VENTURES IN THE INFORMAL SECTOR, AND HOW THEY WORKED OUT IN BRAZIL

by

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List of acronyms

AID	-	U.S. Agency for International Development
AITEC	-	Accion International/AITEC
ATI	-	Appropriate Technology International
BANDEPE	-	Development Bank of the State of Pernambuco
CEBRAE	-	Brazilian Center for Managerial Assistance to Small and Medium Businesses
Cr$	-	The Brazilian monetary unit, the cruzeiro. Most dollar values in the report are the result of converting 1981 constant cruzeiros to dollars at the average rate for 1981--Cr$91.265 to the dollar. In April 1982, the rate was Cr$165 to the dollar.
FIDEM	-	Foundation for the Development of Metropolitan Recife
IDB	-	Inter-American Development Bank
NAI	-	Nucleus for Management Assistance to Manufacturing Firms
PISCES	-	Program for Investment in the Small Capital Enterprise Sector
PVOs	-	Private voluntary organizations
SPC	-	Serviço de Proteção do Crédito (Credit Protection Service)
SUDENE	-	Regional Development Authority for the Northeast
UNO	-	Northeast Union of Assistance to Small Businesses (pronounced OO-nō)

Preface and acknowledgments

In late 1981, AID's Office of Private and Voluntary Cooperation (PVC) asked me to evaluate the UNO program of credit to small businesses in Northeast Brazil. UNO, a Brazilian voluntary organization located in the city of Recife, was founded 10 years ago by the U.S. voluntary organization, Accion International/AITEC.

The PVC office felt that UNO would be particularly interesting for evaluation because: (1) UNO is considered a model of success, not only in delivering credit to small businesses without access to formal credit, but as a voluntary organization that started out from nothing and has now been included in three World Bank projects; (2) the UNO evaluation fit into a series of five evaluations of small-business assistance programs in other countries now being completed by AID; (3) an evaluation of UNO would also be relevant to a two-year research effort of AID (PISCES) to explore ways of assisting informal-sector businesses; and (4) the UNO evaluation was meant as a second step in an exercise carried out by the PVC office to understand better what the special contribution of private voluntary organizations can be to development assistance, and how one can go about evaluating that contribution.

I spent four weeks with UNO in the city of Recife during the months of January and February, about half of which was dedicated to interviewing 25 small businesses that had received credit from UNO.[1] In addition, I interviewed 10 members of UNO's management and staff, accompanied four student workers on routine selection or monitoring visits to clients, attended a training session for UNO's student workers, and sat in on a meeting to organize a group of food-store owners who were UNO clients. I also interviewed five members of Recife's business community (some of whom also hold public-sector positions), who had been involved in UNO's founding and belonged to its board of directors; four economists at the Federal University of Pernambuco who were doing contract research on UNO or Recife's informal sector; two members of Recife's urban development agency, one of the state entities with which UNO works on contract; and the chief of credit to small businesses at the state development bank. Before going to Brazil, I spent a day with AITEC in Cambridge, where I had highly informative discussions with William Burrus, AITEC's director, and Bruce Tippett, formerly of AITEC, who was closely involved with UNO's beginnings.

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[1]Ten small retail operations (mainly food stores and novelty and clothing shops), ten manufacturing firms, and five service establishments.

My work in Brazil was made possible and delightful by the extensive help and generosity of Dr. Maurício Camurça, UNO's director. I learned a great deal from him and his highly intelligent staff. I also thank Alexandre da Costa e Silva and Antônio Ivo Mendes de Albuquerque for accompanying me on my interviews of UNO clients and for helping me gather data from UNO's loan files.

While I was writing, I benefited very much from conversations with Lorene Yap, Pasquale Scandizzo, Anna Luiza Ozorio de Almeida, Ricardo Moran, Lovell Jarvis, Henry Jackelen, Albert Fishlow, Ruth Dixon, Andrea Calabi, Neal Boyle, and Dennis Anderson. A meeting in Washington with AID staff and other project evaluators, to discuss a first draft of this paper, was extremely useful. I am particularly grateful to Ross Bigelow and Judith Gilmore for comments on the first draft.

Jeffrey Ashe, Associate Director of AITEC, took out several hours of his time to discuss his reactions to the draft report with me and to provide excellent written comments, which helped me very much for revisions. Because certain differences in interpretation between us still remain, I thought it would be useful and interesting to the reader to append Ashe's comments to my work. They appear at the end of the report, following the bibliography.

I am most appreciative of the written comments on the draft summary and conclusions sent to me by Maurício Camurça, director of UNO, and have taken the liberty of translating and appending them to my report. I am particularly sorry that funds did not permit our providing UNO with a Portuguese translation of the report in draft form, and that I was therefore not able to benefit from the reactions of Dr. Camurça and his staff to the full draft report. Fortunately, at least, the final report will be translated to the Portuguese.

All translations from the Portuguese in this report are my own.

Summary and conclusions

Everyone's eyes are on UNO in the Brazilian city of Recife. Considered a model of how to provide credit to small businesses, UNO seems to have achieved what many similar programs have not. Its repayment rates, at about 95%, are unusually high. Its management is dedicated and talented, with a continuity that is impressive for an organization paying salaries that are lower than in the public sector. It has succeeded in lending to firms with no previous access to bank credit, and has not allowed political pressures to influence its lending decisions--a remarkable achievement, given the lure of its highly subsidized interest rates. UNO has not succumbed to the temptation to lend larger amounts and to better-off firms, in order to achieve the economies of scale inherent in making fewer and larger loans. By lending to small firms without access to credit, UNO has been a pioneer in Brazil, working where no other agency has, showing that it could be done, and opening a path for the public sector.

UNO was created in 1973 by the U.S. private voluntary organization Accion International/AITEC, with support from Recife's business community, other foreign donors, and the Brazilian public sector. After becoming successfully rooted, UNO did not grow for its first six years; on the average, it made 175 loans per year, at U.S.$2,000 each, with an annual operating budget of U.S.$275,000. Starting with its seventh year, UNO's achievements started to pay off: between 1978 and 1982, it received a resounding vote of confidence from the World Bank and the Brazilian public sector in the form of a manyfold increase in its funding. By the end of 1982, it will have made 2,000 loans in a new program outside Recife, and was projected to be making another 2,000 loans a year in Recife by 1985. Despite this massive increase in its public-sector support, it was allowed to continue being an autonomous voluntary organization, working under annually funded government contracts--now the sole source of its income.

For a model, UNO has surprising flaws. Unit costs of lending are very high and productivity is very low. The program has not yielded the kinds of benefits, in turn, that might justify such high costs. Mainly, (1) the number of firms receiving credit has been small, (2) the assisted firms have not increased output or created new jobs, (3) managerial extension has had little impact on the assisted firms, (4) the credit experience with UNO has not provided the majority of firms with direct access to formal credit institutions, and (5) UNO's learning about how to distinguish good microfirm credit risks from bad has not spilled over to formal lending institutions or translated into greater willingness to lend to microfirms. Some of these paltry results can be traced to UNO's way of operating. Others relate more to the characteristics of the small enterprise sector--and certain mistaken assumptions about it--and to the political-economic environment in which UNO and many similar programs operate.

With respect to costs, an average UNO loan of U.S.$2,000 cost U.S.$1,700 until 1979, amounting to 82% of loan value. In 1981, costs seemed to start downward, with 1981 costs at roughly half the previous level: a loan of U.S.$1,600 cost U.S.$733 in 1981, representing 46% of loan value. Reflecting these high costs, the number of loans made per field worker is low, at 24 per year.

UNO's high costs come as a surprise to anyone who has heard of UNO as a "low-cost" approach to informal-sector businesses--with its low overheads (10%), its cheap student workers (half the cost of a permanent employee), and its meager facilities and equipment. Though one might not be bothered by these costs and their productivity implications in a tiny program like UNO, which made only 387 loans in Recife in 1981, one certainly would not want to expand such a "model" to public-sector dimensions.

UNO justifies its work by pointing to the employment and income its loans provide to small-firm owners who, it says, are poised at the brink of urban unemployment. UNO's clients, however, turn out to be in the top 30% of the distribution of earnings, household incomes, and perhaps even microfirms--and live comfortably above absolute poverty. Most of them voluntarily left formal-sector jobs to start their own businesses. Their place in the distribution, in other words, is not where poverty and unemployment problems are concentrated, though they are truly outside the pale in terms of institutional credit and other benefits of belonging to the formal sector.

One does not need to justify lending to small firms, of course, on the grounds of alleviating their poverty. After all, they have the potential to increase output and contribute to the creation of new jobs--given that they are among the better-off small firms and use labor-intensive technologies. The average UNO client, however, does not expand his output as a result of his experience with UNO--and hence does not create new jobs. UNO's clients, in sum, are too well off to justify lending to them on income or employment (of firm owners) grounds. And their lack of growth precludes a justification on the grounds of increased output and new jobs.

UNO firms do not expand for various reasons. One set of reasons has to do with UNO's way of operating--namely, it does not believe in selecting firms for their expansion or employment potential. The largest share of loans (42%) goes to retail firms with an average number of 1.2 workers--as compared to manufacturing and service firms with an average of 3.5 and 2.0 workers, respectively. UNO is content, moreover, merely to help firms survive; it is not interested, it says, in "creating mini-capitalists." Contributing to the same result, UNO is not aggressive about "graduating" its clients to direct bank credit, nor does it encourage its clandestine clients (half of the total) to become legal. The ongoing costs of being legal, it says, would bankrupt most of its clandestine firms.

A more important set of reasons for the lack of expansion and job-creating among UNO clients--including the successful ones--has to do with the nature of the small-firm sector itself. Many small firms perceive expansion as "unnatural" and even imprudent--mainly because of the management problems involved in taking on new employees. New jobs may look good for benefit-cost ratios, in other words, but they are considered a headache by small-firm owners. Other factors causing growth to be difficult are (1) the problems of seasonal peaks and troughs in demand, (2) the difficulties of acquiring raw materials, and, most important because it is often forgotten, (3) the strong preference among owners of family firms for not complicating their lives. The lack of credit, of course, is supposed to be among the impediments that keep small firms from growing. But when the credit constraint was removed in the UNO case, the other impediments continued dominant. Even if firms do not grow, finally, they will often use their credit to bring about small increases in productivity--the purchase of a vehicle for transport, the buying of raw materials on better terms, a modification of the premises. These changes, though economically desirable, will not necessarily involve the expansion and the new jobs upon which the justifications of small-business programs are predicated.

sustainability

Our expectation that small firms will grow when they are well-assisted has been nourished by the reports on job-creation from small-business programs. My analysis of the jobs created by UNO and some other programs suggests, however, that many of the "new jobs" last only for the duration of the credit. Visiting its client firms soon after the credit was disbursed, for example, UNO reported approximately 230 new jobs per year and 1.6 new jobs per client firm over a period during which a longer-term analysis of the client firms showed an absolute decrease in jobs of 5% (one to three years after the loan was disbursed). Since the same study showed that assisted firms tended to fail less often than non-assisted firms (though the latter results were not statistically significant), a "job-saving" justification might be more realistic, even though it is less impressive.

Though the above-cited barriers to expansion are familiar to us, they tend to be forgotten when we justify programs to assist small firms. If stability is the rule rather than growth, then we must look for other ways of justifying such programs. The saving of jobs, mentioned above, is one possible alternative, though we do not have carefully enough collected data on such programs to know if job-saving is indeed one of their outcomes. The productivity increases cited above are another possibility, though they will not necessarily create jobs and may sometimes even destroy them.

Critics of UNO point to its disinterest in choosing firms for their job-creating and output-expanding potential. The origins of this "flaw," however, are the same as for some of UNO's strengths. UNO has shown a cautiousness in its lending that has contributed to its enviously high repayment rates and to its neglect of the expansion and employment potential. Its caution takes the following form: (1) it lends mainly for working capital (75%) instead of investment; (2) it is loathe to lend to new firms or for the new activities of old firms; (3) in its investment credit, it is cautious about lending for equipment that is over-dimensioned; (4) it shaves loan amounts in relation to the firm's needs; and (5) it lends more to retail firms than to the riskier manufacturing and service sectors. All these behaviors are financially commendable because high delinquency rates in business credit programs tend to be associated with (1) too much investment credit in relation to working-capital credit, (2) overinvestment in equipment that is beyond the firm's marketing or production possibilities, (3) too much credit in relation to firm size, and (4) the financing of new firms, new activities, and large expansions.

UNO's financial prudence may also result in the passing up of firms, or their projects, that are particularly capable of expanding and hiring new workers per unit of credit lent. More aggressive lending, of course, does not necessarily have to lead to higher delinquency rates, as long as one is skilled at screening out the problems. But the ability to screen wisely requires considerable experience, specialized personnel, and resources for research on the characteristics of defaulting borrowers and on the sectors with comparative advantages--all of which UNO has not had. UNO's financial prudence, then, has been quite fitting to its size, though resulting in a loan portfolio that shows little results in terms of expansion of output and creation of jobs. The goals of organizational survival and economic impact, in other words, were partially conflicting.

Had UNO wanted to select clients who truly needed income and employment--the hawkers and vendors, for example, as opposed to the makers of furniture and shoes--it would have had to operate quite differently. Group lending rather than loans to individuals, and loan sizes of U.S.$100 rather than U.S.$1,500, would have been called for. Similarly, if UNO had wanted to strive for significant economic and employment-creating impacts, it would also have had to take on additional activities such as technical assistance, the organizing of producers for group purchasing and selling, research to identify sectors with growth potential, and selection procedures that would identify the particular firms in possession of this potential. In choosing particular sectors, moreover, UNO would have also run the risk of causing market-saturating expansion, perhaps leading to the demise of its expanding clients--an argument that UNO itself makes against choosing clients this way.

That UNO did not carry out several such activities contributed to its survival and its good reputation. UNO stuck singlemindedly to providing only credit to individual firms, despite criticisms from various quarters. To attempt more would be foolish, it felt, because of the limits and tenuousness of its funding. The pursuit of this one task for almost 10 years, and the neglect of additional activities that might have increased the program's impact, provided UNO with the time and the experience to mature into a competent and dedicated operation--the only one of its kind to become prominent in Brazil.

UNO's high costs can also be traced, in part, to its achievements in other areas. UNO's stubborn insistence on excluding better-off firms and lending in small amounts accounts for its success at avoiding the drift upward in the size of client firms and their loans--a drift that happens in many subsidized credit programs for the poor. At the same time, this insistence meant that UNO gave up the possibility of reaping the cost reductions to be had by making at least a small number of large loans. The objectives of wise financial management and serving only the intended beneficiaries, in other words, were in conflict. For the same reason, the goals of reaching small beneficiaries were also in conflict with the indicators commonly used to judge the performance of credit projects and branch-bank managers--respectively, the volume of lending per time period, and the profits made on it.

UNO's modest budget, typical of many small voluntary organizations, also turns out to be an unexpected culprit in the failure to lend at reasonable costs--while at the same time contributing to UNO's achievements. On the one hand, the small and uncertain annual budget (U.S.$275,000) kept UNO from taking on more than it could handle and forced it to be a lean organization. This went along with a remarkably "democratic" office environment, in contrast to the more typical hierarchy of larger bureaucratic organizations. The lean and democratic environment, in turn, contributed to UNO's success at identifying with its clients, and in not feeling squeamish about spending time at their businesses and in their neighborhoods.

Though UNO was admirably constrained in its expenditures on overhead, vehicles, facilities, and personnel, it was nevertheless extravagant in the use of time. This canceled out the cost advantage of its pinched expenditures. The role of the small budget in this extravagance was that it gave UNO the freedom to not worry about reaching a significant number of firms. Not having to worry about impact--the luxury of many small organizations--translates easily into not worrying about how to reach the most borrowers for a given amount of funding, which can be done only by reducing unit costs and increasing productivity. (Other concerns and goals, moreover, took precedence over unit costs and productivity: the voluntary organization's view of its task as "good works," and the more pressing need to survive and gain recognition as a "reputable" organization.) That UNO's small budget and correspondingly limited horizons exempted it from the pressure to develop a low-cost model is an important finding, applicable to many small organizations. The stern financial discipline of small budgets, after all, is usually thought of as forging low-cost ways of doing things.

Is my concern for whether the model can be used to achieve public-sector impacts misplaced? Many small voluntary organizations, after all, cannot even aspire to delusions of impact, unless they are dealing with a circumscribed problem or a very small client group, like lepers. That UNO became a competent and respected organization, one might argue, was good enough; unit costs and productivity are pressing matters more for large organizations with greater aspirations. Similarly, that high economic and social benefits were beyond the reach of the model could be looked at as less important than that UNO represented a job well done, carried out with relatively modest total expenditures and free of the "vices" of large bureaucracies. Although this view is perfectly compatible with the priorities of many voluntary organizations, it is nevertheless not sufficient as a guide for deciding how to spend scarce public-sector funds for development assistance.

What is it, then, that UNO is a model of? How does one reconcile UNO's success as an organization with its failure to develop a replicable or economically and socially significant way of providing credit to the informal sector? The reconciliation becomes easier if we first give up our idea that UNO is a model of how to carry out a certain task, and instead see it as a lesson about how to build a certain kind of institution. The features of this redefined model, taken from UNO's history and elaborated in the text, might include the following: (1) grounding of the new organization in the local elite community; (2) "premature" withdrawal of the outside funding organization; (3) the taking on of only one task rather than many; (4) relatively scant outside funding in non-growing annual increments; (5) a long "quiescent" period during which expansion and diversification of activities do not take place; and (6) an operating style, a type of task, and a support group that all help protect the organization from political interference and from other organizations.

Other aspects of the redefined UNO model are surprising, showing that UNO behaved in some ways less like a "better" alternative to the public sector than we have been led to believe. Although prizing private-sector independence, UNO and its founders never concerned themselves with giving UNO the opportunity to become financially self-sufficient or to have self-maintaining credit funds. Even though the opportunities to charge for services were greater for credit than for many other services provided by voluntary organizations--and even though UNO's clients had already proved themselves willing to pay a lot for credit--UNO and its creators opted for a highly subsidized interest rate and a low commission that guaranteed that the public would always be dependent on the good will of public-sector benefactors. Today, therefore, UNO has virtually no source of funds outside the public sector, a state of affairs that has compromised the autonomy it prizes so highly. UNO's founders, in sum, behaved very much like our image of the public sector--by ignoring opportunities to become financially self-maintaining, and by endorsing an unnecessarily highly subsidized approach to providing a service.

That the UNO experience produced a good organization and not a good technique is perhaps not that disappointing. Building an organization that is suited to an UNO-type task may be more difficult than devising the best way to provide the service. Once the organization is solidly in place, the task of discovering the best technique may be much easier. Perhaps that is why UNO is only now exploring some new ways of doing things, ten years after its founding, and starting on a path leading toward cost reductions. If building the organization requires more effort than finding the right technique, moreover, then perhaps we should alter our concept of the purpose of providing "pilot" projects. We may not need a project to discover the right way of doing things, that is, if we first build a good organization that then has the competence and the character to find the technique itself.

That UNO evolved in the course of using an unsatisfactory technique did not seem to impede its survival or its recognition by the public sector. The life-threatening problems it faced had nothing to do with its high unit costs, or the low social and economic value of its lending. Whether UNO will now move on to the right technique will be apparent soon--after completion in 1985 of the major expansion and diversification of its activities under the three World Bank projects. The UNO that emerges from this expansion, whether successful or not, will be very different from the existing one. The continuity will be found in the organization, and not in its way of assisting small enterprises.

An organization that has been so successful at surviving, like UNO, may be particularly loathe to modify the way it does things because it considers the whole package to have been responsible for its success. UNO's extension program--and its high investment in a loan-application procedure that probably does not increase the likelihood of repayment--are examples of such hallowed yet inefficient ways, which also are followed by other small-business programs. Sometimes, an organization may be spurred to give up such ways when a totally new constraint appears, as has happened with the high lending targets UNO must now keep up with, for the first time, under the World Bank projects. In order for UNO to attain this speeded-up pace of lending, something will have to give that causes its high unit costs to come down. It will also have to show that it is striving toward more impact in order to sustain these higher financial commitments from the public sector.

Because of the difficulty organizations have in giving up some of their ways, outsiders will sometimes be the only ones to understand clearly how the technique can be improved upon, even though the organization is at the stage where it is more than competent to do so itself. The need for a newcomer's vision may explain why a recent program in Ecuador, created in UNO's image by a private bank, has succeeded in lending at a fraction of UNO's costs while still obtaining high repayment rates. It has abandoned UNO's cherished courses for microfirms, which account for 30% of its costs, and has streamlined the selection process; it has even given up evaluation and some other internal control mechanisms, also in the name of reducing costs.

The importance of a cost-minimizing or impact-maximizing constraint in helping an organization shed its inefficient ways cannot be exaggerated. For a large public-sector program, as UNO's is becoming, the constraint is partly a political one: if a large subsidized program does not touch many people, it will be in political trouble. For a private-sector program, as in the case of the Ecuadorian copy of UNO, the constraint is a profit-maximizing one: the bank was forced by law to lend a certain percentage of its deposits to small firms at a low interest rate, or face the alternative of having to purchase government bonds at an even lower interest return. It chose the higher-return alternative (lending to small firms), but wanted to do so in a way that minimized its losses and maximized its returns.

UNO, like many small voluntary organizations, was exposed to neither of these disciplines. Because it is now becoming subject to the public-sector discipline of breadth, it may be impelled to develop a way of operating that deserves imitation. The greater closeness to the public sector, of course, will also threaten some of the very qualities that made UNO successful. Now that it is ten years old, it may be better able to survive these dangers than it was before.

APPENDIX A

COMMENTS OF JEFFREY ASHE OF AITEC ON THE DRAFT REPORT

(retyped from original memorandum)

ACCION INTERNATIONAL/**AITEC**

TO: Thomas McKay, Austin Hymen, George Beloz, Judith Tendler

FROM: Jeffrey Ashe, Senior Associate Director

DATE: July 7, 1982

As you may know, I studied Judith Tendler's report in detail and spent a delightful day speaking with Judith and George Beloz on June 29. In general, the report is excellent and will be of great benefit to the AITEC staff. The many points she raised that I don't discuss here I am in general agreement with. There are several points, however, that were not considered in the analysis. Judith will incorporate many of the observations I made into her final version of the report, but I would like to sum up my points here:

A. HIGH COST AND LOW PRODUCTIVITY

1. It is not accurate to charge all project costs to the costs of packaging loans and monitoring them--i.e., taking the entire budget and dividing this by the number of loans granted. There are other costs--for training, research and evaluation, educating other institutions, scrambling for next year's budget, and simply making costly errors and learning from them--that do not relate in their entirety to loan packaging and monitoring.

   A more accurate measure of productivity requires a more detailed analysis of the UNO/Recife budget.

2. It is also unfair to consider as a cost of project administration what is really a problem of the <u>low productivity of the banks UNO works with</u>. Up until 1981 about 1-3 of the loans prepared by UNO were never granted because of bank delays and red tape. Productivity would increase by at least 1-3 if those costs were considered.

A related problem that increases costs is the extensive documentation required by banks. Once again, this does not reflect so much on the "UNO model" as on the bureaucratic requirements of the banks UNO is working with.

3. It is also likely that part of the problem of "high cost and low productivity" is not the "model," but the low volume of loans granted in the program before 1981. According to the 1982 projections, total costs will be reduced to approximately 28% of the value of the loans granted. This figure is much more consistent with the costs of the AITEC-assisted programs in Bogota with the Fundacion Compartir and in Santo Domingo with the Fundacion Dominicana de Desarrollo. In both projects administrative costs are running about 25% of the value of the loans granted to reach a similar clientele. Both the Cali and the Santo Domingo programs provide considerably more technical assistance than the Recife project, so potentially the costs for the Recife project could be less than the 28% indicated in the 1982 projections.

4. Productivity has increased dramatically in 1981, not only due to increased loan volumes, but to cutting down the steps required in loan packaging from 4 steps to 1. Fine-tuning the model resulted in a great increase in productivity. It also indicates that the UNO staff is not totally unconcerned about project costs.

To sum up, if only those parts of the budget attributable to loan packaging and monitoring, and perhaps technical assistance, were charged to loan administration, if bank inefficiencies were accounted for, and if the enormous increase in productivity due to the increasing loan volume and cutting down the steps required for packaging loans were emphasized, it is likely that administrative costs would be closer to 20% than 50%. At 20%, or even 30%, UNO becomes a "model" that deserves serious consideration by other public and private institutions.

Finally, the UNO project is compared to a theoretical public-sector project that could deliver credit at a 20% administrative cost. In Brazil, the public sector institutions for small and micro businesses:

(1) do not reach the UNO level of beneficiary
(2) even when they do reach larger businesses are much less productive than UNO
(3) are subject to more political pressure.

Also, typically, public sector projects have a higher default rate than the UNO project, an additional cost which should also be considered. If reaching micro businesses is a worthwhile goal, experiments such as UNO may be necessary to help show the public (and private) sector a way to reach them more effectively.

B. IMPACT

The discussion of the cost-effectiveness of the Recife project and ACCION/AITEC's efforts to make the model more effective in other countries are academic if these projects do not:

(1) create new jobs
(2) increase income
(3) increase business survivability.

This part of the report underestimated the impact of the program.

No reference is made to the data on employment generation presented by the program since its origins in 1972, which indicates that one new job is created for roughly every $1,000 loaned to these businesses. These records have been kept quite conscientiously since the beginning of the project.

Even if the new jobs created last only a year, that impact on income for very poor people is not insubstantial. If employees make $5 a day ($1,250 a year), more new income for very poor people will be generated through new salaries than the value of the loans themselves.

Actually the record for job generation may be better. A study done on the 200 loan recipients of the AITEC-assisted Cali Caravajal project since 1977 shows an average increase in new jobs of 3 per business. A substantial proportion of these businesses have kept this high number of employees for from 3-5 years. Only in 8 businesses did the number of employees drop. Of the money loaned in the Caravajal project, 85% was for working capital, countering the argument that the impact of working capital loans is necessarily short-term.

Similar impressive results were demonstrated in the AITEC-assisted Dominican Development Foundation's enterprise program. Here, 184 new jobs have been created over the last year in loans averaging under $2,000 to 63 businesses. In this program, however, long-term employment impact is yet to be demonstrated.

Both the Cali project and the Santo Domingo project work only with manufacturing and service businesses in contrast to the Recife program, where a majority of those assisted are micro commerces. One problem with the report was that an inordinate amount of time was spent looking at small retail stores, where the impact on employment is likely to be the least. Little attention was given to manufacturing and service businesses.

I admit the data presented by the program on income and employment could be better. The report's presentation of the lack of income and employment impact, however, is not substantiated adequately and runs counter to the evidence collected in the UNO program and other similar efforts elsewhere.

Another aspect of the impact of these projects which has been indicated consistently is the increase to the business owner. Figures projected through the end of 1982 in the Fundacion Dominicana de Desarrollo project indicate that through lending $312,000 to 156 business owners there will be a total of $224,000 of new yearly income created for the owners. This is in addition to the $503,000 of yearly income from the 291 jobs that are expected to be created. New income in the first year, then, totaled $815,000. In Cali, the average income of the beneficiaries increased 40%.

C. LEVEL OF BENEFICIARIES

The finding that UNO beneficiaries are by no means the poorest of business owners in Recife is essentially correct. However, her case is overstated for two reasons:

(1) The study of 500 UNO beneficiaries she refers to shows the income level of these businesses <u>after</u> they had received a loan. If the data from Santo Domingo and Cali are correct, the income of these businesses should have increased by somewhere in the vicinity of 40%. To be accurate, the income figures as the businesses entered the program would have to be considered.

(2) The major data on income compared the UNO beneficiaries with the entire state of Pernambuco for non-agricultural laborers. This is like comparing the income levels of Nairobi with the small towns in the hinterland. Often income levels in the major city are considerably higher than in the small towns. A valid comparison would require that the micro business owners be compared with other similar non-agricultural occupations in Recife.

There is no question, however, that these loans are not reaching the poorest urban entrepreneurs. This requires a different methodology such as is being tested in the solidarity group component of the Dominican Republic Foundation's micro enterprise program. The justification for reaching "micro-businesses" is the employment they generate for poor people, the teaching they provide to those who have no access to it and the provision of needed goods and services to the poor community. Often income levels in the major city are considerably higher than in the small towns.

I agree that there are major limitations in the UNO model.

(1) I think these types of programs should manage their own credit funds. Only by handling their own credit funds will they receive enough income from the interest spread to become potentially self-sufficient. The Fundacion Dominicana de Desarrollo project manages its own credit and covers a significant part of its costs by doing so.

(2) These programs should charge a rate of interest that covers costs. I believe that the interest rates should be higher than the market rate to insure that those businesses that are relatively more needy will be beneficiaries of the program.

(3) These programs should eliminate to a large degree free technical assistance. In the Bogota/Compartir program assisted by AITEC, micro businessmen who are interested will pay for their own technical assistance courses.

(4) These programs, after working successfully with credit for 2 or 3 years, should enter into other kinds of services, such as group purchasing of raw materials.

(5) Programs should stress those firms which have the greatest possibility for creating jobs. ACCION's new programs which assist the micro enterprise sector focus entirely on manufacturing and services. Both of these areas have a much greater potential for job creation.

I feel that the kinds of changes now being tested in other ACCION/AITEC assisted efforts will increasingly show the validity of this kind of approach for larger scale replication by public institutions and perhaps, more likely, private institutions.

APPENDIX B

<u>COMMENTS OF DR. MAURÍCIO CAMURÇA, DIRECTOR OF UNO,</u>
<u>ON THE SUMMARY AND CONCLUSIONS TO THE EVALUATION</u>

<u>Comments of Dr. Maurício Camurça, Director of UNO, on the Summary & Conclusions to the Evaluation*</u>

...As in the case of any model, the UNO model cannot be analyzed without placing it in the context of Brazilian reality and, particularly, that of the state of Pernambuco. Factors that are considered flaws in the evaluation really turn out to be strengths, when analyzed against this broader background.

UNO's high costs and low productivity must be analyzed in relative rather than absolute terms. In a country in chronic crisis, where great uncertainty surrounds everything that happens, decisions and actions are taken with enormous difficulty. Just look at the sorry state of domestic firms, and of the very institutions responsible for the country's development programs. Budgeted funds that are received only after months of delay result in uncertainties, tensions, and increases in costs. Against this background--which time did not allow you to get to know better--UNO actually does better than the national average in terms of costs and productivity.

The social and economic justification for choosing the stratum of enterprises we work with is clearly explained in our documents. It seems that you may have misinterpreted UNO's objectives. We have never intended to assist the lowest strata of the informal sector, nor was UNO created for that purpose. Very much to the contrary, our target group is constituted by the highest stratum of the informal sector--the microenterprise. We are interested in reaching the smaller microenterprises--which can be seen clearly by the fact that the enterprises we assist fall well below the ceiling definition of a microenterprise in Brazil.

Urban poverty (absolute and/or almost absolute) is not, and never could be, the object of our concern as an entity assisting microenterprises. In order to analyze how well off

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*Translated from the Portuguese by Judith Tendler. The comments are contained in a letter from Camurça to Tendler. Some parts of the letter that were unrelated to the evaluation were omitted from the translation--they are indicated by a string of three periods. Camurça's letter was in response to a draft version of the evaluation in English. Unfortunately, AID funds were available for translation to the Portuguese of only the final report, so that UNO did not have the benefits of the complete draft report in Portuguese, and could comment only on its own translation to the Portuguese of the Summary & Conclusions.

small and medium firms [not to the poorer strata of the informal sector].

Many international and national institutions--and even those who have never been concerned with the amelioration of poverty--are pointing to programs of management, financial, and technical support to microenterprises as "evidence" that they are attacking the problem of urban proverty--as if this were the only valid approach to the problem. For this reason, some international entities use the words "microenterprise program" to describe social projects of assistance to the lower strata of the informal sector--i.e., itinerant vendors, independent suppliers of services, and even persons without income, such as rag-collectors, the unemployed, etc. Herein lies the source of the confusion--i.e., the [mistaken] evaluation of a program for microenterprises as if it were supposed to cover the informal sector in its entirety.

UNO's greatest shortcoming--if one wants to identify it as such...--lies in the fact that after ten years of experience in Recife, it still has not been able to work through groups of producers, organized according to type of activity--improving its training programs and offering a variety of approaches toward management assistance, lowering its costs, and raising the number of microenterprises reached. This approach is being used only in the interior program at this point--and only timidly, given its novelty. Unfortunately, you visited only Recife, where UNO has only one of its projects as opposed to the seven in the interior...