SME FOCUS

WORLD BANK GROUP / SMALL AND MEDIUM ENTERPRISE DEPARTMENT

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"Pioneering Work in a Tough Sector"

Interview with Nemat Shafik

IN THIS ISSUE:

PAGE

New Directions in Metrics: Evaluating the Impact of SME Work

PAGE

Partner Profile: Small Enterprise Assistance Funds

PAGE

Meet the Team

Worker sews shoes in a workshop in Albania. Microenterprises are a key source of employment for women around the world.

As the World Bank's vice president for private sector development and infrastructure, Nemat "Minouche" Shafik is helping to shape the Bank's new strategy for strengthening small business worldwide. She shared with *SME Focus* some ideas on the past and future directions of this work.

Q. Why have small and medium enterprises become a priority for the World Bank Group?

A. All of us believe that having a dynamic SME sector is consistent with a vigorous and thriving economy. SMEs as a group employ many more people than large enterprises do, and since developing countries are very concerned about employment, SMEs clearly have to be part of the solution. The important thing is to make sure that the rules of the game in a particular economy and the kinds of services offered to businesses do not reflect discrimination against small firms. We need to eliminate those biases—whether in the local policy environment, which may sometimes present regulatory burdens that are especially difficult for small firms, or with local financial institutions, which may find it much more costly to provide services to small firms than to big ones.

Q. What are the most important issues to be addressed?

A. The overriding challenge has to do with capacity building, rather than with inadequate finance. There is a need to build the capacities of financial intermediaries to serve SMEs, and the capacities of SMEs to prepare business strategies and carry them out.

New Internet technologies are helping us overcome one of the biggest constraints, the issue of transaction costs. We're exploring new, cheaper ways to get accounting, marketing, procurement, and basic financial services to SMEs, as well as cheaper ways for small businesses to sell their products.

Q. Can you assess the Bank's past work with SMEs?

See INTERVIEW, page 2

Nemat "Minouche" Shafik
Vice President, Private Sector Development and Infrastructure.

INTERVIEW, from page 1

A. The Bank has a long history of trying to support SMEs. It has worked in three main areas: general support to the business environment and advocacy of policy reforms; use of credit lines to provide financial support directly; and provision of technical assistance.

Frankly, the Bank has had mixed success with these. For example, in those cases where the policy reforms have been adopted, work on the policy environment side has been successful. But the record of credit lines has been very mixed. Although they did transfer some resources to SMEs, they didn't build sustainable capacity in the intermediary to continue providing resources to small business. Once the credit line disappeared, the local financial institution had no incentive to continue providing that credit to the SME sector. They still preferred to serve larger clients. I think the World Bank needs to get away from that model.

Q. What would replace it?

A. In most cases, we should be able to provide SMEs with credit on commercial terms and have local banks actually take those risks without requirement of a government guarantee. The whole point of doing this is to get banks comfortable with taking credit risk for small business.

Q. What about technical assistance for small business?

A. Our approach is changing, with a stronger emphasis on building local TA providers that are commercially viable. In the early days we often provided TA through quasi-public entities, with poor results. Frankly, having civil servants provide business advice to inexperienced entrepreneurs was often a recipe for disaster. But now we're seeing interesting experiments that are more commercially oriented.

In Lithuania, for example, we did a loan that helped the local consulting industry provide SMEs with long-term support by offering matching grants for a limited period. And in Kenya, we partially financed vouchers that small entrepreneurs could use to purchase business advice from anyone they wanted. Most sought advice from other entrepreneurs, rather than from a public agency or consulting firm.

Q. What kind of measures can we use to learn whether our work with SMEs is succeeding?

A. Many of the items mentioned in the new SME strategy—number of jobs created, amount of new investment mobilized, and so forth—are the kinds of benchmarks we're going to use. But there are some broader measures as well. Do we see innovation in the sector? Are SMEs creating economic opportunity where it didn't exist before? Are commercially oriented local intermediaries emerging to serve SMEs without public sector support?

The banking and consulting industries are globalizing. Citibank is everywhere, McKinsey is everywhere, Arthur Andersen is everywhere. But they all tend to skip the SME market. So the local banks and consulting companies are going to be pushed down-market, so to speak. I've seen it happen in several countries. Faced with foreign competition, the local intermediaries are ultimately forced to look at small business as part of a search for new markets.

If we could push that trend a little more, it would be very important. But this is pioneering work in a very tough sector. It's going to take a while to figure it out.

Q. Do you feel pressure to show results fast?

A. There is some pressure to deliver, but there's also a keen awareness that no one has the answers. This is an area where many people have tried and failed, so I think we have some room to experiment. But our experiments will have to be informed by the lessons of the past. ■

Nemat Shafik was interviewed by Rob Wright of IFC in May 2000.

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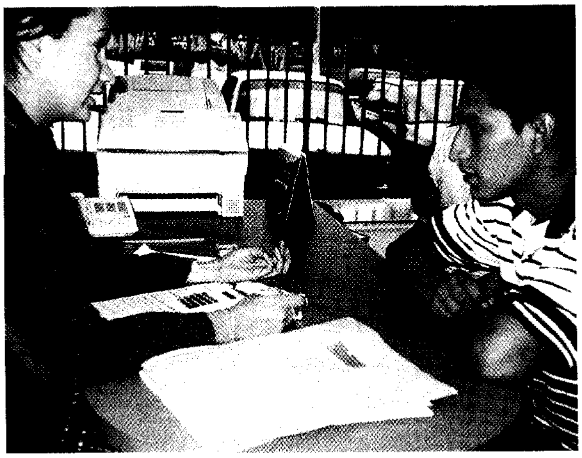
NEW DIRECTIONS IN METRICS: Evaluating the Impact of SME Work

A brutally honest self-appraisal can be unsettling, to say the least. But it can also lead to breakthroughs—in the World Bank Group's case, perhaps even to new success in delivering effective, empowering assistance to small businesses around the world.

That's why the new SME Department is conducting a review of the Bank Group's more than $8 billion in financing and technical assistance for small and medium enterprises. No one denies that past results have fallen short. "We looked at what we did before, and realized there was a problem with measurement of SME intervention," explains the department's director, Harold Rosen. "Now the challenge before us is to understand better the results and impact of past SME work, and to use this to improve the effectiveness of our activities going forward."



SME lending: effectiveness must be carefully evaluated.

The review is highlighting pitfalls to avoid and successful practices to emulate. Among the immediate lessons:

• SME programs are of limited benefit in countries where markets remain severely distorted. They should be established mainly in places where the macroeconomic framework and the policy and regulatory environment are favorable—or at least on a serious path to improvement.

• Working with the right local financial institutions is key to making World Bank lines of credit succeed. The Bank should choose only those intermediaries that are ready to take the steps needed for successful SME lending. It should strengthen their capacity with technical assistance and then leave them free to set the terms and conditions of their subloans in line with their needs for profitability.

• Delivering Bank-financed technical assistance to SMEs has proved difficult and costly. Newer projects that use matching grants or vouchers to involve private sector providers are showing more promise than earlier ones that relied heavily on government. More research is needed on ways to deliver technical assistance sustainably.

• Direct investment in SMEs has not been profitable for IFC due to high processing costs, but it does have positive development impacts, especially in frontier markets. This approach needs to be employed more selectively, with more attention to processing efficiency and a quick response to the needs of entrepreneurs.

• IFC's project development facilities have had positive development impact, but low levels of cost recovery. Greater emphasis on local capacity building and active coordination with other donors and partners will enhance the facilities' overall contribution.

A Tool for Donors and Businesses

A central question is how best to measure the impact and cost-effectiveness of the Bank Group's SME operations. Until

See METRICS, page 7

SEND US YOUR IDEAS!

DO YOU HAVE AN IDEA FOR WHAT WORKS IN THE SME WORLD? WE'D LIKE TO HEAR.

People in the field who work closely with SMEs have by far the best insights on what needs be done. Wherever you are, whatever your expertise—policy, finance, management, business development services, or something else—we'd like your input.

The World Bank Group's new SME Department plans to gather good ideas about all key aspects of SME finance and development and share them as widely as possible around the world. This will help us launch a series of innovative pilot investment and technical assistance projects targeting unmet small business needs in several countries. Various types of support may be available for pioneering new efforts arising from this process, which is open to our partners within the World Bank and in outside organizations.

Your insights will also help the SME Department develop a new series of fact sheets and "best practice" notes. These short publications will spread the word about experiments that have worked well and have potential for replication, drawing on success stories from international practitioners as well as from within the Bank Group. The intent is to establish a body of good practice, raise standards, and maximize the use of successful models. Some of the topics being considered include:

- **Strengthening capacity—especially at the local level—to assist SME pilots**
- **Case studies of SMEs that have succeeded in difficult operating environments**
- **Matching grants, vouchers, and credit guarantees**
- **Overcoming constraints in the policy environment**
- **Special issues of women entrepreneurs**
- **Expanding access to e-commerce**
- **SMEs in private provision of infrastructure**

To share your ideas, contact Rob Wright (rwright@ifc.org).

East African Entrepreneurs Build Market for Business Services

Innovative World Bank projects in Kenya and Uganda are putting purchasing power and choice into the hands of small business owners to enable them to obtain needed skills through training. In the process, the projects are expanding the markets for business development services and attracting new private suppliers to this emerging sector.

In Kenya, micro and small enterprises, known as *jua kali*, have absorbed a growing share of employment as state enterprises have downsized and employment has stagnated in the large-scale private sector. But *jua kali* productivity is typically low. In response to this problem, the Kenya Micro and Small Enterprise Training and Technology Project is using vouchers to enable *jua kali* entrepreneurs to purchase management training.

As a demand-side instrument, the voucher project departs from the old approach of supporting public training institutions that rarely provided the hands-on assistance small businesses need. Now, an array of suppliers—master craftworkers, consulting firms, private training institutions, technology institutions, and financial institutions—are packaging their services for *jua kali* clients. Local private agencies handle allocation of the vouchers.

More than 11,000 vouchers have been issued, 60 percent of them to women entrepreneurs. Six thousand workers and owner-managers have received training, and there has been a 50 percent increase in employment and income among training recipients. Skilled craftworkers have emerged as the leading providers of training.

Financed through a $21.8 million loan, the project currently subsidizes up to 90 percent of the cost of each voucher, but cost-sharing percentages rise with second and third vouchers. The catalytic effect of the initial subsidy is already evident as *jua kali* now frequently purchase training without vouchers from providers who have demonstrated the value of their services.

Meanwhile, a similar program in neighboring Uganda is also showing encouraging results. The "Business Uganda" Development Scheme, or BUDS, is part of a larger World Bank project to help the Ugandan private sector become more competitive.

Under BUDS, Ugandan enterprises can receive 50 percent of the costs of business development services purchased from private suppliers. With an overall allocation of $3 million to be disbursed over four years, the project makes grants of up to $100,000. BUDS also helps firms determine which services they need, select a supplier, and obtain the best services from the supplier.

Nearly half of the more than 18,000 beneficiaries to date are women. Small firms, industry associations, and farming associations have made greatest use of the program, and training in basic business skills is the most popular service. Although the effect on sales is difficult to measure, an interim impact survey found that BUDS was a "trigger" that encouraged firms to take risks with untried initiatives, eventually leading to growth.

For more information: Lucy Fye (lfye@worldbank.org) or Thyra Riley (triley@worldbank.org).

A stronger small business sector can help raise living standards in Indonesia.

After the Crisis, a Boost for Indonesian SMEs

The Asian financial crisis severely affected Indonesia's small business sector. Declining domestic demand, rising inflation, skyrocketing interest rates, and an unstable political environment forced most SMEs to cut back on production. Many had to stop operations entirely.

At the request of the Indonesian government, and in close cooperation with the rest of the donor community, the World Bank developed an integrated approach to assisting Indonesian SMEs. The work has focused on four areas: policy advice to the government, donor coordination, pilot projects, and investments.

POLICY ADVICE

Within the Indonesian government, dozens of ministries manage different, and at times conflicting, SME programs. Indonesia also has many laws and regulations that discriminate against small business. Working with the Asian Development Bank (ADB), the World Bank is helping the government focus its SME strategy, change discriminatory policies, and streamline its support programs. To further this work, the government has created an inter-ministerial task force that is now reviewing and restructuring the disparate programs and laws that affect SMEs.

DONOR COORDINATION

The U.S., Japanese, German, Canadian, Australian, and European Union aid agencies—not to mention dozens of international NGOs—all have SME programs in Indonesia. Yet there has been little coordination between these groups. This contributes to the fragmentation of the SME programs in the country. The Bank has been working to increase collaboration between the aid agencies and to move donors toward broader agreement on an SME strategy in Indonesia.

PILOTS

A voucher program being piloted in East Java is introducing market-driven methods of providing business development services to SMEs. Funded by the World Bank through Swiss Trust Funds, the program has been successful in delivering high-quality, low-cost services. The pilot has been presented to the government for possible roll-out nationwide.

INVESTMENTS

To improve the ability of the private sector to provide support to SMEs, the International Finance Corporation is considering a number of SME-related investments. These include a microfinance investment, the establishment of an SME portal through a local bank, and creation of a nationwide credit bureau.

The Indonesian government remains extremely interested in SME development. The message of less government interference and more private sector activities is well received by many senior decisionmakers. Popular pressures will also contribute to the momentum for change. Nevertheless, it is by no means certain that current efforts will be able to undo policies that have benefited powerful interests in the past. Continuing the dialogue with all levels of government and the private sector is crucial for the World Bank Group and the entire donor community.

For more information:
Wendy Teleki (wteleki@worldbank.org).

Investment in a Gambian Private School

Education and literacy are clear development priorities for Africa, at the core of capacity building for economic advancement. With the public sector in Africa unable to meet all education needs, there is strong demand for affordable private schooling. Yet educational entrepreneurs have had great difficulty raising financing from commercial lenders, who have rarely seen education as part of the business world.

In response, the International Finance Corporation recently invested $41.4 million in 11 small education projects around the world, seven of them in Africa. A loan to a private school in The Gambia illustrates the potential of this unconventional approach.

Students perform at ceremony to celebrate the opening of the new Ndow school.

Located outside Banjul, the Ndow group of schools is privately owned by their founder, Hariette Ndow, a former teacher and principal. With her preschool and primary schools enjoying a national reputation for quality education, she decided to complete the complex with a middle and high school. The investment program started in 1992 and the middle school opened two years later.

In 1996 Ndow went to the Africa Project Development Facility (APDF) with a plan to add new facilities for the high school. Although most local lenders were unfamiliar with financing private education, APDF was able to help define the project scope, estimate investment costs and financial requirements, prepare financial forecasts, identify financial institutions—and eventually mobilize funds. Its pivotal role in developing the project highlights the synergies between IFC and its project facilities.

Since the school earns money by charging tuition in the local currency, the dalasi, the owner preferred not to take out a dollar loan and expose the business to foreign exchange risk. So IFC took the unusual step of guaranteeing a local currency loan to the school from a local bank for the equivalent of $238,000, repayable over five years. The proceeds were then used to build new science and computer laboratories, classrooms, a carpentry workshop, a library, and other facilities.

With an enrollment of 1,200, the new Ndow Middle and High School serves mainly middle-class students. Tuition is affordable at $300 a year, and the school also offers scholarships. An unusual feature is the school's emphasis on educating girls, who make up two-thirds of the student body. This innovative investment is helping private sector educators prepare Gambian students for university and for eventual roles in building their country. It may also serve as a model for other private educational institutions in Africa.

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Modou Badara Njie (mnjie@ifc.org).

PARTNER PROFILE: Small Enterprise Assistance Funds

Investing over the long term in the small, unlisted companies of high-risk markets is a task most mainstream fund managers shun. If done right, however, it can bring enormous benefits to emerging private sectors. That's the mission of Small Enterprise Assistance Funds (SEAF), an important new partner in the World Bank Group's SME work.

SEAF spun off from the international relief and development agency CARE in 1989 to pursue opportunities in Central and Eastern Europe. It branched out to Latin America in 1997, and is currently in discussions about expanding to Asia. A U.S.-based nonprofit, SEAF operates small equity funds on a largely commercial basis while using some donor funds to offset its operating costs. Its young and talented staff, the majority of whom are host-country nationals, possess a rare combination of business acumen and commitment to grassroots development. They work closely with their small investee companies over several years to build revenues and technical and managerial capacity—and, ultimately, value in SEAF's own equity positions, which average about $250,000 at point of entry.

While its operating model varies somewhat from country to country, SEAF typically launches a country or regional SME equity fund with backing from development institutions, then hunts for promising firms that seek outside capital and management support to grow. After taking a large minority position, SEAF provides extensive training and technical assistance on a roughly 60/40 cost-share basis, usually receiving about $15,000 annually per company for the service.

In Poland, site of its first fund, SEAF has sold 9 of its 37 investee companies, earning a 32 percent return and helping to create nearly 2,000 jobs. A typical example is Holding Centrum, which grew from a Solidarity start-up run from its founder's apartment into a nation-wide chain of 50 bookstores that may soon list on Warsaw's over-the-counter stock exchange. Technical assistance grants from donors helped it grow.

In Peru and Bolivia, by contrast, SEAF has limited or no donor grants to draw on and must cover its own costs. While this could reduce eventual returns by a few percentage points, it will not limit overall effectiveness, says president and CEO Bert van der Vaart.

SEAF began working with the World Bank Group in 1996 through a $600,000 IFC/GEF line of credit. The following year it conducted an assessment of SMEs in the West Bank and Gaza. Interested in SEAF's reputation for efficiency in making small investments and providing access to pre-funded technical assistance, in 1999 IFC helped triple the size of the group's year-old fund in Macedonia. Recently IFC and SEAF jointly launched a $25 million Trans-Balkan Fund for Bosnia, Bulgaria, Albania, Romania, Macedonia, and Croatia, and they are considering several other ways to work together as well. ■

SEAF AT A GLANCE

WHAT IT IS: **A nonprofit investment group based in Washington, D.C. that focuses on SMEs in frontier and transition economies.**

MISSION: **To promote economic development and encourage entrepreneurship in emerging free-market economies by providing equity capital and business assistance to local SMEs through commercially sustainable models.**

HOW IT WORKS: **SEAF buys stakes in companies too small to interest most foreign investors, then builds them through its own role as an activist shareholder, complemented by fee-based services and donor-funded technical assistance. It seeks exit opportunities as the companies mature, usually selling after 5–7 years.**

MANAGES: **$87 million.**

For more information, contact:

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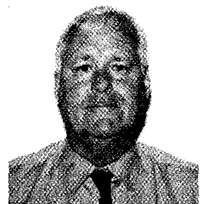
Introducing the management team of the World Bank Group's new Small and Medium Enterprise Department.

HAROLD ROSEN
American
Current position:
Director of SME Department.
Recent experience:
Director, Central and Southern Europe; manager, Southeast Asia and Pacific; manager, Financial Planning and Policy.

MAX AITKEN
Australian
Current position: Manager, SME Department.
Recent experience: Principal investment officer, Central and Southern Europe; established and managed Pacific Islands Investment Facility; involved with IFC investment activity in Southeast Asia, Pacific, and Central Europe.

LIZ BRONDER
American
Current position:
Program manager, SME Department.
Recent experience: Program manager, Offices of the Vice Presidents; also worked in Infrastructure, Asia, and Europe.

TOM DAVENPORT
Canadian/British
Current position: Manager, SME Department.
Recent experience: Manager, Mekong Project Development Facility.



ALEXANDER KEYSERLINGK
Canadian
Current position: General manager, Africa Project Development Facility; manager, SME Department.
Recent experience: General manager, IFC initiatives in Africa; manager, Africa Project Development Facility; resident representative of IFC in Germany; chief executive officer, African Management Services Company.

PETER MOUSLEY
Canadian/British
Current position: Program manager, SME Department.
Recent experience: Director, Multilateral Development Banks Division, Canadian International Development Agency; head of Canadian Development Program based in Accra, Ghana.

VINCENT RAGUE
Kenyan
Current position: Chief investment officer, Financial Markets, Middle East and North Africa Department; manager, SME Department.
Recent experience: Manager and secretariat, Knowledge and Learning Council, World Bank Group; first IFC regional representative in Southern Africa.

LEILA WEBSTER
American
Current position: Program manager, SME Department (will join the SME Department on Sept. 1, 2000).
Recent experience: Business development services program manager, Mekong Project Development Facility.

METRICS, from page 3

now, heavy staff involvement in a project often ended at the approval stage. After that, the progress of individual companies was rarely tracked in any formal way. Did the loan help nurture growing businesses? Or did its recipients default? Without one-on-one interaction in the field, it was often hard to tell. Measuring a project's impact on employment or its demonstration effects is also far more than a simple numbers game.

The lack of a standardized monitoring and evaluation system also hindered provision of technical assistance—not only to individual SMEs, but also to intermediaries who often need help in establishing systems to gauge the credit risks of potential subloan candidates.

The overarching problem—lack of a centralized evaluation effort—has now been resolved with the establishment of the new SME Department as a focal point within the Bank Group for SME work. Pulling the work together and elevating its strategic base will "link outputs of the department to results on the ground," says IFC's Rajiv Kochar, who is spearheading the efforts of the department's new metrics team. "We're working to set up a new ratings system that will allow management to allocate resources to those SME activities with the highest impact."

In the coming months the metrics team will develop a basic framework for project monitoring and evaluation. This framework will establish a set of standardized criteria to help measure impact and effectiveness. The goal: to create a decision-making tool that everyone from donors to individual businesses can use to determine how helpful the Bank Group's assistance really is.

The tool must be flexible enough to be adapted to the objectives of the different types of programs being evaluated. Impacts of training programs cannot be measured in the same way as loans, for example, even though there must be consistency in the overall standards applied. But new monitoring and evaluation mechanisms will be put in place for all new SME undertakings. It will not be easy, but staff strongly believe that an integrated, strategy-guided approach will help them achieve their goal of building up small businesses in developing countries everywhere. ■

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CALENDAR

Seminars

7TH WORLD SUMMIT OF YOUNG ENTREPRENEURS.
August 28–September 1, 2000, in New York, N.Y.
Sponsors: U.N. Institute for Leadership Development.
www.ildglobal.org
E-mail: ild@yorku.ca

EMERGING GOOD PRACTICES IN BUSINESS DEVELOPMENT SERVICES.
September 4–8, 2000, in Turin, Italy.
Sponsor: International Training Centre of the International Labour Organisation.
www.itcilo.it/english/whatisnew/index.htm
E-mail: SME@itcilo.it

30TH EUROPEAN SMALL BUSINESS SEMINAR.
September 20–22, 2000, in Gent, Belgium.
Sponsors: Vlerick Leuven Gent Management School and Economic Council of East Flanders.
www.vlerick.be/esbs2000/

GLOBAL CONFERENCE ON MICROENTERPRISES.
September 26–28, 2000, in New Delhi, India.
Sponsor: World Association for Small and Medium Enterprises.
E-mail: arun@wasmeinfo.org (Arun Agrawal)

NETWORK ON POVERTY AND INEQUALITY MEETING.
October 11, 2000, in Rio de Janeiro, Brazil.
Sponsors: Latin American and Caribbean Economic Association, World Bank, Inter-American Development Bank.
www.iadb.org/sds/document.cfm/1190/english/general/1489
E:mail: ariannal@iadb.org (Arianna Legovini)

NEW OPPORTUNITIES IN THE KNOWLEDGE-BASED ECONOMY: THE ROLE OF SMES IN THE NEW MILLENNIUM.
October 29–November 1, 2000, in Seoul, Republic of Korea.
Sponsor: International Small Business Congress.
http://isbc2000.kfsb.or.kr/

2ND OECD CONFERENCE ON WOMEN ENTREPRENEURS IN SMES.
November 29–December 1, 2000, in Paris, France.
Sponsor: Organization for Economic Cooperation and Development.
www.oecd.org/dsti/sti/industry/smes/news/women2000.htm

Training

BDS 2000 TRAINING PROGRAM.
July 24–August 11, 2000, in Glasgow, U.K.
Sponsor: Springfield Centre.
www.springfieldcentre.com
E-mail: bds@springfieldcentre.com

MICRO BANKING SUMMER ACADEMY 2000.
August 28–September 8, 2000, in Kronberg, Germany.
Sponsor: Bankakademie Micro Banking Competence Center.
www.mbcc.bankakademie.de
E-mail: stange@bankakademie.de (Anja Stange)

In the World Bank Group

AFRICA PROJECT DEVELOPMENT FACILITY (APDF) FIELD STAFF TRAINING.
June 19–June 28 and July 3–July 12, 2000, in Cape Town, South Africa.

OPENING OF BALKANS ENTERPRISE FACILITY.
Early July, 2000.

WORLD BANK GROUP ANNUAL MEETING.
September 26–28, 2000 in Prague, Czech Republic.