to small-scale industries. In accordance with the terms of reference for this study, the research team carried out surveys of small-scale industry financing and related programs in eight developing countries.

2. The countries visited were selected on the basis of geographic dispersion, difference in level of development and industrialization, and the existence of promotional programs for small-scale industries. They included Colombia, Guyana, Iran, Korea, Trinidad and Tobago, Tunisia and Zambia. A short visit was also made to Singapore.

3. The general findings and conclusions of the study, however, have not been based only on these surveys. The research team's experience ranged from small-scale industry problems in developed countries such as Sweden, and in relatively high income developing countries such as Israel, to low income countries such as Bangladesh and Kenya. The consultants also drew on the World Bank Group and SIDA experience in the promotion and financing of small-scale industries and on information from major organizations active in this field. These included ILO, UNIDO, the GATT/UNCTAD International Trade Centre and some bilateral institutions.

4. This report, in common with other studies of small-scale industries in developing countries, is seriously handicapped by the inadequacy and frequent unreliability of the data and other information available. Because small-scale industries are the least organized and most "informal" industries in most countries' manufacturing sectors, their activities are often unreported and at best underestimated. The data that are available are frequently not comparable to statistics for an economy as a whole. The unavailability of data regarding specialized institutions and commercial banks' financial operations pertaining to small-scale industries was a particular problem for this study. The views expressed in interviews in various countries were therefore often of necessity based upon impressions rather than on statistical records. The analysis that follows is naturally affected by these limitations. Nevertheless, the principal conclusions emerged across countries, so they may at least serve as hypotheses on which practical proposals may be based until better data are available.

## II. DEFINITION AND CONTRIBUTION OF SMALL-SCALE INDUSTRIES

### Operational Definition of Small-Scale Industries

5. The definition of small-scale industries varies with a country's size and level of industrialization. Thus enterprises which may be classified as "small" in some countries, are termed "medium sized" or even "large" in others. Even within a country the small industry group may sometimes be usefully subdivided into sub-categories for different programs. The following principal categories appear to be most meaningful for operational purposes:

(a) Small, independently owned, manufacturing enterprises, 1/ employing up to 20 workers. This group appears to require the major concentration of support in most countries. Enterprises in this size group form an important training ground for indigenous entrepreneurs and have a significant growth potential. They are particularly important in the small non-industrialized countries where the number of enterprises in this group is generally limited. In other developing countries these enterprises usually form a fairly large group. In general, enterprises in this group have the most limited access to financing and managerial and technical service institutions.

(b) Enterprises employing 20 to 50 workers. These enterprises should also be included in financing and technical assistance programs for small enterprises. Although in most countries they are less disadvantaged, and their needs are less acute than those of the smaller enterprises, they nevertheless generally require more specialized assistance than a development bank can usually offer.

6. Industries employing over 50 and up to 200 workers are also eligible for assistance under small industry programs in several countries, but they have fewer of the typical characteristics of small units. They tend to have a fair degree of division of labor in management functions, and are usually capable of using regular development bank type financing. They can usually also obtain short-term credit more easily from commercial banks than firms with less than 50 workers.

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1/ This study is concerned with independently owned small-scale enterprises. Data, however, are usually collected in terms of industrial establishments, and some of these are owned by medium and large scale firms. It is not thought, however, that this is a major source of distortion in the data base.

7. The number of workers is only one indicator of small enterprises requiring specialized assistance. Another factor is the investment per worker, which could indicate the degree of labor intensity of an enterprise. In a few extreme cases, such as in certain chemical plants, capital investments may be so high and the number of workers relatively so small, that such enterprises should not be classified as "small" for operational purposes; nor would they generally require specialized services designed for small-scale industries. In any case, investments per worker might provide another indicator of small enterprises. In practice, the value of total (rather than per worker) fixed assets of a firm is sometimes applied as an upper limit for small industry classification. The country surveys found a range of regulations limiting small-scale industry loans to firms with US$100,000 in fixed assets to those of US$1 1/2 million in total assets. On the whole, limits based upon the value of assets have little practical use as a guide to program formulation on an inter-country and/or inter-industry basis.

8. It is important to stress that small-scale industry programs should focus, as much as it is possible to evaluate, on economic impact, rather than on size, whether this is judged by employment or capital investment. Such issues as job creation, the training of entrepreneurs and the competitiveness and efficiency of the industrial structure, should guide the formulation of small-scale industry programs.

9. The term small-scale industries should be broadly interpreted and incorporate the following groups:

(a) Handicrafts and cottage industries may sometimes be included in a small-scale industry program, if such enterprises appear to be potentially competitive as individual or cooperative enterprises and where special organizations for their support do not exist.

(b) Artisan type enterprises should be encouraged whether they are traditional (such as bakeries), or modern (such as motor car garages), even if the occupation is not solely of a manufacturing nature.

(c) Manufacturing related activities such as transport and construction may often be usefully combined with manufacturing in small business programs. In some countries lacking indigenous entrepreneurs, even relatively simple trading activities may require encouragement if a pool of entrepreneurs capable of manufacturing activities is to be created. However, as these activities mostly require training in commercial skills, it is usually desirable to keep support separate at the program planning stage, and in the allocation of funds and priorities. Overall, various types of "small business" activities must make a meaningful economic mix. Unfortunately in some countries making efforts to support indigenous entrepreneurs in both manufacturing and trading activities, an imbalance in the assistance given to such

firms seems to be emerging. In Kenya and Zambia, for example, trading tends to be overemphasized, whereas in Tunisia the opposite is likely to be true. A particular country situation may warrant separate agencies to handle trade and services industries; in another, separate programs under one agency dealing with various types of "small business" may be preferable.

(d) Typical small-scale manufacturing activities proper in the traditional sector include food processing industries, textiles, clothing and footwear, woodworking and metal working.

(e) "Modern" small-scale industries catering to more sophisticated markets either directly or as sub-contractors, tend to be technologically more complex and capital-intensive, and to have more standardized products. They tend to play some role in all the principal branches of the industrial classification.

This typology is necessarily sketchy, and cannot be interpreted rigidly. There are other important differences, for example, between the role and needs of import substitution enterprises and export oriented manufacturing firms.

10. For operational purposes, a clear distinction should be made between small industries in urban areas and those in rural areas. Urban areas generally have greater concentration of entrepreneurs, of small business and of small-scale industries. In rural areas business activity is less concentrated, and there is usually very little manufacturing. In some rural areas the distribution of goods and services is still very weak, and particular attention to distributive services may be required, pointing to a small business program, before the expansion of manufacturing becomes possible. It is often advisable to include medium-sized factories in the same special programs as small industries in rural areas. In general, the encouragement of small-scale industries in rural areas is meaningful only in the context of regional integrated development programs as they focus on raw material supplies, local demand and overall employment possibility. This aspect of small-scale industry development is therefore not covered in this study.

11. Whatever the program planned, it is important that a balance be struck among the relative importance of various economic activities in development. Program flexibility can be increased as experience in assisting small enterprises grows, so that programs support overall growth and diversification of the manufacturing sector and related areas.

12. Small-scale industries are sometimes referred to as a sector with the result that their role in, and their dependence on, the total industrial structure is not fully appreciated. It is vital to integrate the support to small-scale industries with overall industrial planning.

Some Observations on the Contribution of Small-Scale Industries to Development

13. The analysis of the economic role of small-scale industries in development was not the objective of this study. The point of departure was the hypothesis that enough was known about the positive effects of small-scale industries on development, and of the disabilities under which they usually operate, to suggest that their particular encouragement is necessary to ensure a sound overall industrial structure in most developing countries. However, insofar as the surveys undertaken for this study bear on the basic hypothesis, the findings are reported here.

14. Quantitative estimates of the contribution of small-scale industries to employment and value added in the manufacturing sector are gravely handicapped by the lack of information on, or gross underestimation of, their activity in the official data. With the exception of Iran, Tunisia and Zambia, in the countries studied establishments with fewer than 5 workers are excluded from manufacturing data. In Singapore and Trinidad and Tobago enterprises with fewer than 10 workers are excluded. In some countries, only licensed or otherwise officially recorded workshops are included in the data, so that numerous unlicensed workshops and artisan enterprises are excluded even if they fall within the size groups surveyed. Table 1 presents official data for the share of small-scale industries, that is, establishments employing up to 50 workers, in manufacturing employment and value added for eight countries. (No data are available for Guyana; Israel is included for comparative purposes.) Where possible (Colombia, Tunisia & Trinidad) estimates of total employment in and value added by small-scale industries were also made. Table 2 shows the growth of manufacturing in the countries studied between 1960 and 1970.

15. Even where official data coverage is limited, small-scale industries contribute significantly to employment in manufacturing. In most of the countries studied small industries employing 10 to 49 workers account for approximately 20 to 30% of the manufacturing labor force. However, in countries for which estimates for all small-scale industries could be made, the contribution to employment in manufacturing (and to total employment) was seen to be substantially higher. Thus for Colombia and Tunisia the contribution to employment in manufacturing rose from 30% and 20% respectively to some 70%. In Trinidad the proportion of employment in manufacturing doubled from some 20% to some 40% when enterprises with less than 10 workers were taken into account. In Iran where official statistics cover all registered enterprises, small-scale industries accounted for some 80% of total manufacturing employment. The contribution of small-scale industries to value added in manufacturing is similarly undervalued in most countries' official statistics. For Trinidad and Tobago the estimated share is 24% compared to the official figure of 14%, for Colombia it is 32% compared to an official figure of 14%. For Iran which has a more complete official coverage it is 44%.

16. In sum, official data in most countries tend to seriously underestimate the contribution small-scale industries are actually making to the economy. This is often accompanied by inadequate attention to the productivity

Table I

The Contribution of Small Manufacturing Enterprises to Total Manufacturing
(In current prices)

| Year | Country | Size Establishments by Number of Workers | Establishments Number | Establishments Percentage | Employment Number (000's) | Employment Percentage | Gross Value-Added Million US$ | Gross Value-Added Percentage | Value Added Per Worker US$ |
|---|---|---|---|---|---|---|---|---|---|
| 1970 | Iran | 1 - 19 | 165,943 | 99.0 | 600.5 | 76.4 | 613.1 | 34.8 | 1,020 |
| | | 20 - 49 | 1,006 | 0.6 | 29.1 | 3.7 | 153.9 | 8.7 | 5,289 |
| | | Total 1 - 49 | 166,949 | 99.6 | 629.6 | 80.1 | 767.0 | 43.5 | 1,218 |
| 1970 | Israel | 5 - 19 | 4,093 | 69.9 | 36.4 | 17.2 | 146.6 | 11.5 | 4,028 |
| | | 20 - 49 | 1,025 | 17.5 | 31.6 | 14.9 | 161.1 | 12.6 | 5,098 |
| | | Total 5 - 49 | 5,118 | 87.4 | 68.0 | 32.1 | 307.7 | 24.1 | 4,525 |
| 1971 | Korea | 5 - 19 | 18,132 | 77.5 | 149.1 | 17.6 | 135.1 | 7.3 | 906 |
| | | 20 - 49 | 2,913 | 12.4 | 87.2 | 10.3 | 102.4 | 5.5 | 1,174 |
| | | Total 5 - 49 | 21,045 | 89.9 | 236.3 | 27.9 | 237.5 | 12.8 | 1,005 |
| 1971 | Singapore | 10 - 19 | 656 | 36.2 | 8.9 | 6.4 | 26.2 | 4.6 | 2,944 |
| | | 20 - 49 | 632 | 34.9 | 19.5 | 13.9 | 53.9 | 9.5 | 2,764 |
| | | Total 10 - 49 | 1,288 | 71.1 | 28.4 | 20.3 | 80.1 | 14.1 | 2,820 |
| 1973 | Zambia | 1 - 19 | 220 | 39.3 | 1.9 | 4.6 | | | |
| | | 20 - 49 | 155 | 27.7 | 5.1 | 12.6 | n.a. | | |
| | | Total 1 - 49 | 375 | 67.0 | 7.0 | 17.2 | | 15.0 | |
| 1969 | Colombia | 5 - 19 | 4,273 | 59.7 | 41.6 | 12.8 | 50.3 | 5.1 | 1,209 |
| | | 20 - 49 | 1,626 | 22.9 | 49.3 | 15.1 | 89.4 | 9.1 | 1,813 |
| | | Total 5 - 49 | 5,899 | 82.6 | 90.9 /a (511.6) | 27.9 (68.5) | 139.7 | 14.2 (32.0) | 1,537 |
| 1970 | Trinidad and Tobago | 10 - 49 | 196 (3,288) | 60.1 (96.2) | 4.5 (13.6) | 17.6 (38.8) | 12.6 /b (23.5) | 14.4 (24.0) | 2,730 (1,724) |
| 1971 | Tunisia | 0 - 19 | 460 | 55.0 | 4.2 | 7.0 | 15.7 | 5.9 | 3,738 |
| | | 20 - 49 | 215 | 23.0 | 7.0 | 12.0 | 27.5 | 10.4 | 3,929 |
| | | Total 0 - 49 | 675 | 78.0 | 11.2 /c (111.2) | 19.0 (70.7) | 43.2 | 16.3 | 3,857 |

/a All figures in parentheses are revised total figures which include estimates for the informal sector and correct for underestimation of smaller firms. See sources for explanations.
/b Gross output data available are basis for estimate of value-added.
/c Permanent employment only.

Sources: Iran: Ministry of Economy, Organization for Small Scale Industry, unpublished survey data. US$ = Rls 76
Israel: Industry and Craft Survey, 1970. US$ = IL 3.5
Korea: Report on Mining and Manufacturing Survey, 1971. US$ = Won 373
Singapore: Census of Industrial Production, 1971. US$ = S 2.40
Zambia: Ministry of Commerce, Manufacturing Companies and Employment at October 1973. Value-added estimate from Industrial Survey Zambia, K. Levison, June 1971.
Colombia: Departamento Administrativo Nacional de Estadistica. Boletin Mensual de Estadistica, Nos. 250-251, May-June 1972. Bogota. Unofficial estimates of 0 - 4 and 5 - 14 groups based on 1964 estimates in R.A. Berry, "The Relevance and Prospects of Small Scale Industry in Colombia, "Economic Growth Center, Yale University, Discussion Paper No. 142, April 1972.
Trinidad and Tobago: Central Statistical Office, September 1973. Estimates for the 0 - 9 worker firms are based on CSO registration figures for 1970. US$ = TT 2.00
Tunisia: Recensements des activites industrialles, Resultats 1971. Institut National de la Statistique, 1973. Estimates for informal sector are from IVe Plan de developpement l'Office d'Artisanat. US$ = .484 Dinars.

Table II

General Characteristics of Industrial Development

| Stage /a<br>Country | Population<br>1970 (Million) | Population<br>Density (per sq. km.) | Population<br>Annual Growth Rate 1960-70 (%) | Gross National Product<br>1970 (Million US$) | Gross National Product<br>Per Capita (US$) | Gross National Product<br>Real Average Annual Growth Per Capita 1960-69 (%) | Gross Value Added in Manufacturing<br>1970 (Million US$) | Gross Value Added in Manufacturing<br>Per Capita (US$) | Gross Value Added in Manufacturing<br>Real Average Annual Growth 1960-69 (%) | Exports<br>As Percent of Non-Resource Based Manufactures in Commodity Exports 1968 /f (%) | Exports<br>Annual Growth 1960-1970 (%) | Labor Force<br>As Percent of Population (%) | Labor Force<br>In Manufacturing (%) | Labor Force<br>Value Added Per Worker in Manufacturing (US$) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Non-Industrialized | | | | | | | | | | | | | | |
| Guyana | 0.7 | 4 | 2.8 | 280 | 370 | 0.7 | 26 /h | 37.6 | 5.0 | 1.2 | 4.6 | - | 15.1 (1960) | n.a. |
| Zambia | 4.1 | 6 | 2.5 | 1,640 | 400 | 5.4 | 107 /c | 26.0 | 19.8 /d | 1.0 | 13.4 | 31.2 | 2.6 (1969) /g | 3,255 (1968) |
| Industrializing | | | | | | | | | | | | | | |
| Colombia | 21.6 | 19 | 3.2 | 7,350 | 340 | 1.5 | 987 /b | 48.2 | 4.5 | 9.6 | 3.6 | 29.4 | 12.8 (1964) | 3,915 (1969) |
| Iran | 28.7 | 18 | 2.9 | 10,800 | 380 | 4.9 | 1,425 | 49.6 | 11.0 /e | 3.2 /c | 12.0 | 30.2 | 16.7 (1966) | 2,164 (1968) |
| Korea | 31.8 | 323 | 2.6 | 7,910 | 250 | 6.4 | 1,351 | 42.5 | 14.2 | 74.3 | 39.6 | 32.0 /c | 13.2 (1971) | 2,111 (1970) |
| Trinidad & Tobago | 1.0 | 184 | 2.1 | 880 | 860 | 3.8 | 130 /c | 127.4 | 10.1 | 12.8 /e | 4.7 | 33.6 | 14.7 (1960) | 3,261 (1969) |
| Tunisia | 5.1 | 31 | 3.0 | 1,270 | 250 | 2.1 | 163 | 32.0 | 6.2 | 23.0 | 4.7 | 24.1 | 9.5 (1966) | 2,943 (1970) |
| Semi-Industrializing | | | | | | | | | | | | | | |
| Israel | 2.9 | 141 | 3.2 | 5,690 | 1,960 | 5.3 | 1,20 | 414.3 | n.a. | 73.2 | 13.5 | 34.9 /c | 23.2 (1971) | 6,636 (1970) |
| Singapore | 2.1 | 3,571 | 2.4 | 1,900 | 920 | 4.5 | 377 | 179.5 | 19.0 | 11.6 | 3.3 | 33.2 | 13.9 (1957) | 2,870 (1969) |

/a Stage of industrial development is determined by indicators developed in IBRD, Industry Sector Working Paper, April 1972.
/b 1969
/c 1968
/d Seriously dropped off.
/e 1967
/f Exports of non-resource based manufactures exclude petroleum, and related products, and unworked non-ferrous metals.
/g Year applies to both columns 1 and 2 under Labor Force unless otherwise indicated

Sources: IBRD, Development Economics Department, Economics of Industry Division, "Statistical Indicators of Industrial Development: A Critique of the Basic Data," October, 1973 (Draft Report)
Population: Columns 1 and 2, Table 1A
Column 3, Table 1B.
Gross National Product: Columns 1 and 2, Table 1A
Gross Value Added in Manufacturing: Columns 2 and 3, Table 1A
Exports: Column 2, Table 1B
Labor Force: Columns 1 and 2, Table 2
Column 3, Table 1A.

IBRD, Industry Sector Working Paper, April 1972, Annex 1, pp. 1-3.
Gross National Product: Column 3
Gross Value Added in Manufacturing: Column 1 and 4.
Exports: Column 1.

of small-scale industries, and to their potential for growth. The systematic collection and analysis of small-scale industry data should thus be included in information on the manufacturing sector to ensure an appropriate base for policy formulation.

17. In all countries studied, the percentage contribution of small-scale industries to value added was smaller, sometimes by a half (Iran, Korea, Colombia), than to employment. The principal explanation of this gap is lower capital intensity; poorer organization of productive factors in many smaller enterprises is also a factor. Further inferences about labor/output ratios cannot be made from overall data. The degree of net effective protection enjoyed by large-scale enterprises is often greater than that which small enterprises can obtain, because the system of protection tends often to benefit mainly larger enterprises. Thus although the value added in domestic currency may be higher for large than for small enterprises, in international prices the differential may be substantially reduced.

18. Traditional small-scale activity tends to be concentrated in non-durable consumer goods, such as textiles, food preservation, clothing and shoes, and printing and publishing, as well as in some intermediate goods. However, in most of the countries visited, small enterprises are moving into other "modern" manufacturing areas as opportunities arise. These opportunities depend on increasing demand and on the supply of local or imported raw materials and of intermediate inputs from larger industries. They are frequently stimulated by trade and other policy changes. Where small-scale industries develop in a healthy policy framework, they broaden out in their coverage, sharing in the output of a large number of industrial sub-branches in which economies of scale are not an important factor in production.

19. Observations and discussions in the countries surveyed indicate that small-scale industries do indeed play an important role as a practical training ground for indigenous entrepreneurs and managers. This is particularly important for the promotion of indigenous entrepreneurship in those countries in which previous colonial regimes failed to do so. Whether small enterprises eventually grow into the larger size group or remain small depends on an individual entrepreneur's abilities, on government policies, particularly those regarding financing, and on the specific conditions within the industry branch. In the countries visited many medium and large enterprises have grown out of small ones within the last decade, although the time taken and the share of total enterprises in this category vary. Thus, small enterprises do appear to serve as entry points and as a practical training ground for local entrepreneurs and managers.

20. In some of the countries visited, small-scale industries have also served as an important training ground for workers; here they have learned manufacturing skills and adapted to an industrial environment and thus to conditions encountered in larger enterprises. Some skilled workers from larger enterprises have also established small enterprises of their own. Such movement is part of a general process of breaking down the barriers to a transition from a traditional to a modern economy, and hence has positive implications for social development.

21. The experience in these and other developing countries suggests that small-scale enterprises do tend to be better adapted than larger ones to local conditions, to using local materials, and to drawing on unskilled or semi-skilled labor. Although it is true that many small enterprises are too weak to survive so that the bankruptcy rate is usually considerable, the large absolute numbers of such units, particularly in the industrializing countries, show a remarkable survival capability. Some, as already noted, are also able to compete and develop into modern medium and even large-scale enterprises.

22. The surveys underlined the complexity of measuring the economic efficiency (private and social) of various sized manufacturing enterprises. Economic efficiency is affected by relative factor prices, the availability of managerial and other skills, access to varying levels of technology, scale factors in a particular industry, and the competitive aspects of the industrial structure. These vary among countries, and even among regions within a country, so that generalization is difficult. Some aspects of efficiency are internal to an enterprise, some are external, accruing to the economy as a whole. "Efficiency" only has meaning in relation to overall economic and social objectives. The methodology of measuring "efficiency" is little developed, the practical problems of field research in this area are enormous, and it will take time before reliable results will be available. It therefore seems important that the observations of the surveys strengthen the presumption that the encouragement of small-scale industries is likely to be worthwhile in development terms.

23. It must be emphasized that the encouragement of efficient, productive and profitable small-scale industries is not presented as an alternative to the stimulus to medium and large-scale enterprises, but as a complementary element in the process of industrialization. The experience of developed countries suggests that a well balanced industrial structure requires a considerable scale span of enterprises. The failure to provide a competitive basis for small-scale industries in relation to medium and large ones is thus likely to impede the process of industrialization.

## III. ESSENTIAL ELEMENTS OF SMALL-SCALE INDUSTRY PROMOTION PROGRAMS

24. Small-scale industry programs now figure prominently in the national development plans of many countries, principally because of the alarming proportions of unemployment and underemployment. In Colombia, Trinidad and Tobago, and Tunisia, Governments are typically placing increasing emphasis on employment-oriented policies; and they assume that the encouragement of small-scale industries will increase employment opportunities. The problems created by rapid migration to overburdened urban centers, and sometimes to better job opportunities abroad (from the Caribbean and Mahgreb countries) provide additional pressures for supporting employment-generating activities and providing entrepreneural openings. The desire to improve the distribution of income is leading to a search for policies and programs which will assist a country's "backward regions." The increased participation of indigenous entrepreneurs through ownership of small-scale enterprises is particularly important in some countries (Zambia, Trinidad and Tobago, Tunisia, Kenya).

25. One of the major prerequisites of an effective program is a strong government commitment to small-scale industry promotion and a realistic view of what can be accomplished in a designated time period. In almost all the countries visited, governments state their strong interest in small-scale industry promotion. However, in most of these countries, and in other developing countries where similar objectives are emerging, the statements are not translated into effective action. The lack of effectiveness arises from one or other of the following reasons:

(a) The stated interest in the promotion of small-scale industries represents sometimes little more than "lip service"; the "revealed preferences" of governmental incentive and assistance programs point out that in practice priority is given to large enterprises.

(b) The goals set for small-scale industries usually surpass reasonable expectations, particularly if existing policies and incentives discriminate against small and labor-intensive units.

(c) The resources allocated to small-scale industry programs are not sufficient, and this is compounded by the inefficient ways in which the programs are implemented.

(d) Programs for small-scale industries are not integrated with the rest of industrial and other sector development; linkage potentials are therefore not utilized.

26. Thus even where governments make an effort to promote small scale industries, there has been little overall impact. The notable exception is India, where central government policies and state programs for financial

and technical support have made an impact. In general, however, in developing countries the vast majority of small enterprises demonstrate their ability to get started and survive despite rather than because of government support. There is ample evidence that many existing firms could substantially increase their productivity and rate of growth, and that new firms could be established in a variety of product lines if policies were more favorable, or at least, not discriminatory, and if adequate financing and technical assistance were made available.

27. An effective program to promote small-scale industries cannot be successfully initiated and implemented unless a government is truly committed to such action. This is particularly true in the non-industrial countries where there has yet been very little growth of indigenous small-scale industries. A commitment has to be transformed into a system of policies and incentives designed to place small enterprises in a position to compete on an equal footing with large enterprises for financial and other resources, and into institutions capable of putting such policies into effect. Programs have to be well-defined and based on a realistic evaluation of the conditions prevailing and the resources available in a given country or region. Given the shortage of capital and human resources, an effective program must generally be selective and commensurate in scale with the means available. To the greatest extent possible, policies should be implemented through a system of incentives, rather than by direct government administrative intervention. The lack of administrative skills often makes such intervention ineffective or even counterproductive because of bureaucracy, red tape, and poor quality of staff.

28. The formulation of a promotion policy for small-scale industries, together with the design and follow-up of programs to implement it, require a centralized high level government unit. At present, in most countries the lack of a clearly defined responsibility and a division of responsibilities lead to inefficiency. The location and organization of such a unit must be determined by conditions prevailing in the country concerned. The unit could consist of a special department in a Ministry of Industry (as in Korea) or in a development bank (as in Singapore). Alternatively, a special statutory body could be set up (as in Iran). In all cases, however, the unit should concentrate its efforts either solely on small-scale industries, or on small industries as part of a small business program.

29. The major functions of a small-scale industry promotion unit should include:

(a) Formulation of policy measures for small-scale industries in conjunction with overall planning for the economy as a whole and for the manufacturing sector in particular. A high level unit is needed to ensure contact at an appropriate level with other planning and implementing agencies.

(b) Investigation of discriminatory aspects of existing policies and the formulation of positive policy countermeasures. This again requires high level contact with other agencies responsible for overall industrial promotion.

(c) Furthering the implementation of appropriate policy measures through legislative and/or administrative action.

(d) Establishment of operational institutions and programs to assist small-scale industries and on-going supervision of such institutions.

(e) Evaluation of institutional and program effectiveness.

(f) Initiation of the systematic collection and analysis of data pertaining to small-scale industries.

30. A small-scale industry policy unit should be headed by a high-level official, charged with the sole responsibility for small-scale industry or business promotion. The government should seek to attract competent staff to such an organization by offering remuneration and status compatible with that of staff engaged in large industry promotion. The permanent staff need not be large, but should be of professional caliber. The agency might require the loan of staff for short periods of time from other agencies and it would have to be empowered to commission studies in particular areas. For example, the effects of import regulations, tax holidays, and similar incentives require study in most countries.

31. The importance of policy formulation cannot be overemphasized. One of the major problems facing small-scale industries in all but a handful of developing countries is the actual discrimination of existing policies against them.

## IV. FINANCING SMALL-SCALE INDUSTRIES

### Access to Finance

32. Only very sketchy information is obtainable with respect to the extent of institutional lending to small enterprises. It is therefore difficult to estimate the numbers and kinds of such enterprises that actually succeed in obtaining bank loans, or the terms on which they obtain them. Nevertheless, surveys in the countries visited confirm that small manufacturers -- as compared with larger manufacturing enterprises and with retail traders -- generally face much greater difficulties in obtaining short-term, medium-term, or long-term credit through institutional channels.

33. The nature and extent of these difficulties is, of course, subject to wide variation. Small entrepreneurs with established reputations and/or substantial collateral of a type acceptable to local bankers can in many cases obtain some short-term financing in the "official" market, often on the basis of personal promissory notes or against accounts receivable. On the other hand, obtaining bank credit of any kind is extremely difficult for enterprises which are less well established, and in particular for new entrepreneurs. The latter groups constitute the majority of small-scale industrial enterprises in many developing countries; they include cottage industries, artisan workshops, and the most labor-intensive of the small factories.

34. To an even greater extent than in the case of short-term financing, the use of medium- and long-term bank credit by small-scale industry is generally restricted to the larger and better established enterprises. Even the relatively favored small enterprises whose access to short-term financing is adequate for their working capital requirements frequently encounter severe difficulties in obtaining medium- and long-term funds for expansion or modernization. In at least some of the countries visited (for example, Colombia, Iran, and Korea) this is a critical bottleneck, evidenced by the existence in significant numbers of well established, small enterprises whose owners have the requisite experience to undertake the debt burden associated with long-term investment, but who have insufficient access to the necessary credits. To a considerable extent, the need for medium-term financing is met by "turning over" of short-term loans, but only at high cost to the borrower and in violation of sound business practice. In some countries, medium-term credit is obtainable by some of the more established and "creditworthy" small enterprises through the commercial banking system, but only to a limited extent.

35. In the absence of recourse to institutional sources of financing, small enterprises in developing countries are often excessively dependent upon credit from suppliers, purchasers, or extra-bank sources and money lenders. The difficulties encountered by at least some small-scale industries in borrowing from credit institutions is attested to by their borrowing in the unofficial (or "curb") money market. In Korea, for example, small industrial enterprises have been borrowing in the "curb" market at interest rates of 35% to

40% (compared to the maximum "official" short-term lending rate of 17.5%) -- not only for marginal amounts, but, according to some sources, for a substantial part of their credit requirements. In Colombia, small enterprises have borrowed from extra-bank sources at interest rates of 36% to 60%, while the regulated lending rate is around 24%. Often, the smallest enterprises make little distinction among various types of credit and the particular uses of each, and as a consequence are likely to use whatever credit they can get from any source for the purchase of tools or machinery, for repairs or improvements, for raw materials, or to finance sales. Interbusiness and "unofficial" loans are sometimes functionally equivalent to equity financing, to the extent that such loans are available for an "indefinite period" and often involve "silent partnership" with lenders.

Constraints Upon Access to Finance

36. From the viewpoint of financing institutions, small enterprises are less attractive than larger ones for the following reasons: (a) smaller profit potential; (b) administrative difficulties; and (c) institutional inertia. The relative importance of these three factors varies from country to country and from sector to sector, but all three are contributory to the generally prevailing shortage of institutional credit for small-scale industries.

37. The profit potential in lending to small-scale industries is less than in lending to larger enterprises because of higher lending costs, greater risks, and the fact that small enterprises typically do not make significant use of other revenue yielding services offered by financial institutions, such as letters of credit, guarantees, and so on. Moreover, where customer deposits are a major source of bank funds, the borrowing needs of small firms generally yield in priority to those of preferred large depositers. Lending costs tend to be high because small enterprises generally need to borrow only small amounts, while the costs of loan administration contain a significant fixed component which is not proportional to the amount loaned. In addition, dealing with inexperienced borrowers requires a relatively high level of staff time input. Risks tend to be greater because small enterprises are typically deficient in equity and acceptable collateral, as well as because the risk of business failure is relatively high, particularly among new entrepreneurs.

38. Administrative difficulties in extending credit to small-scale industries arise from a variety of causes, the relative importance of which varies from country to country. Most pervasive and significant, perhaps, is the fact that lending to a large number of heterogeneous and widely dispersed enterprises is intrinsically more demanding -- in terms of both time and effort -- than dealing with a smaller number of more established and more familiar firms. Basic problems of contact and communication often represent a severe constraint, since in most developing countries few small enterprises are easy to contact at short notice (as for instance by telephone) and many are not conveniently accessible even by automobile. In a number of countries (or sub-regions thereof), bank personnel are likely to be separated from small entrepreneurs not

only by physical factors but also by differences in language, literacy, or culture. Even where such barriers do not severely inhibit contact and communication, personnel of financial institutions are likely to find "new" small borrowers relatively unfamiliar with documentation and accounting conventions, inarticulate or imprecise in the formulation of and presentation of business plans, and generally more "difficult" as customers.

39. While the kinds of administrative difficulties described above cannot be eliminated fully, their inhibitory effect upon the availability of institutional credit to small-scale industries could in many cases be ameliorated by innovative measures on the part of bank management. Typically, however, neither the inclination nor the motivation for such measures are to be found in the banking systems of most developing countries, although there are occasional exceptions. Managerial personnel of successful financial institutions generally tend to be conservative in the conduct and supervision of their business operations. At best, they are reluctant to undertake innovative measures in the absence of clear opportunities for increased profit at acceptable risk. Often their revealed preference is to maintain, with minimum necessary change, an established pattern of profitable customer relationships. Most bank managers in developing countries are not skilled in the art of lending on "book" prospects (an approach required by small companies to a much greater extent than by larger ones), and many are not educated to the profit potential of doing so. Particularly under conditions where loan demand from well established, familiar, medium-to-large firms is sufficient to take up under favorable terms and in accordance with routinized procedure the greater part of a bank's loanable funds, there is little incentive to test untried ground by starting to lend to small industries on a significant scale.

40. The persistence of this inertia is evidenced by the experience of several countries -- including Trinidad, Kenya, and Pakistan -- in which development and commercial banks have been urged by governments to increase their share of lending to small enterprises, and in which matching funds or comparable incentives have in some cases been provided to buttress such requests. Korea provides an exceptional case, where a directive to commercial banks that 30% of their lending be allocated to small- and medium-sized enterprises (5 to 200 workers) showed results, although the share reaching smaller enterprises is not known. In most cases, however, it appears that this type of attempt at persuasion, even when accompanied by incentives, has rarely yielded more than limited results.

41. Factors inhibiting substantially increased institutional lending to small-scale industry (and particularly to the smallest enterprises) do not originate entirely within the domain of bank management. In some countries, the reluctance of financial institutions to lend on a substantial scale to small enterprises has been reinforced by restrictive banking laws or central bank regulations. With respect to the specific shortage of medium-term and long-term credit, in many cases development bank practices require a minimum loan size, thus effectively excluding small enterprises from the favored, subsidized financing available to larger enterprises through development banking institutions.

42. Small entrepreneurs, on their own part, often have difficulty conforming to the procedures and requirements of regular credit institutions. In the smallest enterprises, lack of proper bookkeeping and record maintenance make it difficult to provide information which financing institutions generally require. Moreover, small entrepreneurs in many developing countries are often reluctant to provide financial information to credit institutions. The small businessman's fear of "authority" often exacerbates a mutual distrust between the small businessman and the banker, making it more difficult for the former to cross the social threshold which separates them. The smaller the enterprise, the more the obstacles on both sides are compounded.

Financing Requirements

43. The type of credit that small industries generally find most difficult to obtain is long- and medium-term financing. The relatively low labor productivity of small enterprises is often due to a lack of tools, machinery, or building facilities. Small industries are generally unable to raise productivity by introducing even minimal equipment if they cannot obtain medium- or long-term financing under reasonable conditions. Only the simplest artisanship can be performed without some tools and equipment, and in such fields productivity tends to remain quite low -- as evidenced by the relatively low value of production of artisans and cottage workers, and by their relatively low incomes.

44. The provision of loans to finance normal or "permanent" working capital requirements of small enterprises is in many cases as important as the financing of fixed assets. Although most small-scale industries, and particularly the smallest, are not characterized by lengthy processing or marketing cycles, they need sufficient working capital to finance basic levels of stocks and receivables. Permanent working capital is also likely to represent a significant problem when the volume of business is expanding.

45. In addition to regular levels of working capital, small enterprises also commonly need short-term loans to finance seasonal or other "peak load" capital requirements. Even this short-term credit needed by small manufacturers is required for longer periods than that typically needed by retail traders, since it must be used not only to carry inventories of manufactured products and accounts receivable, but also for raw material inputs and work in process.

46. A minimum amount of equity is needed by small-scale industries not only to limit interest costs (which could become excessively burdensome if the business is entirely dependent upon debt financing), but also to provide an acceptable debt/equity ratio and thereby reduce the risk element for potential lenders. However, few small entrepreneurs possess adequate equity of their own, particularly at early stages of their enterprises. Some small entrepreneurs in developing counties had previously been merchants, or had engaged in other activities -- sometimes even farming -- where they could accumulate some capital resources of their own. In many cases, however, small

enterprises are established by former employees who can bring to the new business little if any equity. For reasons discussed in paragraph 64, it is probably unrealistic to expect widespread institutional participation in providing equity capital to small industries.

47. In general, the less mechanized the enterprise, the smaller are its needs for foreign exchange loans to finance imports. Small industries need mostly local currency loans for the purchase of tools, equipment, and supplies produced locally. Whatever the import content of fixed assets used by small manufacturers, they can usually be financed by local currency loans. Where standard imported equipment is required, it can usually be purchased off-the-shelf from importers for local currency, and the purchase or construction of building facilities requires only local currency.

48. An important aspect of lending programs to small-scale industries in developing countries is the need for a reasonable degree of flexibility in the construction and administration of amortization schedules. More flexibility is needed by smaller enterprises than by larger ones, because the former typically have less ability to forecast cash flow with temporal precision, and less internal control over the scheduling of receipts and payments. Amortization schedules should not be so rigid that such occurrences automatically trigger a crisis between the small borrower and the lending institution. Moreover, a well-designed mechanism for responding to such situations flexibly and without premature recourse to drastic default or collection procedures would probably help reduce the costs of loan administration and supervision. (Further institutional implications of the need for flexible amortization schedules are discussed in paragraph 63.)

Experience with Small-Scale Industry Financing Programs

49. In almost all of the countries visited, specialized arrangements exist to provide financing for small industries. In Colombia and Korea, specialized financing institutions have been established to serve both small-scale and medium-scale industries. A specialized Artisan's Bank concentrating on small-scale enterprises operates in Israel. Tunisia plans to establish a specialized small industries financing institution. In Trinidad a special division for small-scale industries has been organized within the industrial development corporation. In Zambia, one of the public financing institutions specializes in small business, including manufacturing enterprises. In Iran, Singapore, and Colombia, special funds have been established for disbursement to small industries through institutions not specializing in this type of financing. In Colombia, Tunisia, and Kenya, loans to small-scale industries are rediscountable from a special fund at the central bank. In Iran and Korea, special guarantee funds for small industries have been established. Chart 1 presents a graphic summary of the variety of public sector programs used for channeling funds to small-scale industries.

Chart 1

Specialized Public Sector Programs for Financing Small Manufacturers

| | Available for Small Manufacturers via Commercial Banks | | | Specialized Institutions for Small-Scale Manufacturers | | |
|---|---|---|---|---|---|---|
| | Earmarked Funds | Redis-counting Facility | Guarantees | Small Manufac-turers | Division of Development Corporation | Small and Medium Manufac-turers |
| Colombia | | "X" | | | | "X" |
| Iran | "X" | | "X" | | | |
| Israel | | | | "X" | | |
| Korea | | | "X" | | | "X" |
| Singapore | "X"[a] | | | | | |
| Trinidad | | | | | "X"[b] | |
| Tunisia | | "X" | | | | "X" |
| Zambia | | | | | | "X"[c] |

Note: "X" designates one or more arrangements under heading given.

(a) The special fund arrangement has been dismantled and integrated into the regular financing.

(b) For small business generally with about half of lending to manufacturers.

(c) For small business generally, with reportedly 10-15% of its lending to small manufacturers.

50. In several countries (including Iran, Kenya, Korea, and Trinidad), commercial and development banks have been requested by their governments, central banks, or their own boards to increase their lending to small manufacturers. In some cases, guarantees, rediscounting facilities, or matching funds have been provided to back up such appeals. There has been some limited success in increasing lending to small enterprises (particularly to the larger and more established of them) through such requests, when coupled with incentives. Nevertheless, considering the total amount of lending channeled through these institutions, the overall impact in terms of increased lending to small-scale industries may -- at least in the countries surveyed -- be characterized as marginal.

51. The practice of subsidizing interest rates for small-scale industries is not widespread, at least in the countries surveyed. Only two -- Iran and Trinidad -- have concessionary interest rates, with a four to seven percent differential, in favor of small enterprises.

52. In most countries, special funds for lending to small-scale industries have been provided primarily from the government budget, and to some extent from external loans. In Korea, Tunisia, Colombia, and Trinidad, resources of regular banking institutions provide a significant share of the short-term credit available to small manufacturers. Even in these countries, however, small enterprises face grave difficulties in obtaining medium-term or long-term credits from institutional sources.

53. Despite the existence of arrangements along the lines outlined above, however, the bulk of small-scale industrial enterprises in developing countries remain overly dependent upon non-institutional channels of financing (money lenders, family, friends, silent partners, suppliers, etc.), or they do not have access to financing at all. It is true that some of the countries surveyed have only recently begun to implement their programs. Nonetheless, the limited success of most such programs in achieving even a modest impact must be noted.

Institutional Considerations in Financing Small-Scale Industries

54. As discussed in the following section, a number of alternative institutional arrangements (and combinations thereof) may be suitable under varying circumstances for channeling credit to small-scale industries. Whatever the particular institutional arrangements, however, there are some problems and considerations that would be common to all programs for effective lending to small industry.

55. An effective program for financing small-scale industries should incorporate the following elements: (a) provision of all types of loans, including medium and long-term funds for fixed assets and permanent working capital, as well as short-term loans; (b) a branch network to reach small enterprises spread out over widely dispersed neighborhoods in metropolitan areas, as well as those in other urban areas; and (c) provision of basic financial management services.

56. There appear to be significant advantages in an arrangement under which long-term, medium-term, and short-term loans to small-scale industrial enterprises could be provided by the same financing institution, due to three main considerations. First, the financial needs of the typical small manufacturer are less distinctly classifiable in terms of amortization period than the financial needs of larger firms. Second, the provision of all financing requirements by the same institutuion would facilitate the use of credit by small-scale industries, ameliorating problems of physical access and communication, while at the same time reducing the "red tape"and legal complications involved in providing financial reports and collateral or other forms of security to multiple lending institutions. Third, an institution providing all types of credit to a small industrial enterprise could more easily and efficiently follow up on its loans and provide requisite assistance in financial management. Such capability might be expected to have a favorable impact upon the default rate, thus helping to reduce the risk (and thereby the overall cost) of lending to small-scale industries.

57. Integration of short-term, medium-term, and long-term lending within the same institution, however, would be contrary to convention and established practice in most developing countries, and contrary to banking regulations in at least some of them. Even in circumstances where such handicaps could be overcome, it might not always be desirable to do so. Specialization of some institutions in short-term lending and of others in medium-term and long-term financing can yield potential benefits in higher levels of staff expertise and institutional efficiency. It is difficult, expensive, and time-consuming to build a new organization capable of performing multiple complex tasks at an acceptable level of efficiency, and what should be considered in each case is the trade-off between generalization of institutional function and proficiency of institutional performance.

58. In countries or regions where it is either infeasible or undesirable to have long-term, medium-term, and short-term financing directed to small-scale industry through the same institutional channel, and where the small entrepreneur must accordingly deal with two or more financing institutions, some provision should nonetheless be made for coordination of the financing provided by the separate institutions. Ideally, such coordination should extend to facilitating integrated use by the small enterprise of credits obtained from different institutions for different terms. Coordination of this type might be provided as an element of the financial management assistance discussed in paragraph 65, or under the technical services arrangements discussed in Chapter V.

59. Except in the smallest and most geographically compact of the developing countries, one of the major problems confronted by a small-scale industry financing program is that of achieving widespread geographic coverage. In countries where commercial branch banking networks are well established, it would be highly desirable to make maximum feasible use of their trained staff and multiple office locations. The integration of commercial banks into an effective program for financing small-scale industries is not without its difficulties, however; both the problems and the opportunities inherent in such an arrangement are discussed later in this chapter.

60. In countries where it is impractical -- for whatever reason -- to make use of commercial branch banking networks as intermediaries for small-scale industry financing, it will be necessary to establish or strengthen specialized lending institutions along lines discussed in the following section. In such cases, means would have to be found for servicing small-scale industries in locations other than the city or area containing the headquarters of the specialized institution. Perhaps the best way to reach such potential borrowers would be to set up, over a period of time, a number of branch offices. This has been done with some success in Colombia, Israel, and Korea. Cost considerations and the likely shortage of suitable personnel would generally limit the establishment of such branches to a number of regional or provincial centers. Prospective borrowers, however, are likely to reach such centers, particularly for long-term or medium-term financing, provided that distances and travel costs are not excessive.

61. As a supplement to conventional long- or medium-term loans for acquisition of fixed assets, equipment leasing or hire-purchase arrangements may be a suitable financing technique in some countries. Leasing of equipment, as compared to its outright purchase with borrowed funds, has several potential advantages for small enterprises in developing countries. First, it could mitigate the problem of financial security for loans -- a problem that is likely to remain salient among many bankers in developing countries, despite efforts aimed at inducing them to lend more on the basis of "book prospects" and less on the basis of collateral. Second, lease contracts can, within broad limits, be tailored to the circumstances of individual small enterprises. There are, however, offsetting disadvantages to equipment leasing: (a) the concept as well as the contractual procedures involved may be unfamiliar both to institutional staff and to the small entrepreneurs; (b) cultural or historical factors may predispose many small entrepreneurs to preferring formal ownership of equipment over availability for use, even though the practical consequences may be identical.

62. Although leasing companies are not prevalent in most developing countries, their entry might be encouraged. There is precedent for the establishment of leasing companies as subsidiaries or divisions of commercial banks, and in some cases development banking institutions might be willing to engage in similar operations. Moreover, some equipment manufacturers in developed countries maintain extensive leasing operations of their own, and might under appropriate circumstances be induced to expand their international operations. This latter type of approach might be particularly suitable (and attractive to manufacturers) if maintenance and repair aspects of the operation could be coordinated with technical services institutions, as suggested in the following chapter.

63. Because small industries often need provision for some flexibility in meeting scheduled loan payments (as discussed in paragraph 48), financial intermediaries lending to small industries should take into account possible delays in loan servicing. They should take measures to protect their own liquidity in such cases, either by reserve funds or by similar arrangements. External lending agencies as well as domestic governments should facilitate and support such arrangements.

64. It would of course be desirable that equity capital for small enterprises be obtainable from financing institutions. However, to be effective the provision of equity capital should be associated with at least minimal management participation. Provision of equity without such participation might be considered by some entrepreneurs as equivalent to a grant, and could lead to abuse. While experiments in provision of equity capital to small entrepreneurs on a selective basis should be encouraged, the shortage of management capability is likely to preclude widespread feasibility of providing adequate equity from institutional sources, particularly for very small or new enterprises. When, in individual cases, lack of equity is a serious constraint, financing institutions should be encouraged to include in a financing package a small long-term loan at low interest and with a highly flexible amortization schedule. Such a loan could be backed by personal guarantees, and serve as a partial functional substitute for equity.

65. Within the range of technical services discussed in the following chapter, assistance in basic financial management -- such as bookkeeping, debt collection, and cash management -- might best be provided to small-scale industries (and particularly to the smallest enterprises) by the lending institution with which they maintain the closest contact. Such institutions could be expected to have some expertise in this field, and would also have a legitimate business interest in assuring that their borrowers maintain at least minimum standards of financial management. Where capability exists, a standardized and highly simplified computerized bookkeeping service could be offered to small-scale industry borrowers as part of this assistance package, with input procedures designed so as to mitigate rather than exacerbate record-keeping demands upon the small entrepreneur. The provision of such services free of charge, together with appropriate counseling and advice, could well be justified as a risk reduction measure.

Alternative Institutional Channels for Small-Scale Industry Financing

66. A wide range of various institutional arrangements (and combinations thereof) may be suitable under varying circumstances for channeling credit to small-scale industries. The relative appropriateness of such alternative approaches will necessarily vary from country to country, and perhaps from sector to sector within the same country.

67. Selection of an institutional strategy should in all cases take into account the particular pattern of economic, social, cultural and geographic factors associated with a given country or region. There are, for instance, obvious differences in preferred approach between countries in which the primary problem is to increase the productivity or contribution to employment of existing small-scale industries, as compared to those countries in which the most serious problem is the mere lack of entrepreneurship. Perhaps the most important single consideration involves the numbers, kinds, and distribution of existing financial institutions, and the extent to which they have the capability and willingness to participate effectively in promotion of small-scale industry.

68. Although there is a variety of possible institutional arrangements, for practical purposes the more feasible alternatives can be classified in three basic patterns: (a) those involving a specialized small industry financing institution; (b) those involving a specialized small industry division within an industrial or regional development banking institution; and (c) those involving a small industry development fund deposited with a central bank or another appropriate agency for re-lending through commercial banks.

(a) Specialized Small Industry Financing Institution

69. In many cases, the financing requirements of small-scale industries could best be met by a specialized institution whose sole (or at least primary) function is the financing of small enterprises. Such an institution would have the advantage of a staff specifically trained in and oriented toward the problems of lending to small entrepreneurs. There would not be the risk of small-scale industries being in practice overlooked or given lower priority than larger ones -- a risk toward which non-specialized institutions might tend, because of the considerations discussed in paragraphs 37 through 42.

70. If such specialized institutions were to provide small-scale enterprises with short-term loans as well as with medium- and long-term financing, they could also be permitted to accept deposits and current accounts from regular depositors. In practice, specialized small-scale industry financing institutions are unlikely to attract regular depositors on a significant scale, particularly at early stages of their development and where they face strong competition from commercial banks. Nevertheless, such institutions might attract deposits from small entrepreneurs wishing to establish a banking relationship under which they might be able to receive short-term credit. To the extent that a specialized small industry financing institution could not attract sufficient funds from regular depositors, short-term credit needs of small-scale industry could be financed from government deposits, or from rediscount facilities with the central bank. The Artisan's Bank in Israel has demonstrated such flexibility; it accepts deposits from the public and lends for short-term working capital needs along with providing medium-term and long-term loans. The Medium Industry Bank in Korea, also a relatively successful institution, similarly provides short-term credits. Both banks had to build up their business in deposits separately from their lending operations, and still do not depend upon small deposits as their major source of funds.

71. Where small entrepreneurs or artisans have a central organization, such an organization might well be represented on the board of a specialized small industry financing institution. Individual entrepreneurs or artisans could also be encouraged to subscribe -- at least in token amounts -- to the share capital of the financing institution (as is the case with the Artisan's Bank in Israel). Involvement of small entrepreneurs in an advisory capacity, and, when feasible, in partial ownership, could help foster relations between the institution and the small enterprise. It would also help open the institution to information feedback from its customers.

72. The same functions could be performed by a Small Business Bank providing finance for all types of small businesses, as well as for manufacturers. The Citizens National Bank in Korea might serve as a prototype for this kind of institution. The shortcoming of this type of bank could be its broad scope, which could somewhat impair concentration upon the unique financing requirements of small manufacturers. On the other hand, small countries often cannot afford a multiplicity of institutions each catering to a different type of small-scale enterprise. Moreover, the provision of adequate financing for enterprises engaged in manufacturing-related activities such as transportation, construction, and equipment repair could be expected to have a favorable effect upon the environment in which small manufacturers operate.

73. A significant difficulty confronting specialized small industry financing institutions, and one of the major constraints upon and determinants of its performance, would be the problem of attracting qualified management and staff. Such institutions might be gravely handicapped by a shortage of competent personnel, because they might be less attractive than other financial institutions in terms of staff recruitment, particularly at higher levels. No panaceas can be suggested in this respect. Nevertheless, given the crucial importance to such institutions of a qualified staff, salaries and other benefits -- including such intangibles as social status -- should be competitive with those offered by other financial institutions.

74. Except in the smallest and most geographically compact of the developing countries, another serious problem that would be faced by a small industry financing institution would lie in the difficulty of servicing small enterprises located outside of the city or area served by the institution's headquarters office. In Colombia, Israel, and Korea such institutions established a number of branch offices in other major centers, and their experience tends to indicate that such branches are viable. However, while the cost of branch office operations can be lowered as the number of banking services offered is increased, it is obvious that cost considerations, as well as a shortage of qualified staff, would initially limit the number of branches to no more than a small number of key centers. To reach potential borrowers who would not have ready access to these centers, it would be necessary to utilize -- wherever feasible -- commercial bank branch networks. A number of important considerations involved in such an approach are discussed in the following section.

(b) Specialized Small Industry Division of a Development Bank

75. A second feasible alternative for financing small-scale industries is channeling of funds through development banking institutions. In a large number of developing countries, development banks already exist with potential for further expansion in size and scope of operation. Many of them are efficiently managed and have experienced, well trained personnel. They would be in a better position than specialized small industry financing institutions to raise funds from domestic private sources and from external loans. On the other hand, development banking institutions are generally preoccupied with their larger clients or with those smaller firms which are well established

and can meet customary collateral requirements. Even if they were to be strongly motivated toward increased small-scale industry lending, smaller enterprises might in practice tend to receive lower priority than larger ones.

76. Many of the constraints upon small industry lending could be ameliorated if not eliminated by the establishment within a development bank of a specialized division for financing small-scale industries. Such a specialized division would have to be established with the strong support of top management, and enjoy a high degree of operational autonomy. The responsibility of divisional management would have to be defined solely in terms of divisional objectives, in order to preclude diversion of attention from smaller to larger enterprises. Moreover, such a division would have to be freed from institutional regulations which would restrict their ability to function effectively -- most notably, for instance, restrictions with respect to minimum loan amounts, short-term lending, collateral requirements, amortization schedules, and so on.

77. A division organized along these lines could have many of the advantages of a specialized small industry financing institution. On the other hand, it would also face many of the same problems, most notably in the areas of staffing and branch operations. As in the case of a specialized institution, it might be necessary for such a division to channel at least some of its lending through established commercial bank branch networks.

(c) Small Industry Fund with a Central or Development Bank

78. A third alternative would involve a small industry development fund deposited with a central bank or other appropriate agency for re-lending through commercial banks. The effectiveness of such an approach would depend primarily upon the extent to which the commercial banking system of a given country is willing and able to function proficiently within the context of an overall small-scale industry financing program.

The Role of Commercial Banks

79. In many developing countries, commercial banks would have significant advantages as intermediaries for channeling credit to small-scale industries. Typically, they have relatively large and competent staffs, and often extensive branch networks offering widespread geographic coverage. They are capable of offering various types of loans, and their branch systems can help reduce -- on "marginal pricing" grounds -- the extra administrative costs associated with lending to small enterprises. On the other hand, they are probably more sensitive than other types of financial institutions to the constraints upon small industry financing. For this reason, commercial banks could serve as effective intermediaries for small-scale industry financing if they are offered sufficient motivation and are provided with sufficient guidance in the unique problems of lending to small enterprises, particularly to the smallest firms. To be effective, this motivation and guidance must be provided at all organizational levels -- including owners, board members, officers, branch managers, and lending department personnel.

80. Potentially, commercial banks could serve as intermediaries for the provision of a combination of long-, medium- and short-term credits to small-scale industries. In providing long- and medium-term loans, the banks could serve as agents of a specialized small industry financing institution, a specialized division of a development bank, or a small industry development fund. To motivate banks to serve as active agents, they must be offered a commission or margin sufficiently large to permit profitable operation. The size of the required margin would, of course, depend upon the actual level of administrative costs and default risks assumed by the banks; it could be significantly reduced if most of the default risks were underwritten by a guarantee fund or similar arrangement, as suggested in the final section of this chapter. The natural tendency of branch credit institutions to minimize administrative costs by concentrating upon larger loans to more established small enterprises might be mitigated by supplementing the margin by payment of a reasonable fixed fee per loan processed, with the size of this fee unrelated to the amount loaned.

81. In some countries, commercial banks operating as intermediaries in provision of long- and medium-term credits might be willing to provide from their own sources all or part of the short-term credits needed by small-scale industries, as a supplement to these longer term credits. Such complementarity could reduce the funding requirements of the specialized institution or fund, and facilitate the use of credit by small enterprises. It might, however, complicate to some extent arrangements with respect to risk reduction or to collateral.

Interest Rates for Borrowing and Lending

82. A major issue in small industry financing is the rate of interest charged to the final borrower, and its relationship to the supply of credit, on the one hand, and to the cost of credit to the financial intermediary, on the other. In dealing with this issue, a distinction needs to be drawn between the "absolute" level of interest charged to small industry borrowers, and the "relative" level of interest rates charged to small enterprises in comparison with those charged to larger firms.

83. The "absolute" level of interest to small industries would necessarily vary according to economic and financial conditions prevailing in a given country -- its stage of development, supply and demand conditions for credit, rate of inflation, and so on. In any case, provision of adequate financing from institutional sources could help reduce the overall cost of credit to the small entrepreneur by reducing his borrowing from non-institutional sources at very high interest rates.

84. The "relative" rate of interest charged to small industrial enterprises (in comparison with those charged to larger enterprises) is affected mainly by the lending costs of the financing institution. As noted above, several factors tend to make the cost of lending to small enterprises higher than the cost of lending to larger ones. Other things being equal, higher lending costs tend to require a larger spread between the rate at which the financing institution obtains its funds and its lending rate.

85. The actual spread required by financial intermediaries for lending to small-scale industries would depend upon the range of services provided, as well as upon the operating efficiency of the institution. Available experience is too scanty to provide a basis for sound generalization as to the required spread, but a few examples suggest a plausible range of 4 to 6 percentage points. At institutions visited, the spread on medium- and long-term loans ranged from an exceptional low of 2.5% at the Medium Industry Bank in Korea, to about 4% at the Artisan's Bank in Israel, to 5% in one Iranian program. This compares with a spread of 1.5% to 3% charged by many development banks in lending to larger enterprises, according to World Bank data.

86. If financing institutions lending to small-scale industries were provided with funds at interest rates comparable to those at which development banks typically obtain their funds, the higher spread required for lending to small enterprises might result in an interest rate to the final borrower some 2 or 3 percentage points higher than the rate generally charged by development banks to larger enterprises. Although such a differential in interest rates is not desirable, it might be tolerable provided that institutional financing in sufficient quantity is made available to small-scale industries. If the problems faced by small enterprises in obtaining access to institutional financing can be overcome, then the effect of such a differential upon their financial viability is not likely to be very significant. This is particularly true for the vast majority of small-scale industrial enterprises which currently pay for non-institutional finance of interest rates several times higher, or which currently have only negligible access to any type of institutional credit.

87. A government (or external) subsidy to cover all or part of the differential cost of lending to small-scale industries might perhaps be justified on the grounds of differential contribution of such industries to employment and/or entrepreneural development. In many cases, however, there may be a danger that such subsidization might reduce the volume of financing or other assistance available to small-scale industries. Where there is a significant trade-off between the amount and cost of institutional credit for small enterprises, priority should generally be given to the supply of institutional financing in sufficient quantity rather than to equalization of interest rates charged to smaller as compared to larger enterprises.

Risk Assumption and Guarantee Arrangements

88. Another major problem related to financing of small-scale industries on a significant scale is the risk element involved, particularly in lending to newer and/or smaller entrepreneurs. Based on experience in the countries visited guarantee arrangements are generally required on loans for small-scale industry, particularly for long-term financing. Lending on a significant scale to very small enterprises which generally lack sufficient collateral, and in particular to new entrepreneurs, might involve risks too high to be borne by financing institutions themselves without endangering their financial stability and soundness. The institutions specializing in lending to small enterprises in Colombia, Kenya, Trinidad, and Zambia have experienced a high

default rate on their loans. This was partly due to poor follow-up and sometimes to irregular lending practices which led to an unnecessarily high incidence of default, but the problem exists both in substance and in the attitudes of the banking community. Risk assumption is thus particularly important in broadening the sources of credit for small enterprises.

89. In the absence of guarantee arrangements, both specialized institutions and commercial banks would have to be conservative; the smallest and financially weakest enterprises are unlikely to receive sufficient credit if the institutions are to avoid losses. To encourage innovative lending practices, particularly to new entrepreneurs, a guarantee arrangement is required. The share of a loan covered by a guarantee might be high, perhaps 80% to 90% in the early years of a small-scale industry lending operation, but should not cover 100% of the loan. After the institutions have gained experience and confidence in loan evaluation, the guarantee coverage could be gradually reduced. Special arrangements might be required to cover the risks of a specialized small-scale industry financing institution, as compared to those of more generalized institutions lending to small-scale industries.

90. Most of the risks involved in guarantee arrangements would have to be borne by the domestic government. There is no real need for external agencies to underwrite such guarantee funds. In fact, the willingness to undertake such guarantees could attest to the actual seriousness of a government's expressed intent to promote small-scale industry.

91. To the extent that small-scale industry financing intermediaries receive foreign currency loans from external sources, exchange risks should not be passed along to the final borrowers. Unless the intermediaries themselves become strong enough to assume such risks, they will probably have to be underwritten by the government.

## V. PROVISION OF TECHNICAL/MANAGERIAL SERVICES

92. The wide range of activities engaged in by small-scale industries requires that provision of technical/managerial services, like provision of financing, should be oriented by careful identification of target groups, and an appropriate tailoring of assistance to meet their needs. In particular, a distinction must be made between the very small cottage or artisan industries, and the larger enterprises in the process of transition to becoming modern industrial establishments. The objectives of technical/managerial assistance for each target group have to be defined clearly if the assistance is to be effective.

93. The typical small entrepreneur in a developing country has no formal management training, and very little practical managerial experience. Moreover, neither he nor his employees are likely to have received technical training in efficient production techniques. This lack of managerial and technical skills often represents a serious constraint on the development of a small enterprise beyond the level at which it involves an owner-manager and three or four employees. The lack of skills is a particular problem in non-industrial countries and backward regions. If such firms are provided with financing for expansion, without at the same time having access to assistance in using these newly-available financial resources rationally and efficiently, the availability of finance may be ineffective, if not counter-productive. It is therefore essential that a reasonable proportion of the resources directed toward small-scale industry promotion be allocated in such a way as to achieve an appropriate mix between technical/managerial services on the one hand and financial assistance on the other.

94. The nature of technical/mangerial services needed by small enterprises can be categorized as follows:

(a) basic financial management, including bookkeeping, costing, and cash management;

(b) compliance with requirements, including project preparation, of government agencies and financial institutions;

(c) basic operational management, such as material purchasing and marketing of products;

(d) production management, including product design, quality control, and sometimes vocational training in manufacturing techniques or machinery maintenance and repair.

95. While the nature of these services can be generalized, firms at various stages of evolution will require assistance at different levels. Moreover, the small entrepreneur must be shown how he himself can perform some of these functions, and how he can obtain more specialized assistance

commercially if it is available. The need for any particular type of service obviously depends upon the individual entrepreneur, his background and experience, the nature of the enterprise, and the environment in which it is operating.

Existing Arrangements for Provision of Services

96. Of the countries visited, Colombia, Korea, and Iran have developed formal facilities offering some degree of technical assistance to small-scale industries. In these countries, different institutions are responsible for the provision of such services. In Iran, it is the central agency for the promotion of small-scale industries. In Korea, the Medium Industry Bank operates an Extension Services Department, but it is very limited in scope and divorced from lending activities. In Colombia, technical assistance is provided primarily by a special governmental institution responsible for technical and managerial training in all enterprises. All of these institutions have had substantial UNDP assistance, with either UNIDO or ILO being the executing agency.

97. Some institutions providing technical services to small-scale industries in these countries have a professional staff of some 25 to 60 persons. About half the staff has a technical background, and the other half has some kind of managerial training. This is mainly in accounting and bookkeeping and occasionally in marketing or some other managerial functions. The services typically include various forms of training, problem solving in the field, and some demonstration facilities. The technical services provided are often quite specialized and limited in scope, due to the lack of resources and of qualified staff. The agencies are not widely known, especially to the smaller enterprises and to those operating outside the major industrial areas. Technical/managerial services reach only a small fraction of the firms, and these are generally the larger and more advanced ones.

98. Additional services are sometimes available from other institutions such as trade associations and cooperatives. A number of other agencies and organizations also offer technical and management services primarily to large- and medium-scale industries. In more developed countries private firms provide marketing and other consulting services. Industrial raw material and equipment suppliers, and purchasers of subcontracted inputs are frequently among the better sources of assistance available. Chart 2 illustrates the range of services that are provided from various sources.

99. Observations in the countries visited, as well as in other countries, point to the major weaknesses of the technical service programs typically available to small-scale industries: (a) they are too small in scale to reach the very large number of very small enterprises; and (b) they are often not equipped to provide the very basic forms of assistance that such enterprises usually require and can put to effective use. The typical technical services institution's staff are often quite expert in their fields of specialization, but with experience primarily in the context of a large

Chart 2

## MANAGERIAL AND TECHNICAL SERVICES INSTITUTIONS FOR SMALL MANUFACTURERS

| INSTITUTIONS \ SERVICES OFFERED | Accounting | Financial Planning | Liason, Linkages | Legal Services | Project Planning | Product Development | Production Facilities | Materials 'Supply | Marketing | Labour Relations | Training, Recruiting | Joint Sales, Exports | Joint Repair Shops |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Finance Institutions | | X | | | ● | | | | | | | | |
| General Managerial and Technical Assistance Institutions | X | X | X | X | X | X | X | ● | ● | ● | ● | | X |
| Specialized Institutions | | | | | | | | | | | | | |
| - Project Planning | | | | | X | | | | | | | | |
| - Research and Development | | | | | X | X | X | | | | | | X |
| - Testing, Standards | | | | | | X | | | | | | | |
| - Training, Consultancy | X | X | | | ● | ● | ● | | X | X | X | | |
| - Export Services | | | | | | | | | X | | | X | |
| Small Industry Cooperatives | | | | | | X | | X | | | | X | X |
| Private Consultants | ● | ● | | X | ● | ● | X | | ● | ● | ● | | |
| Suppliers of Machinery | | X | | | | | X | | | | | | |
| Joint Ventures | | | | | ● | ● | ● | ● | ● | ● | ● | | |
| Large and Medium Scale Industries | | X | | | | ● | ● | | X | ● | ● | | |
| Procuring Agencies | | | | | | | | | X | | | | |

X = More frequent
● = Less frequent

Note: This chart does not attempt to cover all institutions, services and combinations of offerings.

organization. The services provided are too sophisticated and too far removed from the actual on-going needs of the small manufacturer. All too often, these services are scaled-down adaptations of techniques designed for use in larger and more modern enterprises. There are indeed some exceptions to one or other of the above generalizations, and a few technical assistance programs have in fact provided effective assistance to small enterprises -- for example, the distribution of simple designs to artisans in Tunisia, or a small loan and services program administered by a private non-profit organization in Colombia. Nevertheless, these represent exceptions rather than the rule, at least insofar as very small enterprises are concerned.

Appropriate Technical/Managerial Services

100. Two basic types of technical/managerial services are typically needed by small industry in developing countries: (a) extension services capable of providing rather general advice on operating small industrial enterprises, concentrating largely on management procedures and techniques common to a wide range of varied enterprises; and (b) specialist technical services concentrating on the unique problems relevant to different specific types of industrial activity. These two types of assistance are not mutually exclusive. In fact, they are complementary, and should normally be provided in various combinations, with relative emphasis depending upon conditions prevailing in a particular country or sub-region. Generally, the extension-type approach is particularly useful at earlier stages of industrialization. The more industrialized a country becomes, the more the emphasis should shift to provision of specialist services.

101. Generalist extension services for small industries are in some ways analogous to agricultural extension programs. The individual extension worker, operating largely "in the field" and with the relatively high degree of autonomy required to deal with a variety of widely diversified problems, would be crucial to the success of an extension program. To provide effective support to small-scale industries, and particularly to the very small enterprises, he would have to be a "generalist" capable of identifying problems and providing general advice with respect to relatively simple methods for coping with the kinds of financial and operational management functions required. His experience and expertise should preferably be in small-scale enterprise, rather than in any specialized industrial subsector or in the more sophisticated levels of the service sector. Services provided to the very small enterprise should be simple and applicable to the actual needs of the very small enterprise. At least initially, the extension worker might well concentrate on reaching the small entrepreneur at his own place of business, and working with him in the context of his own familiar environment.

102. Generalist extension workers for small industries might be recruited from among graduates of middle-level vocational schools, or from among former owners or managers of small enterprises. Technical/managerial service centers should experiment in short-term training or refresher courses for extension workers. Extension workers with a technical background should receive some exposure to general problems of business management common to almost all

small enterprises; conversely, those whose background is in general business management procedures should be exposed to technical and vocational problems likely to be encountered in their work.

103. The generalist extension worker would, of course, require access to sources of technological and/or professional back-up. This back-up might well be provided by a central or regional technical services institution for small-scale industries. An institution of this type could serve as a training and/or research center, providing specialists in particular areas, conducting courses in management and production methods and operating demonstration workshops. Such an institution could be expected to operate effectively only in one locality (or at the most, a very small number of localities), but its resources would be made available through the extension service to small enterprises at the local level.

104. In addition to extension services, other sources providing more specialized types of assistance should be made available to small-scale industries. Such sources might possibly include, but not be limited to:

(a) assistance in basic financial management, such as bookkeeping, debt collection, and cash management, which might best be provided by financing institutions, for reasons discussed in the previous chapter;

(b) technical services institutions normally catering primarily to the needs of medium- or large-scale industries, but which could -- under appropriate circumstances and perhaps through the mediation of the extension service -- provide useful assistance in a small-scale industry context;

(c) vocational and/or basic managerial training courses offered through the country's educational system, or through other governmentally or externally financed educational programs;

(d) private sector sources from which assistance might be obtained at little or no cost, such as equipment manufacturers or other suppliers, or purchasers of a small firm's output on a subcontracting basis; and

(e) private sector professional services, such as legal, accounting, and management consulting firms, from which assistance could be obtained at market rates. (Under appropriate circumstances, the extension service might be able to arrange for such services at preferential rates, by contracting on behalf of several small enterprises on a group or "package" basis.)

105. The small enterprise could be charged only a nominal fee for regular services provided by the extension generalist. Such a nominal fee might be useful in enhancing the perceived value of the service to the entrepreneur. More advanced entrepreneurs would require more specialized accounting, legal,

engineering, or management consulting services, which could be provided by headquarters staff of the technical services institution or by other sources mentioned in the above paragraph. When such specialist services are provided, the entrepreneur might reasonably be expected to bear most, or sometimes even all, of the cost involved.

Preferred Auspices of Technical/Managerial Services

106. One of the most effective ways to reach out and assist the very small enterprise is probably through services providing both technical/managerial assistance and access to financing. Such services could identify the needs of the small enterprise, and help provide a "package" of techncial and financial assistance. It would be desirable for such a service to be operated by an integrated institution providing both technical services and financial assistance. There are three major advantages to be gained from the integration of these functions within the same institutional framework:

(a) centralizing accountability for plans and measures to support small-scale industries;

(b) facilitating coordination of financial and technical inputs for programs as well as for individual small enterprises; and

(c) minimizing the number of separate contacts required of the small entrepreneur.

107. A technical service institution for the provision of extension services to small-scale industries would preferably be specialized in working with small enterprises, for reasons involving both the unique type of expertise involved, as well as the need for a primary -- rather than marginal -- interest in and commitment of the assistance to firms at this size level. Such specialization is important because of: (a) the distinctive nature of services required by the very small enterprise, as compared to those required by large or even medium-size firms; and (b) the unique "stylistic" problems of working with relatively unsophisticated owner-managers, rather than with the relatively more experienced and professionally-oriented managerial personnel of larger enterprises. The very small firm usually needs assistance in basic and simple techniques which generally have little applicability in (or are assumed as a matter of course by) larger firms, which might more typically need professional advice on a specific technological or managerial problem. Personnel of non-specialized technical service institutions are likely to find the problems of larger enterprises more "interesting" or professionally challenging, and they may find it easier to work with the relatively more sophisticated managers of larger firms than with the relatively unsophisticated and tradition-oriented entrepreneurs more commonly encountered in small-scale industries. In most countries, general technical services institutions, including "productivity institutes," are not particularly adapted to serving small entrepreneurs, and might be reluctant to provide adequate back-up for extension workers operating in this sector.

108. In only two of the countries visited was a close relationship found between provision of technical services and provision of financing. In Singapore, the Light Industries Service often insisted on the use of technical assistance as a precondition for lending. In Colombia, the Caja Agraria has a program for managerial assistance to small borrowers, and the Corporacion Financiera Popular helps borrowers with bookkeeping and accounting problems. No such integration has been found in other institutions, not even in Korea where the major extension department for small-scale industries is located at the Medium Industry Bank, but, as already noted, operates as a separate service.

109. It is perhaps not surprising that the integration of technical/managerial services and financing for small-scale industries has so far been attempted in only a few countries. The basic problems in establishing and operating such an integrated technical/financing service institution for small-scale industries are high costs, a dearth of suitable staff, and administrative difficulties. These problems would be compounded should such a technical/financing service extend its operations to provincial centers.

110. The establishment of institutions providing both finance and technical services to very small enterprises would seem to be the only way of testing the hypothesis that this is the best approach to the provision of assistance. Experience gained would be valuable in illuminating the problems involved (including the crucial problem of the evolution of methods for recruiting, training, and evaluating extension workers), and providing insight into ways and means of introducing such institutions on a wider scale. It would, however, be unrealistic to expect many such institutions to be established, except where an intensive in-depth development program is being implemented, either in a small country or in a regional setting.

Alternative Auspices of Technical/Managerial Services

111. An alternative approach would be to introduce technical/managerial services which are administratively separate from, yet closely coordinated with, the provision of finance by intermediaries at the local level. The relationship could work both ways. A financing institution -- particularly when making a long- or medium-term loan -- should generally be in a position to notice, if not to identify, basic weaknesses in a small enterprise, and require it to make use of available technical/managerial services. In some cases, utilization of such services could be made a precondition for lending of funds. Reciprocally, the provider of technical/managerial services should be in a position to recommend the provision of a loan when appropriate. Such close collaboration would require mutual trust between the staffs of technical/managerial services and financing institutions at the local level.

112. If the technical service cannot be established under the auspices of a small-scale financing institution, it would probably still be desirable to be set up as an autonomous or semi-autonomous organization, rather than as a government department. Small entrepreneurs are often reluctant to make direct use of services available from a government agency, for fear of fiscal

and/or bureaucratic problems. The backbone of a successful small-scale industry technical/managerial service must be a career and professional staff, with an orientation different from that found in the civil service of most (although not all) developing countries. This core staff of experienced professionals could well be supplemented by volunteer workers, as has been done in Colombia with some degree of success.

113. A technical services institution specializing in small-scale industries appears preferable. Where the establishment of such a specialized institution is not feasible, specialized and/or professional support to extension workers could be given by a general technical services institution, provided that a special department is set up for this purpose, with its sole responsibility defined as the rendering of assistance to small enterprises.

Funding of Technical/Managerial Services

114. Costs of extension services are bound to be high. Data available on such services in countries visited, for example Iran and Singapore, indicate a high cost per enterprise receiving such assistance. Further experience and some standardization of operating procedures on the basis of a large network might indicate whether costs of services can be significantly reduced. In any case, a technical service would almost certainly have to be supported from budgetary sources. Even if technical/managerial services are provided by a financing institution, they would have to be subsidized.

Possible Assistance by External Agencies in Technical/Managerial Services

115. External agencies can assist domestic governments to analyze the opportunities for, and to define the overall objectives, policies, and resources, required for the development of small enterprises. Thereafter, assistance can be provided in designing the required programs or services, corresponding institutions and their organizations, and management information systems. Successful experience is very limited in these areas in the developing countries. It is therefore worthwhile to develop models of organization and management information systems for the institutions serving small-scale enterpreneurs. The models could be based on successful cases in industrial countries but would have to be adapted and tested out in developing countries. Even description of the very basics -- formulation of objectives, strategic planning, reporting systems, program budgeting, and management audit -- could be useful.

## VI. RELATED ARRANGEMENTS

### Industrial Estates

116. Industrial estates originated with developed country attempts to attract industry to "depressed areas" by providing developed land, infrastructural facilities, and sometimes factory shells and some common services such as warehousing, transport terminals, and office space for industries. In the last 25 years this concept has been used in a variety of ways in developing countries, ranging from an economic way of providing infrastructure for the modern manufacturing sector to attempts to combine assistance to small-scale industries with rural development objectives. As a tool for large-scale industralization, industrial estates have been financially and otherwise successful in many countries, notably in Colombia, Israel and Singapore of the countries studied. In some cases, in Israel and again Singapore, they have also proved to be useful in assisting small-scale industries. These instances are, however, exceptional. On the whole industrial estates have not been very cost effective in promoting small-scale industries.

117. As in technical assistance, industrial estates are only effective if the target group to be assisted is clearly identified, and if the estate is planned for its needs. The choice of appropriate location, the acquisition of land and construction at market rates, and efficient real estate management can then follow. Where these factors are not given due consideration, the estate facilities are costly and/or not attractive as a relocation incentive for small manufacturers. They tend to be underutilized and may require continuous subsidies as in Bangladesh, Kenya and Trinidad. The estates then put a drain on scarce resources which could be used to assist small-scale industries in other ways.

118. The planning of industrial estates can be related to the following target groups:

(a) Very small, traditional enterprises: Except in non-industrial countries, these are generally very numerous, and at best, an industrial estate can only reach a very small proportion. Such enterprises usually combine the need for a dwelling with that for a workshop, and this is the type of assistance that should be provided, preferably in close proximity to other business and to the source of labor.

(b) Slightly larger units: "flatted factories" such as those provided in Hong Kong and Singapore may be useful. Again they need to be located in close proximity to commerce and labor supply and only a very small proportion of the total is likely to be reached except in countries just beginning to industrialize.

(c) Enterprises in transition to modern manufacturing: A small-scale industry section in an industrial estate largely intended for medium- and large-scale industries may be desirable. It can provide cross-subsidization opportunities in providing land and infrastructure, and common facilities such as workshops for repairs, product development and personnel training. These would have to be focused on the industries most likely to develop. By being placed in the context of a "mixed" estate, these services are likely to be ensured much fuller use than if they are only operated for small-scale industries proper. The locational integration of various sized industries is particularly important if subcontracting is to be encouraged.

(d) Export enterprises: Assisting small-scale industries to become involved in exports, whether directly or by sub-contracting to either local or foreign firms, may also be assisted by the integration of small enterprises into medium- and large-scale "export" zones.

(e) Rural small-scale industries: As already noted, the development of rural small-scale industries can only be carried out effectively in a comprehensive rural development framework. It is clear from past experience that industrial estates in rural areas are likely to fail to encourage industrial growth, let alone stimulate rural development, without such integration.

119. The identification of various target groups with specific needs does not mean that they should have separate geographic location. On the contrary, Hong Kong and Singapore experience suggests that location proximity is an extremely important element in stimulating those linkages which lead to constructive relationships between variously sized manufacturing enterprises.

120. The integration of various sized plants is important in attempts to decentralize industrial development by stimulating regional centers to provide facilities for industry. Here too, however, the bulk of the very small traditional firms are likely to prefer more traditional locations where they can combine living and producing activities.

121. Industrial estates for small-scale industries have tended to be high cost in the past because they adopted unduly high construction standards. Most small entrepeneurs can put up working facilities more economically than bureaucratic organizations. Ownership of some land and building facilities could provide acceptable collateral for loans to purchase equipment or working capital needs. However, when small entrepreneurs cannot finance the acquisition of land and construction of buildings, leasing arrangements should be made available.

122. Estate projects should be operated on a commercial basis. If subsidies are allocated on developmental grounds (for example, rentals during the first years of operation) or because of anticipated social benefits, these

costs should be financed out of special development funds and should be segregated from the commercial accounting of income and expenditure. Demonstration services -- such as how to make new products, booklets on new investment opportunities, and basic management advice -- might be subsidized and provided free.

Cooperatives

123. On the basis of experience in the countries visited as well as in other developing countries, cooperatives have not made a significant contribution to the promotion of small-scale industries, except under particular conditions and for particular services. Only a few cases of successful small-scale industry production cooperatives are known. Israel is one example. Despite past governmental aspirations in some countries, for example, in Tunisia, that small industries be set up as full-scale cooperatives, social and economic conditions in most developing countries do not seem conducive to the continuous successful operation of production cooperatives in the industrial field.

124. On the other hand, cooperatives appear to have been useful instruments for particular services in some developing countries. A remarkable example of this nature is the successful promotion of exports by medium and small industries in Korea. In the West Indies, purchasing of materials for small-scale industries has been undertaken in some cases on a cooperative basis. The guarantee of loans to small-scale industries can in some cases be partly covered by cooperative arrangements for mutual guarantees.

125. In summary, under particular conditions, some specific functions can be usefully provided by certain service cooperatives. In some cases, cooperatives need to be encouraged and assisted. In other cases, some of the more difficult functions facing small enterprises could be assumed in whole or in part by a central public organization which could order and market a variety of products made in small workshops. Such an arrangement is particularly suitable for artisans and handicrafts. In Tunisia, for example, Artisanat has been operating, serving a large number of small artisans in one of the following ways: (a) as employees of Artisanat; or (b) self-employed artisans provided with free design samples, quality control and marketing.

Linkages with Large-Scale Industries

126. Small-scale industries can sometimes be established and promoted through linkages with large-scale industries, where small-scale industries serve as suppliers of components or products to large enterprises. Such arrangements are based upon a division of labor between enterprises at different size levels. They are particularly important for export oriented firms.

127. In many cases, small entrepreneurs are unable to perform the whole range of functions involved in enterprise management, such as product planning, marketing, finance, and so on. In other cases, a very small enterprise

might reach its limit of growth when the owner-manager can no longer efficiently assume the more complex management functions required by a large enterprise.

128. Vertical linkage between small and large industries can help sustain growth of the former, or in some cases even help establish new small enterprises. Small enterprises can supply large firms with such inputs as components, semi-manufactured products, or packaging materials, on a sub-contracting basis. Sub-contracting can facilitate some entrepreneurial functions of small enterprises, such as product planning and design, quality control, and marketing.

129. Large-scale industries can also assist sub-contractors in the purchase of materials, provision of capital, and even training of workers. Also, in a successful linkage operation, large-scale firms can perform some promotional functions which would otherwise be performed by a public (or publicly-supported) agency. Such linkage arrangements can, therefore, provide social benefits in promotion of small-scale industries.

130. Large-scale firms are not always willing to initiate subcontracting arrangements, particularly when organizational efforts are required. Sometimes they prefer in-house production of components. When relatively advanced components are involved, large-scale enterprises often tend to prefer imports for the following reasons.

(a) Whole sub-systems can be purchased abroad, while local small enterprises can often supply only individual parts.

(b) Imports often enable a firm to acquire a greater number of parts from the same source than could be provided by any single domestic supplier, particularly where small-scale industries are involved.

(c) Imports are often easier to finance through supplier's credit.

131. The social benefits of linkage arrangements between small and large-scale enterprises suggest that government agencies should promote such linkages. In terms of organization, the central government unit responsible for small-scale industry policy formulation could set up a department charged with the following functions: First, to survey and identify prospects for linkages and second, to propose measures which would encourage such linkages. For example, incentives could be offered to firms which engage in local sub-contracting. The financial and technical services required could be provided by the respective operating institutions. In some countries, information centers, acting as an exchange for subcontracting, have been set up.

## VII. INTENSIFICATION OF INTERNATIONAL AGENCY LENDING FOR SMALL-SCALE INDUSTRIES

132. A number of factors lie behind the very limited involvement of external agencies in small industry lending to date. First, in the past the importance of small-scale enterprises in industrial or overall development, particularly with respect to the very small units, tended to be underestimated. The identification of the contribution of small enterprises to industrial output and particularly to employment, and of their role as a training ground for indigenous entrepreneurs, has changed such views in recent years. Second, the inherent difficulties in lending to small enterprises and in providing associated managerial and technical support are very considerable. The experience of the last 25 years suggests that assisting small-scale industries to develop is much more difficult than providing the stimulus for medium-scale and large-scale enterprises. The former discussion as to financing and technical/managerial requirements of small-scale industries indicates the possible directions of an intensification of international agency lending for small industries.

### Policy and Program Approach

133. External assistance is not likely to be effective without a genuine policy and program commitment by a country's government to the development of small-scale industries. This generally requires the elimination or offsetting of discrimination against small-scale industries, and the establishment of substantive programs for their assistance (as discussed in Chapter III).

134. Given the great difficulties in effective lending, it is important that the target groups to be assisted be identified within the wide range of small enterprises. The diversity of country needs, and within countries of different types of small-scale industries, has been stressed throughout this report, as much as the common characteristics of the problems identified. To reiterate, the range of enterprises which require and deserve aid runs from handicraft and artisan activities to the establishment of modern small manufacturing enterprises.

135. It is neither necessary nor desirable, in most lending programs, to draw too rigid a distinction between manufacturing and other related activities, particularly in the smaller and least industrialized countries. Thus, activities such as transportation, contracting, and semi-industrial repair or service shops should not be excluded from lending. In some countries, the encouragement of indigenous distributive activities may be important. Generally, the smallest enterprises (employing fewer than 20 workers) are more handicapped than the larger ones in access to financing and technical/managerial services; and in many countries they should receive priority on the grounds of greater need. At the same time, they are the most difficult enterprises to assist. On the whole, the kinds of small enterprises eligible for financing from international agency sources might in fact best be determined by the capability of domestic institutions to provide financing and

technical/managerial services in an effective way, rather than by a priori eligibility regulations or limitations.

136. To make a significant contribution to the promotion of small-scale industries, the role of the external agencies has obviously to be much wider than the provision of resources for loans to small enterprises and would have to take into account the following considerations: First, assistance should be oriented by an overall approach to small industry promotion in a particular country context, and wherever feasible in terms of programs based upon evaluation of the opportunities and prospects for small-scale industry development in particular countries. Second, lending should be used to the greatest extent possible as a lever for institution building, probably to a greater extent than in lending to larger industries, since small industries generally face much greater difficulties in overcoming institutional and environmental obstacles than do larger enterprises. Because the major instrument of and constraint upon external agency increase of resources for lending to small-scale industries would probably be the capacity and effectiveness of domestic financing institutions, funds for strengthening such institutions should be included in assistance programs to the maximum extent feasible. Third, the share of resources allocated to the financing of some basic technical/managerial services would have to be substantial.

137. The crucial element in external agency financing of small industries would be to assist in establishing institutional arrangements which could effectively promote small-scale industry. The particular form and context of such institutional arrangements must be formulated according to specific conditions prevailing in the borrowing country. Among the numerous and diverse patterns of potentially feasible institutional arrangements, four basic options are summarized in the following.

Option 1: Small-Scale Industry Financing Institution

138. The foregoing analysis suggests that a specialized financing institution could in many cases best serve the needs of small industry in developing countries. In addition to external financing, such an institution would draw upon long-term government deposits or loans, and (where regulations permit or can be modified) on central bank rediscount facilities. It would provide long- and medium-term financing, complemented by short-term loans either from its own funds or (where feasible) from commercial bank sources. In some countries, a "small business" rather than a "small industry" bank could be more suitable. Such an institution would have the advantage of an exclusive focus upon the problems of lending to small entrepreneurs, and thus avoid the risk that small firms would in practice be given lower priority than larger ones.

139. In practice, effective small industry financing institutions (in some cases also serving medium-scale industries) exist in only a few countries. A considerable increase in lending would in fact require external agencies to help establish new small industry financing institutions in a number of other

countries, and to greatly strengthen the existing ones. In such cases, external agency assistance would be most deeply and directly interwoven with institution building -- a lengthy but worthwhile process.

Option 2: Small-Scale Industry "Windows" in Development Banks

140. An alternative option would be to lend to an existing industrial or regional development bank, for the specific purpose of re-lending to small enterprises. In some countries, this may be faster and perhaps easier than helping establish a new specialized financing institution for lending to small-scale industries. However, a necessary condition for the effectiveness of such lending is that the development bank be sufficiently motivated, as well as expert, in actively promoting small industry. Lending to small enterprises would have to be considered as an important function, rather than as a marginal and sometimes neglected line of business. This would probably require a separate department or affiliate to specialize in working with small-scale industries, in the establishment of which international agency assistance and support would usually be required. As in the case of specialized small industry financing institutions, development banks with specialized small-industry "windows" would in most cases have to work cooperatively with commercial banks which could provide both geographic coverage and complementary short-term financing.

Option 3: Development Funds Channeled Through Commercial Banks

141. The international agency could provide funds for setting up a special fund in a central bank, development bank, or other appropriate institution, for re-lending to small-scale industries through commercial banks. This re-lending would include long-, medium-, and short-term loans in accordance with the needs of the final borrower. Such an arrangement would fail to provide for specialization in lending to small industry, but in some countries might have the offsetting advantage that it could be put into effect within a relatively short period. The commercial banks wishing to serve as intermediaries would have to be given adequate commissions together with substantial guidance and management support in the specific problems of lending to small enterprises.

Option 4: A "Package" Lending Program

142. A "package" of financial assistance to small-scale industries might be appropriate in some countries or sub-regions thereof. Such a "package" could include, in addition to the provision of loans through one or other of the previously described options, such other elements as small industry components of industrial estates, technical/managerial services, and so on. A "package" program of this type might be channeled through an existing financial institution, or through a government agency with overall responsibility for promotion of small-scale industries. It could incorporate and help integrate a number of important elements in an overall small-scale industry promotion program. The emphasis would be on the comprehensive program approach rather than only upon institution building.

143. The above options are not, of course, mutually exclusive. They can be combined in various proportions according to the particular conditions existing in a given borrowing country. Whatever the institutional channels and arrangements, there are a number of common elements which should characterize external agency assistance for promotion of small industries.

Flexibility in Lending

144. The unique financial requirements of small-scale industries make necessary a liberal approach to lending. Loans to financial institutions for re-lending to small industry should have liberal amortization schedules, to enable such institutions to provide for flexibility in their own amortization schedules.

145. Lending should include long- and medium-term financing for fixed assets, as well as for "permanent" working capital. Short-term credits for seasonal or peak-load working capital should wherever feasible be provided from resources of the domestic financial intermediaries.

146. Most financing for small-scale industries, particularly for the smallest enterprises, would have to be in the form of local currency loans, since little foreign exchange would be needed by such borrowers. The techniques of local currency loans by the WB Group are presently well established, and could be utilized for small-scale industry lending. The share of external agency funds in total loan amounts to the final borrowers would have to be decided not upon the basis of direct and indirect import content, but in relation to the share which could be provided by the domestic financing intermediary from its own sources or from government funds.

147. Due to the small size, geographic dispersion, and great variety of small enterprises, the external development agency could maintain very little contact with the final borrowers in small-scale industry loan programs. Nevertheless, in order to give direction to the domestic program and to the domestic intermediaries, where feasible, it might be desirable to follow up individual loans on a sample basis.

148. Given the importance and shortage of institutions and services capable of providing effective technical/managerial assistance to small industries, particularly at the smallest size group, loans should generally include a significant technical assistance component, particularly for institution building. Loans could also include financing to help establish or expand technical services institutions, provided they specialize in assisting small enterprises. Training facilities for staff of technical and financing institutions could also be financed.

149. It is unlikely that external agencies would be able to finance technical assistance or extension services provided directly to small enterprises. Most technical assistance provided directly to small entrepreneurs would have to be financed from government budgetary sources, sometimes supplemented by funds or staff provided by external agencies.

Staff Requirements

150. This report is not concerned with international development agencies internal organizational implications of an intensified program to promote small-scale industries. Nevertheless, it must be recognized that sizeable small-scale industry lending is a complex activity which would require particular expertise in the donor agencies. The staff requirements for assisting a country to evaluate small-scale industries on a nationwide basis and to devise suitable policies and programs would have to be intensive. In addition, the small amount of an average small-scale industry loan per institution and per borrower would make heavy demands on staffing. Staffing considerations would thus necessarily play an important role in determining the degree of involvement with small industry financing and in the choice among available options.

International Collaboration

151. A number of bilateral and multilateral agencies are engaged in assisting small-scale industries financially and through technical assistance programs. At present, collaboration among them is poor. As the financing and technical assistance functions are usually situated in different external agencies, and as a prime requisite for effective promotion of small industry is close coordination between these functions, the need for closer collaboration between external agencies is particularly important. There is great scope for innovative program efforts in this field. Multilateral and bilateral agencies could, for example, experiment in training extension workers for small industries, as suggested in paragraph 102. Bilateral agencies which concentrate upon in-depth sub-regional development programs, should be encouraged and assisted in providing integrated "packages" which would include both financial and technical/managerial assistance to small enterprises. There is also room for cooperation in helping to establish, in a few developing countries on an experimental basis, institutions to provide in an integrated way both loans and technical/managerial services to small enterprises.