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SOME PROBLEMS IN OPERATING A LOAN PROGRAM
FOR CRAFT AND EMERGING SMALL-SCALE
NON-FARM ENTERPRISES IN JAMAICA

By

Middleton Wilson

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Department of Agricultural Economics
Michigan State University
East Lansing, Michigan 48824

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SOME PROBLEMS IN OPERATING A LOAN PROGRAM FOR CRAFT AND EMERGING SMALL-SCALE NON-FARM ENTERPRISES IN JAMAICA*

By

Middleton Wilson**

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**The author was Managing Director, Small Enterprise Development Corporation, Ltd. (SEDCO), Government of Jamaica, 1977-79. An economist by training, he is presently a graduate student in Finance, The Business School, Michigan State University, East Lansing, Michigan.

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This paper is one of a series of reports produced by Michigan State University's Off-Farm Employment Project. The project, which is funded by the Office of Rural Development and Development Administration, Development Support Bureau, U.S. Agency for International Development, has the basic purpose of enhancing the ability of AID missions and host country institutions to identify and implement programs and policies that generate off-farm employment and income opportunities benefiting the rural poor. One of the major components of the project is the generation of new knowledge relating to off-farm activities. In collaboration with host country institutions and AID missions, detailed field surveys of small-scale enterprises are currently being conducted in Bangladesh, Jamaica, Honduras, and Thailand; the results of these studies will be published in this series. A second component of the project involves the marshalling and dissemination of existing knowledge of off-farm activities. A state-of-the-art paper and special studies relating to off-farm activities will also appear in this series. Previously completed studies in this area, currently available through the Off-Farm Employment Project, include:

1. Carl Liedholm, "Research on Employment in the Rural Non-farm Sector in Africa," African Rural Employment Paper No. 5, 1973.

2. Carl Liedholm and Enyinna Chuta, "The Economics of Rural and Urban Small-Scale Industries in Sierra Leone," African Rural Employment Paper No. 14, 1974.

3. Enyinna Chuta, "The Economics of the Gara (Tie-Dye) Cloth Industry in Sierra Leone," African Rural Economy Working Paper No. 25, 1978.

4. Adewale Mabowonku, "An Economic Evaluation of Apprenticeship Training in Western Nigerian Small-Scale Industry," African Rural Employment Paper No. 17, 1979.

5. Steve Haggblade, J. Defay and Bob Pitman, "Small Manufacturing and Repair Enterprises in Haiti: Survey Results," Michigan State University Rural Development Series, Working Paper No. 4, 1979.

6. Enyinna Chuta and Carl Liedholm, "Rural Non-Farm Employment: A Review of the State-of-the-Art," Michigan State University Rural Development Papers, Paper No. 4, 1979.

7. Omar Davies, Yacob Fisseha and Claremont Kirton, "Small-Scale Enterprises in Jamaica: Initial Survey Results," Michigan State University Rural Development Series, Working Paper No. 8, 1979.

8. Enyinna Chuta, "Techniques of Production, Efficiency and Profitability in the Sierra Leone Clothing Industry," African Rural Employment Paper No. 30, 1980.

Copies of these papers as well as additional information on the Off-Farm Employment Project can be obtained by writing:

Carl Liedholm
Off-Farm Employment Project
Department of Agricultural Economics
202 Center for International Programs
Michigan State University
East Lansing, Michigan 48824
U.S.A.

INTRODUCTION

This paper examines the problems of operating a loan program for craft and emerging small-scale (non-farm) enterprises. The classification of small businesses into a category called "craft and emerging small-scale enterprises" was proposed by the World Bank. The Bank will consider funding projects of all sizes in this subsector as long as they meet certain established Bank criteria.

This paper reflects the experience of the author in the craft and emerging small-scale enterprise component operated through the Small Enterprise Development Corporation Limited (SEDCO), a company wholly owned by the Government of Jamaica (GOJ) and established to:

(a) provide management and technical services; and

(b) finance craft and emerging small-scale non-farm enterprises in that country.

We shall look at the criteria set by the World Bank (hereinafter referred to as the Bank) on the projects submitted for funding within this subsector, the effects of those criteria in one specific instance, and the implications of such criteria for other small-scale enterprises.

Jamaica, like other developing countries, has emphasized the small-scale non-farm subsector and particularly the craft and emerging small-scale segment as one of great importance in planning economic policy for the 1980's. This fact is emphasized in the Policy Papers (Government of Jamaica, 1977a) of the Government of Jamaica and the policy statements made by the Prime Minister in his Budget Addresses for the fiscal years 1978-79 and 1979-80 (Government of Jamaica, 1978 and 1979). Even though it is only in the most recent years that the policy of the Government of Jamaica has reflected the importance of the subsector, several government agencies had been created to deal with various ailments of the subsector since 1956. The earliest efforts were initiated to solve problems by developing institutions rather than by emphasizing the role the subsector could play in contributing to the overall economic growth of the country (Government of Jamaica, 1962). An immediate problem that the subsector sought to address was unemployment. Since the end of World War II, Jamaica has had a high level of unemployment -- an estimated 26% of the labor force in late 1979.

During 1976, the Government sought the assistance of the IBRD (World Bank) in devising a program to reduce the high rate of urban unemployment. The Bank responded by supporting the Government's proposals for a Small-Scale Enterprise Program comprised of two components: (a) the Craft and Emerging Small-Scale Enterprises, and (b) the Modern Small-Scale Enterprise Development Project. In the former case, the Bank would provide loans and technical assistance to applicants with net fixed assets of not more than J$25,000 (U.S.$14,045)*; in the latter case, it would underwrite loans from commerical banks for applicants whose net fixed assets did not exceed J$178,000 (U.S.$100,000). SEDCO was created to deal with applications falling under the first component; Premier Investment Corporation (PIC), a subsidiary of the Bank of Jamaica (Central Bank), was to deal with the second.

Prior to the establishment of both SEDCO and PIC, five other institutions were dealing with a variety of needs of the subsector. The request of the GOJ to the Bank indicated that the former was concerned that the needs of the subsector were not being met adequately, economically and positively.

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*Rate of exchange: J$1.78 = U.S.$1.00 (1979).

The Bank had categorized the needs of the subsector into three categories:

(a) raw materials;

(b) working capital financing; and

(c) technical assistance.

Yet the broad needs listed above did not adequately reflect all the needs of the subsector in Jamaica at the time the Bank and GOJ agreed to establish SEDCO. SEDCO's subsequent experience revealed that a majority of the island's small enterprises suffered other disabilities. Whether the latter were of a nature and magnitude sufficient to prevent SEDCO from effectively serving very small enterprises is a question we address later.

In June 1977, SEDCO was legally registered. Its two essential functions in the area of craft and emerging small-scale non-farm enterprise were:

(a) to provide loans not in excess of J$40,000 (U.S.$22,742) to enterprises with fixed capital not exceeding J$25,000 (U.S.$14,045);

(b) to provide management and technical services as required by individuals or firms within the sector.

The World Bank made a loan of J$3.5 million (U.S.$2 million) to the GOJ for lending to SEDCO to lend, in turn, to the subsector (World Bank, 1978). The GOJ was to provide additional loan funds in the amount of J$22 million (U.S.$12.4 million) over five years as follows:

	J$ Millions	U.S.$ Millions
1978	3.0	1.7
1979	3.0	1.7
1980	4.5	2.5
1981	5.5	3.1
1982	6.0	3.4

The GOJ and the Bank agreed that the first ten (Free Limit) projects, which SEDCO would normally approve, should be sent to Washington for approval.

Subsequent approvals would be made by SEDCO but the supporting documents would be vetted by the Bank. SEDCO would make the loan from the funds at its disposal and then apply to the Bank for reimbursement.

At the subcommittee stage of the discussion for establishment of SEDCO, it was proposed that a subsidiary of SEDCO purchase raw materials. This was not encouraged locally as it was felt that this could best be done elsewhere.

Because of its financial input, and as proof of its support of the project, the Bank maintained close supervision by the following processes:

(a) establishing criteria for evaluation;

(b) requiring that the first ten (Free Limit) loans under the program be submitted for the approval of the Bank; and

(c) requesting quarterly reports from SEDCO to demonstrate that criteria were being maintained.

Whether or not a loan was refundable from the Bank's funds did not matter; the criteria of evaluation specified by the Bank still held.

Additionally, the Bank determined that the loans provided by SEDCO could be used for:

(a) the purchase and/or installation of machinery and equipment;

(b) the purchase, construction, reconstruction, addition or expansion of industrial buildings and the installation of services;

(c) the investments needed to maintain or expand production levels through financing of working capital (of the first 50 loans made by SEDCO at least 30% of the total value was for working capital);

(d) the hiring of technical assistance and the preparation of feasibility and market studies, accounting services and training programs for managers and workers.

Three other criteria were established:

(a) SEDCO could not normally finance more than 75% of the project costs of an enterprise <u>except</u> when the credit worthiness (of the enterprises) justified this;

(b) SEDCO could not lend more than 10% of its equity to any one firm or group of firms; and

(c) for both new and existing enterprises, SEDCO would not normally provide financing that would raise the debt/equity ratio of the client above 3 to 1. (This became one of the evaluative criteria and was strictly applied in accordance with the supervision enforced by the Bank.)

The Bank wanted SEDCO to operate as a commercial bank. Since the institution had to operate in a politically sensitive sector, it would initially be caught in a conflict between economic and political realities in considering loans for the small-scale non-farm sector. While the political directorate was aware of the criteria laid down by the Bank and the purposes for which such criteria were established, the directorate was, nevertheless, extremely sensitive to the demands of the electorate, of which the small-scale subsector was a very vocal segment. SEDCO had a need to deliver "good loans" and to develop a system of acceptable criteria so that both local and foreign funds would be attracted to finance the subsector, given that the political directorate had sought to use this institution as a method of tackling urban unemployment. On the other hand, many of the applicants were of the view that SEDCO should operate less like a commercial bank and should assume more risks and be more sensitive to the needs of the clientele for whom it was designed. The argument for this view was that the Jamaica Development Bank (JDB) had financed loan projects that more appropriately should have been funded by a commercial bank, while projects which SEDCO would fund were often less bankable yet would be subjected to commercial banking criteria. The problem here was that the staff of the Bank, having no supervisory responsibility for SEDCO, saw it as simply another commercial bank which provided certain advantages to the small-scale subsector that could not be obtained from a commerical bank. Needless to say, this philosophical dichotomy plagued SEDCO's operations and performance.

The establishment of SEDCO was enthusiastically received by the subsector, especially as many of those whom it would serve believed that it would provide an easier and quicker source of loan funds. Many mistakenly thought that SEDCO would supplement the lending functions of the Small Business Loan Board (SBLB), its predecessor. Those who had such expectations were not aware that the institution had been designed to operate on lines much more stringent than those on which SBLB had operated. Also, the entire slant of SEDCO was different in the sense that, for the first time, an institution in the subsector was designed to be financially self-supporting -- a goal to be achieved in its third year of operations.

Because of the time taken to prepare the institution for operations, and the rigor which went into establishing the criteria and standards, loans were not made until eight months after SEDCO was established. The delay, added to the uncertain future which SBLB faced at that time, made loan applicants somewhat anxious.

In spite of these difficulties, however, SEDCO received a certain amount of understanding and goodwill from such organizations as the Small Business Association (SBA), and the Small Business Development Centre (SBDC), an organization devoted to training small business personnel. But when the foreign exchange shortage began to plaque the economy, followed by a scarcity of raw materials, the small business community began to complain. Complaints related to the delays, the inability of SEDCO to "deliver" loans and even the possibility that SEDCO would not be making loans for which it was designed. In the interval SEDCO tried to carry out some of its other functions, such as training and seeking wider exposure and markets for the clientele it served. It is possible that the criticisms of SEDCO, while sometimes justified, were part of the general criticisms leveled at the Government for the deterioration in the economy which occurred from 1976 - 1979.

The stringency of the controls imposed by the Bank must be seen not only as the usual Bank safeguards, but must also be seen against the background of the operations of the SBLB.

The SBLB was established in 1956, under the Loans to Small Business Act, for the purposes of:

(a) granting loans not exceeding a prescribed amount for any one business . . . as the Board may see fit (this amount changed on two occasions and was eventually less than the loan limit of J$40,000 [U.S.$22,471] set for SEDCO);

(b) guaranteeing loans not exceeding the prescribed amount where the purpose of the loan is one for which the Board may make a loan;

(c) purchasing . . . equipment, plant, tools and other articles necessary for establishing or carrying on such businesses; and

(d) giving financial assistance to Co-operative Societies (Government of Jamaica, 1956).

Source: Government of Jamaica, 1956

Because only a small number of officers were assigned duties such as taking applications, interviewing clients, visiting projects, assessing projects, defending projects at Board meetings, collecting the repayments, and initiating legal actions when and where this had to be done, other aspects of the operations, usually the collection of repayments or the overseeing of projects, were neglected. It is understandable in these circumstances that the Bank would require a different type of institution to carry out all those functions if Bank funds were to be involved. The SBLB had been operational for 22 years; in 1978 borrowers owed J$9,000,000 (U.S.$5,056,000), of which approximately 40% was deemed uncollectable by the Auditors.*

*Capleton Jones and Company

Under the Loan Agreement between the Government of Jamaica and the World Bank, SEDCO would take over the good loans from that portfolio and would undertake the collection of others on a collection fee basis. Up to the end of 1979, efforts were being made to collect as much as possible of the outstanding balances. The experience of the Small Business Loan Board was there as a model against which to judge SEDCO but not to be copied by it.

CRITERIA FOR GRANTING LOANS

Through Steering Committee Meetings held prior to May 1977, the World Bank and the Government of Jamaica agreed upon the criteria for defining those firms or persons who could be granted loans or provided with management and technical services. (The Steering Committee which set the definitional criteria was established after the Government of Jamaica requested help from the Bank in developing a small enterprise corporation.) We shall refer to such criteria as definitional criteria, because it is on the basis of such criteria that a project proposal from a person, firm, or organization would be considered as viable and could then be submitted to the project group for evaluation. The proposal would then be assessed by means of evaluative criteria. We make this observation because we need to distinguish between administrative criteria and technical criteria; the Definitional Criteria were of the former type while the Evaluative Criteria were of the latter type.

Definitional Criteria

The first definitional criterion specified that an application could be considered by SEDCO if it fell into one of the following categories:

(a) building materials and construction equipment for small contractors;

(b) crafts;

(c) food processing;

(d) footwear manufacturing;

(e) garments;

(f) light metals fabrication;

(g) small contractors -- financing of construction;

(h) toy manufacturing;

(i) woodworking -- furniture and woodwork other than furniture.

Small garages manufacturing automobile parts form fiberglass were subsequently added to the list.

The definitional criteria related only to manufacturing because the assumption was made that manufacturing would provide an increase in employment -- the primary concern of the Government of Jamaica. Manufacturing is defined here as the conversion of any type of raw material into a viable finished product, and this definition may vary from that used by the Department of Statistics for the Census of Manufacturing. As it turned out, the number of new jobs to be created, frequently one or two, was quite marginal (see Tables 1 and 2).

The definitional criteria excluded services related to the repair and maintenance of equipment and machinery. It would seem logical, in an economy as highly inflationary as Jamaica (inflation increased 64% between 1977 and 1978 and 40% between 1978 and 1979), that the Steering Committee would have recognized the existing need for good repair facilities for a miscellany of equipment and machinery. Indeed, the problem worsened with the continuing foreign exchange crisis which had plagued the economy for the last 7 years. In such circumstances, financing of repair and maintenance activities could have been considered by SEDCO.

Table 1

PROJECT PROPOSALS BEFORE APPLICATION OF CRITERIA

Date	Number of Projects	Values (J$)	Total Employment	Average Job Per Project	Average Cost Per Job (approx.) (J$)
May 1978	737	5,260,781	3700	5	1400
August 1978	105	934,000	409	4	2300
December 1978*	242	2,547,536	726	3	3500
January 1979*	173	2,153,868	580	3.5	3700
		10,896,185			

Source: Sub-Sector Analyses, Working Papers - SEDCO

*Includes new applications

Table 2

SECTORAL ANALYSIS AFTER APPLICATION OF CRITERIA

Sectors	Aggregate of Loan Applications (J$)		Average Employment Per Project		Costs Per Job	
	August 1978	January 1979	August 1978	January 1979	August 1978	January 1979
Garment	266,350	592,925	3	2.5	2,300	3,000
Footwear	70,500	236,245	3.3	2.75	2,500	4,000
Furniture	310,168	701,908	4	3.5	3,000	4,000
Metal Fabrication	20,000	89,000	4	4	2,500	2,700
Crafts	33,000	58,430	6	4	1,000	1,900
Food Processing	14,000	125,000	4	3.5	800	3,400
Garages	45,360	101,360	4	3	3,750	8,000
Construction Materials	38,000	179,000	9.8	10.4	700	25,000
Subtotal	797,370	2,083,668				
Total	J$2,881,038					

Source: Subsector Analyses -- Working Papers, SEDCO

The second definitional criterion specified that SEDCO should promote only "small productive enterprises," which meant only those activities classified as manufacturing. According to the definitional criterion stated above a householder who made preserves or did canning for retail purposes could be included but a restauranteur could not. We have used the example of a restaurant because both the restaurant and the domestic cannery:

(a) converted raw materials into finished products;

(b) worked with the same raw materials (e.g., ackees);

(c) catered to various markets -- the restaurant to markets such as airlines and business houses, the domestic cannery to a more limited retail market.

The Bank advanced the argument that restaurants were only providing a service, yet the restaurants were providing a high level of employment in a society with a high and increasing level of unemployment (26% in December 1979). Few, if any, well-run and properly managed restaurants closed down during the period of grave economic crisis from 1976 to 1979, while large manufacturing plants and some service-oriented businesses closed for a variety of reasons. The lack of financing was not among the most important reasons for these closures. Besides, from the applications submitted to SEDCO, 43 requested funding for restaurants at a total cost of J$409,800 (U.S.$230,225). It was estimated that the job creation potential was 6 per application at a cost of J$1,500 (U.S.$843) per job. A comparison of the average number of jobs created per application and the costs per job created are shown in Table 2.

The Board of Directors was very concerned that no arrangements were made to finance the catering trade, as was done by SBLB. Since SEDCO was to take over the funds of SBLB, the Board felt that it was necessary that SEDCO also lend to the same clients to whom SBLB had been lending.

We recognize the fact that some viewed manufacturing as the area in which the greatest potential existed for increasing the number of jobs in the economy. However, other areas existed in which the potential increase may have been less expensive per job created. While the institution was established to deal with manufacturing only, we should nevertheless be aware of such areas.

The third definitional criterion was that equity investments not be permitted -- the rationale being that an investor ought to have a financial stake in whatever project he was undertaking. This restriction originally posed a hardship for the Community Enterprise Organization, which became a significant feature of the Government's program to assist communities.

The Community Enterprise Organization is an example of an economic organization, community-based and often community-organized, that has begun to emerge in some developing countries following a socialist philosophy (e.g., Tanzania and Jamaica). In this type of organization citizens of a village or district or members of a group get together and, very often possessing nothing more than their skills, design an industrial or agricultural project for financing. (The U.S. version of this activity is a community project funded partly by the state and partly through loans from the SBA.) This type of activity was new not only to the Jamaican government, but also to the commercial banks operating there. In many instances CEO's lack a clearly identifiable agent or core which could support an application for credit to a commercial bank. Because of the equity criteria established by the Bank, the CEO project, without equity, had to apply to the Jamaica National Investment Company Ltd. -- another government owned company, and only when the equity funding had been made available to the project could it then apply to SEDCO for loan financing. This elaborate process of literally taking money from the same pocket -- the taxpayer's -- meant that many such projects never did reach SEDCO. In fact, only one CEO project was submitted to SEDCO by the end of 1979.

We have dealt at length with the matter of the CEO only because, at the community level, the GOJ saw the CEO as a useful organization for implementing government promises to community groups to speed up economic development. The government, therefore, needed a vehicle to finance the CEO. But SEDCO was designed to operate along strictly commercial lines and could not consider such proposals unless they met the criteria in the first place.

The fourth definitional criterion was that loans should not exceed J$40,000 (U.S.$22,471). While the ceiling seemed adequate for the many loans which ranged from J$5,000 - $10,000, some projects, which in combination could provide a larger number of jobs than those in Tables 1 and 2, had to be excluded because of the criteria.

Evaluative Criteria

Before considering this type of criterion, let us look at the information that was required from each applicant. As stated in the Loan Agreement between the Government of Jamaica and the Bank, loan applications submitted to SEDCO had to provide the following information:

(a) a general description of the project;

(b) a description of the market for the borrower's products, competition to be encountered, and distribution strategies;

(c) a list of the major capital items to be acquired, their cost, and a report as to their suitability for the project.

(d) a detailed estimate of development expenses;

(e) an estimate of total capital requirements, including a realistic margin for contingencies and cost overruns;

(f) an estimate of working capital requirements;

(g) the proposed financial structure of the borrower and related financial arrangements;

(h) an estimated drawdown of funds;

(i) the projected financial statements, including balance sheets, profit and loss accounts, cash flows for the period of the loan and details of the assumptions used in their preparation;

(j) a list of the key personnel and their experience in the line of business; and

(k) the collateral being offered.

The stages to be followed in the processing of an application are shown below:

Steps in Processing Applications

(Required primarily because of implementation criteria.)

Stages

1 Discussing application with applicant (usually requiring more than one visit to office by applicant) -- Evaluation Officer;

2 Placing application on worksheet and ascertaining what else is required from applicant -- Evaluation Officer;

3 Checking information supplied by applicant -- Registry Clerk and Evaluation Officer;

4 Visiting project -- Evaluation Officer;

5 Submitting application to Head, Management and Technical Services Department for distribution;

6 Discussing application with Technical Officer, Extension Officer, Management Accountant, Marketing Officer;

7 Reevaluating application -- Head, Management and Technical Services Department;

8 Checking computations, preparing financial and economic analysis -- Evaluation Officer (possible return to Marketing Department if Marketing report needs further work);

9 Discussing results of computation and marketing analysis with Head, Evaluation Department -- Evaluation Officer;

10 Recalculating computations -- Evaluation Officer;

11 Discussing state of application and any changes with applicant -- Evaluation Officer;

12 Correlating marketing and technical reports;

13 Checking credit and other references;

14 Submitting final draft to Head -- Evaluation Department;

15 Typing (and correcting where necessary);

16 Submitting to Managing Director for approval and for presentation to Loans Committee or Evaluation Committee or Board of Directors;

17 Submitting to approvals authority for approval or refusal;

18 Notifying of Secretary/Legal Officer.

Explanation of Significant Blocks of Time in Processing

Max. Time

3 hours — 1. Discussion of application with applicant -- Evaluation Officer (this includes total time spent with applicant on more than one visit to office);

1 hour — 2. Preparation of application in form and then ascertaining additional information -- Evaluation Officer;

4 hours — 3. Visit to Project by Evaluation Officer, including travel time (average of travel time to rural as well as urban area clients);

4 hours — 4. Development of project profile by Evaluation Officer for Management and Technical Services;

1 hour — 5. Submission of application to Head, Management and Technical Services Department; discussion with Extension Officer, Management Accountant, Marketing Services, Engineering Division;

80 hours — 6. Action by Marketing and Technical Officers, including:

- 4 hours - visit to project
- 66 hours - price checking, market surveying or sampling, customer contacts
- 6 hours - draft report including typing
- 4 hours - discussion with Head, Management and Technical Services - draft report and findings;

Max. Time

Max. Time		
8 hours	7.	Computing financial and economic analyses after report from Marketing -- Evaluation Officer;
4 hours	8.	Discussion of results of computations and Marketing reports with Head, Evaluation Division;
3 hours	9.	Discussion of state of application and any changes necessary (usually some changes had to be made in the project) with applicant;
4 hours	10.	Preparation of final application based on findings, corrections, amendments, additions or changes, further discussions with Marketing, or Extension Services, or Head of the Evaluation Department -- Evaluation Officer;
16 hours	11.	Preparation of appropriate documentation for signature of applicant, inspection of collateral where provided, searching of public records for liens, etc. (most of time spent searching at Public Records office) -- Legal Officer.

The criteria as given by the Bank and the Points System as developed by SEDCO and amended by the Bank are listed below. We also show proposed marginal changes which, while facilitating some of the applications, did not substantially alter the fact that the criteria became an obstacle to a number of applications being processed. The criteria also became the basis for an attack on SEDCO by both politicians and a number of businessmen from the sub-sector who felt that the organization had not helped the craft and emerging small-scale non-farm subsector.

Three elements in the loan process are of particular interest: collateral, the interest rate charged and the information requirements that the borrower must meet.

Collateral

The evaluative criteria specified that an applicant should provide 100% collateral for any loan granted to him. Furthermore, in the points system developed for the evaluation process, the Bank made it explicit that an application had to earn the full 7 points for collateral; no

Criteria and Project Evaluation Points System

Old Criteria (Bank's)

I.	Management	points (20)
	Technical ability	5
	Past performance	5
	Knowledge of marketing	10
II.	Finance	points (40)
	Internal Rate of Return (if over J$20,000)	12
	or	or
	Payback period/break even (if under J$20,000)	12
	Collateral	7
	Debt Service Ratio (2:1)	7
	Debt Equity	7
	Interest Cover Ratio (3:1)	7
III.	Economic	points (30)
	Foreign Exchange Earned/ Saved	10
	Employment generated or closure prevented which would have resulted in lay-offs	5
	Local raw materials used	10
	Underutilized capacity	5
IV.	Others	points (10)
	Impact on community/training	10

Criteria as Modified by SEDCO in Accord with the Bank

I.	Management	points (20)
	Technical competence	0 - 10
	Management - competence (past performance or knowledge of business)	0 - 10
	(Minimum points required - 15)	
II.	Finance	points (20)
	*Internal Rate of Return or payback period	0 - 10
	Break even Analysis	0 - 10
	**Debt Service Ratio (not lower than 2:1)	0 - 10
	*The internal rate of return should not be lower than a rate equal to the interest rate plus 3.	
	**Minimum debt service ratio should be 2:1.	
	(Mimimum points required - 20)	
III.	Economic	points (15)
	Foreign Exchange Earned/ Saved	0 - 10
	Employment generated or closure prevented which would have resulted in lay-offs	0 - 5
IV.	Market	points (15)
	Demand for end product acceptability	0 - 10
	Pricing considerations	0 - 5
	(Minimum points required - 10)	
V.	Technical	points (15)
	Introduction of new process or technology	0 - 10
	Underutilized capacity	0 - 5
	(Minimum points required - 5)	
VI.	Others	points (0 - 5)
	Impact on community	---

situation existed in which there could be less than 7 points; either there was or there was not full coverage by collateral. Collateral included all machinery and equipment to be purchased, as well as any held by the applicant which did not carry a mortgage.

Collateral became a contentious issue within and outside of SEDCO. While the arguments against the provision of collateral by a borrower were either political or emotional in nature, they nevertheless recognized:

(a) the deteriorating economic position of the country and its impact on the small business sector;

(b) the lack of satisfactory collateral of many small businesses;

(c) the fact that in many instances much of the collateral would have been pledged previously.

Furthermore, the issue of collateral had been a sore problem between the small business sector and the commercial banks. This problem was recognized as one of the reasons why an organization such as SEDCO had been established. Many persons were of the view than in order to circumvent the lack of collateral by an applicant, the Government had to provide an organization that would make loans with minimal emphasis on collateral.

Within SEDCO, efforts were subsequently made to effect a compromise in the interest of the borrowers by allocating proportions of the 7 points. These proportions were based on the type and value of the collateral offered. SEDCO's efforts did not lead to a worsening of the loan portfolio or a deterioration in the evaluation process. Despite the fact that efforts were made within SEDCO to adjust the 7 points within the overall constraints imposed by the Bank in order to facilitate borrowing, opposition remained both within and outside SEDCO. The opposition was more political than economic and was concerned not only with the fact that small-scale businesses were being asked to provide collateral but also with the fact that collateral played such a prominent part in the evaluation process.

In order to understand the background of this matter and the attitude adopted, we refer in particular to the Small Business Loan Board (SBLB), a government-owned organization established in 1956 for the purpose of providing loans to small-scale enterprises. The SBLB loans were not as restricted as SEDCO laons; the SBLB had lent for such diverse purposes as purchasing fishing boats and taxi meters. While SEDCO incensed applicants by emphasizing the need for collateral, such collateral as required by SBLB could vary in size or was not required, and it played a less important role in the decision of whether or not to grant a loan. The emphasis on collateral was seen as a feature of commercial banking, used especially where and when the Bank did not want to grant a loan. Against the above background, the problem of collateral assumed more serious proportions than necessary; it was seen as more than simply a precaution taken by a lender against the risk of loss stemming from a failure of the borrower.

SEDCO continued to seek ways to lessen the severity of the collateral requirement without endangering the loan portfolio. Eventually it operated on the principle that collateral would be crucial only in borderline cases and more so where the entire loan was to be made for working capital purposes. This did not, up to the time of writing, affect the repayment schedules.

At the heart of the collateral issue was the proposition that SEDCO should have been more like a development bank than a commercial bank. In our view, a development bank is more concerned with the earning capacity of a project and less with the security of the funds advanced. The view that SEDCO should have operated more like a development bank rather than a commercial bank confused many of the discussions about SEDCO in forums outside of the institution and partly made the difference between what type of institution was needed and what was supplied. Commercial banks are primarily lenders of short-term funds. They have no special interest in a project other than the repayment and the rate of interest that the project can pay on its borrowings. A development bank -- such as SEDCO should have been -- is interested in the project as a means of economic development, particularly in areas in which there is little or no economic growth.

Had SEDCO been established less like a commercial bank, then the terms and conditions on which financial assistance could be offered would have been different and accommodation could have been offered to some of the "politically" espoused projects that were viable but lacked sufficient requirements to meet the criteria laid down by the Bank.

It would be true to say that there was no dearth of commercial banks in Jamaica from which financing could be obtained for any business venture able to meet the criteria stipulated by the commercial banking sector. Unfortunately, the craft and emerging small-scale sector could not meet all the criteria and had, from time to time, experienced serious problems in obtaining funds from commercial banks. This did not mean, however, that the craft and emerging small-scale subsector should be ignored. A proper analysis of the subsector was necessary in order to assess:

(a) the extent to which obtaining financial assistance was a problem;

(b) the real requirements and needs of the subsector;

(c) the type of funding institution that could best serve the subsector.

Interest Rate

While the question of collateral remained primary and created much controversy, the question of the rate of interest passed almost unnoticed. Since its inception in 1956, the SBLB had made loans to the subsector at 7½%. Because of continued inflation in Jamaica for over 22 years, inflation which had accelerated even more rapidly since 1973, the Government was in reality subsidizing many of the small-scale enterprises that had obtained loans from the SBLB. When SEDCO and the Bank signed the Loan Agreement, SEDCO was charged (through GOJ) a rate of 7½% and was instructed to lend at 11% per annum. Before the matter was approved by the Cabinet, it was feared that it would create a controversy when the borrowing public was made aware of the rate, but this did not occur. Bank employees argued that the rate of interest had to be measured against the 14% charged by the commercial banks and 13½% to be charged by the Premier Investment Corporation, the other component of the Loan Agreement. Those who had borrowed from SBLB previously and had applied to SEDCO did not seem concerned with the change in the rate. For a very short while, persons who applied to SBLB while SEDCO was operational continued to be charged the 7½% rate of interest.

The Bank staff, believing the 11% rate of interest was justifiable, was also of the opinion that political reasons kept the prevailing interest rate for very small-scale enterprises at the excessively low level of 7½% per annum. SEDCO's original policy statement had not specified the rate to be charged, but the Bank saw to it that the Government of Jamaica accepted the 11%. In support of its stand on the matter of interest rate, the Bank staff decided that while the GOJ would resist SEDCO's charging the weighted commercial rate (13½%) to very small-scale enterprises, government officials would accept 11% per annum as an interest rate adequate to cover

SEDCO's cost of lending operations (including provisions against losses) after the first two years. The minimum rate was considered acceptable because:

(a) it was a substantial increase over SBLB's 7½% rate; and

(b) it exceeded substantially the maximum bank deposit rate of 7% and Government Bond yield of 8%.

Questions asked by borrowers about the 11% rate of interest focused primarily on the reason for the increase above that usually charged by SBLB. No one refused to pay the rate charged; no one questioned how the rate was calculated. It is doubtful, in fact, that many borrowers were fully aware that SEDCO was charging interest on the amount borrowed and not the reducing balance. Even if someone did raise the question, the fact that he could obtain a loan at a rate lower than that charged by the commercial banks was a factor in SEDCO's favor.

At the time this paper is being written, insufficient information on repayment schedules prevents us from saying categorically that the rate of interest did or did not constitute a burden on borrowers. We believe that the state of the economy was more of a factor to be reckoned with in this regard. Some may think that a rate of interest of 11% could be punitive in the situation, but, again, we have no record of this being so because the matter was explained at length to the borrower when his repayment schedule was presented to him. There had been no open demurral on the subject. Probably the collection system which SEDCO had instituted took care of any potential default caused by the burden of the high interest rate. We should also refer to the preliminary results of the Small-Scale Enterprise Survey which sought to ascertain, among other things, the problems which confronted the small businessman. While interviewees mentioned working capital as one important problem, no one indicated that the rate of interest was creating a burden. Given the rate of interest which SEDCO was required to charge, and the way the interest rate was computed, SEDCO could have been self-sufficient after three years of operations.

Information Requirements

The effective market demand, as given by the applicant, was often difficult to assess with little supporting information; verifying information concerning the applicant's past market performance was also difficult. Both required the scrutiny of financial records where they existed, and in many instances there were none at all or those that existed were very sketchy. This meant interviewing, where possible, customers who had conducted large volumes of business with the applicant. In addition to the lack of basic information, there was often a lack of cooperation from sources able to validate the information, or frequently the applicant relied upon a mixture of conjecture and memory in giving information. Valid and acceptable records were available in many instances, however, as evidenced in the comparison of application processing costs. The applications for which little information existed or could be verified required a great deal of data reconstruction -- a time consuming and, therefore, expensive process.

One other feature of the market analysis or the effective demand for the product must be mentioned. In many instances applicants were involved in several business activities difficult to separate into distinct categories on the application form. It was not easy to separate out the financial data in which one was interested. In many cases, when a loan was granted, the applicant was required to keep an order book which would be available to SEDCO's staff when required.

The difficulty in the development of marketing information was most apparent in the case of craft manufacturers on the North Coast and western part of the island who sold as itinerants in the tourist areas. We can readily appreciate the difficulty by first looking at how the tourist industry in Jamaica has changed over the years. Currently more tourists are coming to Jamaica as packaged tour visitors and this means that all the basic expenses -- hotel, local tour fees, airfares, etc. -- have been included in the packaged cost. Experience has demonstrated that these visitors do not arrive with much discretionary income to spend on non-packaged items. Bank of Jamaica statistics have shown that between 1975 and 1977 the number of tourists declined and then rose again between 1978 and 1979 (Bank of Jamaica, 1975-78a, b). Parallel to this change was a similar fluctuation in the receipt of foreign exchange from tourists, expecially in the area of expenditure on local items and activities not included in the pre-packaged expenses. The manufacturers and vendors of craft products in the tourist areas have faced more extensive competition from tour operators, restaurants, operators of entertainment ventures, etc. for the reduced level of tourist expenditure.

As Jamaica has experienced grave foreign exchange difficulties since 1973, the criteria concerning foreign exchange earned/saved assumed major importance in the valuation procedure. It posed certain practical difficulties for evaluation. Jamaica's known natural resources -- bauxite, cane sugar, beaches and clear water for tourism -- are few in number and where they enter into the economic system they are exploited on a much larger scale than that operable by units in the subsector under consideration. Most of the raw materials used in the non-farm small-scale subsector are imported, e.g., cloth, leather, aluminium sheeting, plyboard, plastic, etc. It becomes difficult, therefore, to ascribe a positive contribution made by a unit in the subsector to the overall economy when it is recognized that:

(a) raw materials have to be imported;

(b) most sales are domestic and thus generate little non-foreign exchange earnings;

(c) small-scale non-farm subsector enterprises usually must purchase their raw materials through a distribution system which has a built-in mark-up of 20 to 50 percent.

An analysis of the foreign exchange component of unit production costs showed the extent to which imported raw materials are used in the production process:

Item	Import Component
Clothing	33 1/3%
Food	33 1/3%, based on packaging costs
Woodwork	60% (lumber)
Metalwork	100%
Garages	100%
Footwear	66 2/3%
Toys	100%

Source: Government of Jamaica, 1977b

On the whole, the subsector was a net consumer of foreign exchange and showed less potential for earning foreign exchange because of the cost structure than did larger firms which might also have been net consumers. This imbalance would continue either until substitution could be found for the imported raw materials, and this would be externally decided (by purchasers in foreign markets), or until production costs could be made competitive in overseas markets.

The above criteria created controversy among the applicants; they believed that information was required which, in most instances, they did not possess and which they regarded as irrelevant in their circumstances. It should be remembered that SEDCO was also attempting to improve the record keeping skills of these businessmen, a skill which was absent in many cases. Employees of SEDCO, many of whom were required to evaluate projects, believed they should have been given some discretionary authority to determine the number and types of documents required from an applicant. The view was also expressed that for a loan of $500 or less the loan evaluation was not worthwhile, as time spent to process the loan, and often to acquire information from the applicant, was a cost to him (he often had to employ accountants, etc. to provide the information in the form in which it was required). The cost of processing a loan is revealed in the steps required to process a loan. Many of these steps had to be repeated while processing each application.

Even where a check list was provided that clearly pointed out the information required, the information supplied was often either incomplete, offered in a piece-meal fashion, or it took a long time to produce; the need for what seemed a long list of things induced frustration and irritation among many of the applicants. In a commercial bank, on the other hand, applications for personal loans, which is what many of these were, usually required less information than that requested from a large business. In SEDCO's case there was no distinction between a loan to an individual and one to an unincorporated business. The need for such a large amount of information, which is normal in commercial banking transactions involving large but <u>not</u> necessarily small businesses, was seen as creating difficulties for the small businessman. This must be seen in light of the expectation by the Government that SEDCO would:

(a) speed up the processing of applications;

(b) operate less like a commercial bank in its relationship with borrowers; and

(c) provide less bureaucracy in the processing of loans.

The criteria described above were those used to assess the applications which had survived the definitional criteria. Even among these, serious deficiencies were noted in record keeping, demonstrated technical knowledge and modern (formal) management practices. It was obvious, however, that in many instances loan applicants were willing and able to invest personal or borrowed funds in a venture.

Two points should be emphasized here. The first, as learned through experiences of SBLB and SEDCO, is that two types of loan applicants existed in the subsector:

(a) the small businessman who needed modest financing "to bootstrap" himself; and

(b) the political "hanger-on" who wanted a loan because he was a supporter of the Government and felt that the Government was obligated to him.

Both types had applied to SEDCO, and in many instances, after judging the proposals only on the basis of "papers" submitted, SEDCO would have granted loans to both. However, SEDCO had a system whereby its field officers not only visited with the applicants but also made the usual discreet inquiries and did other cross-checking to ensure that a genuine project existed for which an application had been submitted. From the list and quality of loans approved, SEDCO can claim some success here.

The second point involves the classification of ownership or types of investors. At least 75% of the applications which reached the evaluative criteria stage were from persons who had an identifiable legal, physical and on-going structure; the other 25% were from backyard operators and single operators involved in essentially one-man operations.* In many

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*SEDCO would eventually cater to anything from a one-man backyard (primitive) non-traditional activity to the well organized and properly managed enterprise with an unlimited number of employees. At first, it was proposed to define a small enterprise activity as one which offered employment to a maximum of one hundred persons per enterprise, but this was dropped.

instances they were unemployed persons, according to the classification of the unemployed as laid down by the Department of Statistics, or they were craft manufacturers and vendors primarily dependent on itinerancy or tourism for distribution of their wares. Many of them followed no disciplined in-shop production practices; they often produced when and where feasible, as well as if and when raw materials were available.

SEDCO found other deficiencies that were most persistent, even intractable in some cases, and which pointed to the type of institution that should have been established. These deficiencies were:

(a) illiteracy and lack of numeracy skills among applicants;

(b) lack of knowledge about the bureaucratic procedure in establishing a business;

(c) lack of basic training in any definable skill;

(d) unfamiliarity with requirements of the government departments which regulated, supported and controlled businesses;

(e) lack of basic money management skills and ability to deal separately with personal and business funds;

(f) difficulty in purchasing small and even insignificant quantities, especially in overseas markets;

(g) lack of clear marketing strategies, especially to sell in the protected CARICOM (Caribbean Common Market);

(h) inability in most cases to assess specific markets, although the Jamaican market for most of the products of small businesses was protected in their favor;

(i) inability to deal with competition from CARICOM and even larger producers;

(j) insufficient information given by loan applicants in response to inappropriate criteria established by financial institutions (although there were several institutions offering adequate financial aid to the subsector).

In the light of the deficiencies listed above, and given the expectations of the small business subsector, it becomes apparent that the Government could have developed a more appropriate institution. Such an institution could be (a) subsidized by the Government if some of the segments of the criteria were to become less stringent or (b) operated as a development bank with possible 'hard' and 'soft' windows. One could not reasonably expect a commercial bank-type institution to provide help in addressing the problems listed above without compensation.

In many instances production ventures, even well-established ones, revealed certain management deficiencies, which ranged from illiteracy of the proprietor to absence of financial records. Many loan applicants were unable to understand and apply meaningful bookkeeping methods; sometimes they relied on memory, often defective, to store financial information. In some cases there may have been a greater need for management assistance than financing. Where financial assistance was a clearly established need, the project then had to demonstrate that an effective demand for the product existed, either on the basis of data from past production and sales or from market research done by SEDCO. Frequently the records of past performance were either non-existent or insufficient to support the projected demand and production. Occasionally, the in-house knowledge of operations by SEDCO employees yielded a more realistic forecast which was often non-supportive of the application. While the in-house forecaster was always willing to facilitate the application, even to the extent of proposing changes in the amount of loan or managerial assistance required, the applicant remained disappointed at not being able to obtain any amount or the specific amount requested. Often he had to recast the application to reflect real facts as distinct from presumptions. This disappointment was voiced to others and was reflected in questions which politicians asked about the applications.

Given the complicated nature of the evaluative criteria, the organization had to do more than simply grant loans. SEDCO had to reconstruct many applications into a form acceptable for evaluation anywhere. This was done by introducing a system for extracting both formal and informal information which was then translated into an acceptable format. From this format examination of the applicant's proposal could be considered.

COST OF LOAN EVALUATION

Before evaluation operations began in June 1978, SEDCO decided to establish a roster of projects from which loan applications could be selected. In the first three months of evaluations 737 applications were submitted covering a wide range of activities both within and outside of the categories specified under the definitional criteria. The 737 loan requests totaled J$5,260,781 (U.S.$3,480,791); of this, the amount considered acceptable totaled J$797,390 (U.S.$447,972); the loan requests submitted between December 1978 and June 1979 totaled J$4,701,404 (U.S.$2,641,262); the amount approved was J$2,083,668 (U.S.$1,173,676).* One-third of these loan applications had been submitted to commercial banks previous to June 1978 and had either been refused or withdrawn.

Readers should be reminded that commercial banks have not been eager to finance projects with guaranteed government loans to small business ventures because of the high real cost -- often unrecoverable -- of making such loans. Such was the experience in Jamaica. The crux of the matter in granting loans to the subsector with which we are dealing is that the Benefit/Cost is less than one when all the hidden costs are summed. As shown in Table 3, it costs more to make a loan of J$500 (U.S.$280) than to make one of J$10,000 (U.S.$5,617) or J$40,000 (U.S.$22,471).

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*See Tables 1 and 2.

Table 3

SEDCO: LOAN EVALUATION COSTS (LABOR ONLY) BY SIZE OF LOAN APPLICATION

Officers Involved	Loans Up To $500	Loans $500 - 15,000	Loans $15,000 - 40,000
Evaluation Officer (1 week of actual time)	$200	$200	$200
Marketing Officer (2 weeks of actual time)	466	466	466
Legal Officer, Head - Loan Department, Accounting Clerk (2 days)*	124	124	124
Traveling ($50 - $75)	50	30	30
Extension Officer, Management Accountant, Head - Management and Technical Services	180	90	90
Search and credit check, etc.	25	25	25
Typist (1 day)	24	24	24
Accounts Clerk*	12	12	12
Technical Officer (1 day)	40	40	40
Registry Clerk (2 half days each-1 day total)	12	12	12
Head - Evaluation Department	63	32	**
Evaluation Committee (three members)	180	180	**
TOTAL	$1,376	$1,235	$963

NOTE: Additional costs included machine time, machine operator, stationery, cards, receipt books, payment books, stamping documents, evaluation of equipment by independent valuator, miscellaneous, telephone calls, unscheduled visits, immediate payment of insurance on equipment defrayed on annual basis, and assessment by Managing Director.

*Clerks usually help applicants for smaller loan to sort out and obtain information.

**Sent to Board of Directors directly. Members of the Board were not remunerated.

Loans at the lower end of the scale J$1 - $1,000 (U.S.$0.56 - $561) cost more to process (because of the criteria) than loans at the top end of the scale J$20 - $40,000 (U.S.$11 - $22,471). By virtue of the time required to obtain all the information, to pay the required visits to the production area, to inquire about the market and to receive approval by all appropriate authorities,a loan of J$500 (U.S.$280) could cost as much as J$1,500 (U.S.$843). From SEDCO's point of view, it was better financially -- although not politically acceptable -- to make only loans which ranged from J$10 - $40,000 (U.S.$6 - $22,471). Yet the majority of applications were in the range of J$1 - $5,000 (U.S.$0.56 - $2,808), and fewer were in the J$10 - $40,000 (U.S.$6 - $22,471) range.

The larger loans invariably took less time in preparation; the smaller loans usually began with insufficient and even inappropriate information and hence required a great deal of processing time. In some instances, the application remained in SEDCO for a longer period of time because the applicant never returned to complete it. We have not calculated in monetary terms the costs of processing such applications. The Evaluation Officer had to reprocess an application more often for a small loan that a large one. Usually the applicant for the larger amount brought with him the required documents, and often was a person who had "been through the ropes" of applying for loans. From the time the application was submitted until the check or checks were drawn, a period as long as three months could have elapsed if vital information was missing from the initial application. To illustrate this matter of the deficiency of information and its impact on the waiting time of the applicant, we refer to a case with which we are familiar and which befittingly describes the commonplace.

Satisfactory footwear in Jamaica, especially women's footwear, was a scarce commodity. While local producers of good footwear did exist, and they partially met the demand and received a reasonable rate of return, their volumes of production were not large. Good shoes were usually imported and those which came in through devious means were especially expensive. Thus, there seemed to be an obvious market for locally made footwear. Yet it was an agonizing effort to get applications from footwear producers into an acceptable form, for most of them did not exceed $500. In many instances, a professional auditor would find an examination of their books fascinating, perhaps, but unrewarding. In some cases there was a minimum of record-keeping, in others none at all. Such reconstruction as was required to support the claim of successful past operations or to chart the path for future operations was left entirely to the staff of the loan granting organization.

Two separate assessments were made of the costs involved in making loans. In the first instance, an Evaluation Officer was especially commissioned to assess the time and costs involved. The officer was to look at the loans already made, reconstructing where necessary the steps taken and the time spent on each step by the officer involved. Next he was to follow up the loans currently being processed. All the divisions involved provided him with their financial costs of each application. The officer assessed three sizes of loans, (a) $500 and below, (b) $10,000 - $20,000, (c) $40,000, as these were the most frequently requested amounts. He then followed each loan through the processing procedure set out by the Head of the Project Evaluation Department (an Adviser provided under Technical Assistance from the World Bank but recruited by and answerable to the Board of Directors of SEDCO).

In addition to this, the officer studied worksheets of the Evaluation Officers as well as record books which tracked the movement of an application between divisions and among officers. Consultations on progress and general discussions were held with the Head of the Project Evaluation Department. Costs were based on:

(a) emoluments of the officers involved; and

(b) actual traveling expenses reflected in travel claims.

Where costs had to be allocated, they were prorated on the basis of time spent and/or materials used.

This procedure was initiated because some laons were three months in the processing. The other check was done by the Managing Director who kept an extract of the time an application arrived, to whom it was sent for what action, the number of visits required of an applicant and the amount of time each division spent on visits to the projects. In addition to this, he maintained a personal interest in the progress of several applications through the "pipeline," and by direct contacts not only with the various Heads of Divisions but also with the officers working on the particular application. Most of the first one hundred applicants to SEDCO met with the Managing Director first. Some parts of the application were usually completed in his presence, or he gave advice to the client as to how to go about applying for the loan he required.

Often applicants would approach the Managing Director in the hope that he would speed up the processing of applications. This was born of the belief that to get approval quickly you see the Head of the organization, not an uncommon attitude in Jamaica, where many persons seeking help, particularly in the realm of politics, try to see the appropriate Minister in the Government. This feature, however, in no way influenced the way SEDCO set out to do its business. The point to be made is that the Managing Director was always aware of the times, the costs, the progress and the obstacles involved in processing each application. His cost information was based not only on the logs kept in each division but also on other costs, e.g., travel expenses, machine time, and work of the non-professional staff.

The crucial problem, as the evaluation staff discovered, is that the smaller loan requested, the greater the difficulties encountered. There are some particular points we would like to share regarding difficulties with small projects:

(a) Any person with a good small project would, in most circumstances, be able to obtain a personal loan from any commercial bank with proper security. Hence, it is our view that loans not necessarily acceptable to commercial banks or small loans which would extend over a long period of time should be submitted to SEDCO. This problem reflected the state of the business.

(b) Regardless of whether the loan request was for used equipment, new equipment or whatever, the experience was that invariably one had to meet with the applicant more than once to double check background, prices and credit references. This consumed a great deal of time. It was usually easier, however, to obtain relevant information for new equipment, whether for a smaller or large item. Assessing costs of second-hand equipment was more difficult and many small loan customers were purchasing such items.

Politics and the Criteria

Apart from the objectivity and impersonality which they impart to the evaluation process, the criteria had the unspoken advantage of excluding political patronage and political decision-making in granting an individual loan. Whereas in Jamaica's case there was no overt political directive or interference, there were covert efforts, either by individual politicians or members of the Board of Directors. The latter group continually voiced objections to the stringency of the criteria and suggested that this was a subtle control over them by an international lending institution. Apart from their political considerations -- most of the members of the Board were either active politicians or supportive of the Government in power -- members of the Board were very concerned about the close control the Bank exerted over SEDCO. Added to all this was the failure by the political directorate to understand the hybrid organization that it had spawned.

What seemed obvious is that while the management tried to operate the institution with objective criteria laid down by the Bank, small business groups within the economy saw SEDCO operating as just another commercial bank and inappropriately so. Caught between these two opposing views, the organization was "strait jacketed" and received little consideration or goodwill from the political powers. To submit to the incessant pressure from politically inspired groups and persons, in the form of granting more loans than was feasible at that stage, would have been an invitation to disaster for the organization. Because of pressures exerted both internally and externally, and because of the Bank's recognition that loans were not being made at the volume predicted, SEDCO not only had a rough passage but was often bewildered by the convergence of forces, especially those that set operational limits.

CONCLUSION

Although the record is yet to come in on the success of most SEDCO loans, two things are reasonably clear. First, within the context of existing operational procedures, overly narrow definitional criteria -- particularly those excluding the service sector -- may have unnecessarily limited the population of borrowers. Second, the experience of SEDCO indicates that any conventional lending program which attempts to evaluate, in a meaningful way, the economic or financial merit of loan applications of very small enterprises can only survive by continuous subvention: to cover costs may be difficult, if not impossible, at existing interest rate levels.

The analysis of SEDCO's operations reinforces what has been learned in similar lending schemes elsewhere (see, for example, Kilby [1981] for Kenya and Anderson [1980] for the Philippines). Namely, it is the nature of very small enterprises that those operating them do not possess the precise information that will allow a determination of creditworthiness. For conventional lending programs to develop such information is extremely costly and will normally reduce the benefit-cost ratio to less than one, expecially when the expense of evaluating unsuccessful applications is added in. The situation is made more difficult by the fact that Jamaican small enterprises appear to suffer from more than just financial constraints; consequently there may not be just a single "missing component," which Kilby (1978) has tentatively identified as a prerequisite for successful assistance programs.

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