International Sources of Finance for Small Businesses
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Paper presented at
The Conference on Financing Development in the Caribbean
Sam Lord's Castle, Barbados.
December 4 to December 8, 1989

CONFERENCE ON
FINANCING
DEVELOPMENT
IN THE CARIBBEAN

The Conference on Financing Development in the Caribbean is sponsored by Commonwealth Secretariat, Regional Programme of Monetary Studies and The Central Bank of Barbados.

Cooperating and supporting institutions: CARICOM, Caribbean Development Bank, Economic Commission for Latin America and the Caribbean, Commonwealth Fund for Technical Cooperation, Canadian International Development Agency and The World Bank.

# INTERNATIONAL SOURCES OF FINANCE FOR SMALL BUSINESSES

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In view of the difficulty of extending financial aid directly to small scale enterprises, most bilateral and multilateral financial support to small enterprises is indirect and channelled through local development banks or commercial banks or NGOs. Data on such lending (most finance is loan, but some agencies offer 'lines of equity' e.g. IFC) is not disaggregated and does not appear to be readily available. Hence, it has not been possible to compile a statistical snapshot of what the different donors are doing for small firms in the different Commonwealth countries. Most people identify a major research gap in this area. What follows below is some information on official sources of international finance in some Commonwealth countries. Four factors stand out:

First over the last few years there has been an upsurge of support for small business in the Caribbean. The number of donor agencies now active in the region is formidable. USAID is without doubt the largest. Other major donors supporting the development of small business in the Caribbean include the EEC, UNDP, ILO, UNIDO, IADB, IFAD, CIDA, GTZ and many foreign NGOs. As part of USAID's strategy it has created or supported new national and regional private sector institutions. The most significant of these for micro/small businesses is the network of National Development Foundations. The NDF in Jamaica is currently expecting to have financial and/or technical assistance from no less than 9 different development agencies, the Canadian's being the most generous, a planned CDN$3.5 mn over the next 3 years.

Second, it is important to clarify what is meant by small business as international assistance varies depending on the type of small business. The most commonly used quantitative criteria relate to:

number of employees
annual turnover
total assets
fixed assets (incl. land & buildings; excluding land & buildings)
equity investment

The matter is further complicated by the fact that for different types of small business - manufacturing, retailing, tourism or agriculture - it is not always possible to apply the same criteria. For this reason, a number of institutions use different criteria for the different sub-sectors. They cover the entire spectrum from informal micro-enterprises, which probably comprise the vast majority of small firms and which are quite different in character from medium sized companies employing dozens of people. Also what is small in a small economy is quite different from small firms in large economies - for e.g. there are 5,000 small companies listed on the Indian Stock Exchange - most of which are regarded as small firms in the context of a major developing economy but are large when compared with the average Caribbean enterprise.

Most bilateral and multilateral lending delineates target groups by the minimum size of fixed assets and as such has not benefitted the very small, informal, micro-enterprises. In fact most donor agencies have found it too restrictive and administratively costly to designate small enterprises as the only beneficiaries and have designed programmes from which both small and medium enterprises would benefit. In the small countries of the Caribbean, most companies are well within the small and medium-enterprise category as compared with international standards. As such, all general industrial lending to these countries is assumed to benefit small and medium enterprise. But what becomes inevitable is that the better organised small companies, arguably less in need of special financing programmes, appropriate the funds that are available and the really small firms get crowded out. Therefore it would seem that multilateral lending policy while ostensibly designed to benefit small enterprises fails to take account of the differentiation that exists between companies that are small and large in the Caribbean context.

<u>Third</u>, it would be a fair comment that isolated pieces of assistance from donors have been commoner than comprehensive or co-ordinated efforts to overcome the special problems confronting small entrepreneurs. There are also potential private sources of international finance - i.e. predominantly local branches of multinational banks and more exotic types like debt conversion
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funds.

An, finally, the experience with using intermediaries, either public or private sector development finance companies (DFCs) or commercial banks has been rather mixed.

## EXPERIENCE WITH INTERMEDIARIES

### Development Finance Companies

In some countries, particularly in the Caribbean, DFCs have been active and successful sources of both finance and technical assistance for small firms in a broad range of sectors. However, in general DFCs are unsatisfactory vehicles for on-lending to small enterprises for the following reasons: (1) they are too centralised making it difficult for the small businesses outside the metropolitan centres, to make contact (2) they have complex project appraisal procedures beyond the capacity of small firms (3) they lack domestic resources for working capital, the major financial requirement for small businesses (4) they usually operate with inadequate staff and at high administrative cost.

It would be interesting to reflect on a report by a World Bank Task Force to the Caribbean Group for Co-operation in Economic Development. Although this report was prepared in 1980 delegates may wish to consider how valid its observations are today "some DFCs in the Caribbean are illiquid, unprofitable and drastically understaffed. Most of them used to operate primarily in the agricultural sector and were never well staffed to process development loans in other productive sectors. These problem DFCs are suffering from one or more of the following: undercapitalisation, understaffing, overly rigid regulations, too small a volume to pay overhead costs, interest rate ceilings that affect their financial viability and lack of operational autonomy. There are allegations with respect to a number of DFCs of undue political involvement in day-to-day operations. In the smaller economies there is a special problem of critical mass: the volume of lending that world be required to support the staff and administrative overheads of a viable DFC is relatively large in comparison with the size of the local economy in its present state of development".

If this remains a fair verdict should we think of reforming DFCs or considering other vehicles as intermediaries?

Commercial Banks

Commercial banks have certain district advantages over DFCs which is why some donors like the World Bank have preferred to channel a large portion of lending for small enterprises through commercial banks. These advantages are: (i) they have the necessary domestic resources and as such are better able to meet small business' need for working capital and term loans for fixed assets; (ii) they offer a greater variety of banking services; (iii) they usually have a large branch network permitting contact with small enterprises on a local basis; (iv) they are better able to respond quickly to the needs of small businesses.

On the other hand, commercial banks are seldom able to meet the needs of small enterprises for several reasons. First, many small firms which apply for loans frequently lack such business capacities as accounting, marketing, inventory controls, and the like, without which even promising new activities are not bankable. Second, most commercial banks do not have the facilities to appraise and process medium-term project loans in the productive sectors. For the most part commercial banking practice in the Caribbean for e.g. is concentrated on consumer lending and lending to the distributive sector. When commercial banks do lend to productive enterprises, loans typically require heavy personal collateral to offset the risks involved in lending to enterprises in the absence of analysis of the long-term basic soundness of the venture itself. Moreover, term lending is rare: funds are usually made available in the form of short-term lines of credit, suitable for working capital but not for expansion or for the purchase of new machinery or equipment. If a firm rolls over its credit line for expansion, it risks a shortage of working capital. Finally, the risks involved in lending to small enterprises are simply too great for many commercial banks in the light of legally permissible or politically feasible rates of interest.

In short, the main needs of small enterprises unmet by the commercial banks are the following: (a) long-term lending via non-revolving lines of credit; (b) technical assistance in developing projects; (c) some way around the problem of high risk; and (d) in some cases supplementary sources of equity finance.

Various approaches will be needed to alter commercial bank practices including risk sharing through government rediscounting arrangements or guarantee schemes where feasible and assistance by promotional agencies in project preparation.

Specific Programmes of Assistance by Multilateral Agencies

From July 1977 to June 1984, The World Bank lent $1.97 bn in 63 projects to support small and medium enterprises (SME) in 35 countries. In 1984 lending to SME reached 28.9% of all lending for industry through financial intermediaries. As target groups are delineated by the minimum size of fixed assets, informal, micro-enterprises. Lending to SMEs has been channelled through DFCs or commercial banks and experience with both, as noted above, has been mixed.

IFC's Capital Markets Department has extended financial services to small and medium sized industrial enterprises in 7 countries and has worked through established banks to provide loan financing and business advisory services to such companies. The following table lists the Commonwealth countries which have been assisted between 1971-1988.

FINANCING TO SMALL AND MEDIUM-SCALE ENTERPRISES (IFC)
(1971 - 1988)

Kenya

| | | $ mn |
|---|---|---|
| (1976) | Kenya Commercial Bank - SMSIE Scheme | |
| | IFC loan | 2.00 |
| | Total fund mobilised | 4.20 |
| (1981) | Kenya Commercial Finance Corporation (KCFC) - SMSIE Scheme | |
| | IFC loan | 5.00 |
| | Total funds mobilised | 10.00 |
| (1982) | Industrial Promotion Services | |
| | IFC equity | :15% |
| | IFC equity | 1.0 |

| | | $ mn |
|---|---|---|
| **Malaysia** | | |
| | Malaysia Ventures Berhad - a venture capital company oriented to small and medium-size companies | |
| | IFC equity | :20% |
| | IFC equity | 1.0 |
| **Sri Lanka** | | |
| (1978) | Bank of Ceylon - SMSIE Scheme | |
| | IFC loan | 2.00 |
| | Total funds mobilised | 4.80 |
| (1981) | Bank of Ceylon - SMSIE Scheme | |
| | IFC loan | 5.00 |
| | Total funds mobilised | 15.00 |
| **India** | | |
| (1986) | Export Import Bank - credit line | |
| | IFC loan | 15.00 |
| **Zimbabwe** | | |
| (1988) | UDC Ltd | |
| | IFC loan | 10.00 |
| **Asian regional** | | |
| (1984) | South East Asia Venture Investment Company and South East Asia Venture Investment Management Ltd. - oriented to small and medium companies in Asean region | |
| | IFC equity | :5% |
| | IFC equity | 1.00 |
| | IFC equity | :10% |
| | IFC equity | 1.05 |

USAID has been by far the most generous donor supporter and provides aid to a variety of regional and sub-regional projects, programmes and institutions with the goal of promoting micro/small/medium scale enterprise development. Of these the most relevant and important for the Caribbean is the Small Enterprise Assistance Project (SEAP) which is carried out under the aegis of the Caribbean Association of Industry and Commerce (CAIC).

SEAP is a 5 year $9 mn project designed to run from 1986-91. Since it began, it has made the greatest progress in supporting micro-enterprises. By the end of 1986, $3.0 mn had been committed and 409 loans, valued at $1 bn, had been disbursed (average loan $25,000).

Another project in the Caribbean which is aided, by USAID, is High Impact Agricultural Marketing and Production (HIAMP) which is a $40 mn initiative intended to promote private sector businesses in non-traditional, export-oriented fishing, agriculture and agro-processing in the Eastern Caribbean. Its goal is to seek out and develop new projects with local partners and partial funding from a new body, the Agriculture Venture Trust, which can invest between $20-500,000 per project. Thus far, two projects have been approved one of which will benefit some 150 small farmers growing passion fruit in Dominica, which is a country of particular concentration.

USAID helped establish the National Development Foundations (NDF) through the NGO - Pan American Development Foundation - in 1981. It is the most active of all the institutions in the Caribbean lending to small, especially micro, business. NDFs are now funded through the USAID Small Enterprise Assistance Project, Barclay's Development Fund, the Inter AMerican Foundation, the Foundation for International Training, CIDA and local contributors. NDFs provide credit (for viable projects which would not otherwise qualify from funding from commercial sources) and technical assistance. There are 11 NDFs in the Caricom countries: the first was established in Dominica in 1981, in Jamaica in 1981; Barbados in 1982; St. Lucia, Belize, Grenada and St. Vincent in 1983; Antigua in 1984; St. Kitts in 1985; Guyana in 1986 and Montserrat in 1987.

In 1987 the 11 NDFs disbursed 613 loans valued at $1,072,071 with an average loan size of $1,749. Jobs affected, a classification that includes new jobs created and jobs sustained or supported by the loans, totalled 1,205. In 1986 the corresponding totals were: loans disbursed 409, valued at $858,653, of an average size of $2,099, affecting 1,088 jobs. Loans were made to a variety of sub-sectors including manufacturing, agro-processing, retailing, services and agriculture.

USAID has also set up a Private Enterprise Revolving Fund which extends loans to small enterprises which do not normally have access to credit facilities. Reconnaissance teams of experts from the US business community are sent out to target countries (among Commonwealth countries these are Sri Lanka, Kenya, Jamaica and Zimbabwe). Support thus identified for local small private business is in addition to USAID's annual country programmes.

Another American organisation assisted by USAID is the International Institute for Co-operation in Agriculture which is active in small business development in the Caribbean (mainly through seminars for small farmers, traders and manufacturers).

CIDA HAS ONE Caribbean programme targeted at 8 countries in the Eastern Caribbean which is about to start. Budgeted at Cdn $7mn over 3 years, the Small Project Implementation Facility (SPIF) is intended to provide finance for infrastructural projects which will support employment generating productive activity by the private sector, preferably oriented towards exports. Projects must however be requested by governments.

SPIF's input to any one project must be in the range of Cdn $50 - 500,000, of which 70% has to be spent on equipment, material or services from Canadian sources. The kind of project it would finance is a small jetty for local fishermen, a chilling store for vegetable farmers, a rural road to access productive land or an incubator facility for new small business.

CIDA is also reported to be designing a programme in Jamaica targeted at pre-micro businesses with only one or two persons involved, e.g. street vendors, the loans available in the range J$100-200.

The GTZ or German Agency for Technical Co-operation, has a business co-operation programme which aims to foster every sort of commercial linkage, with or without the transfer of capital between Germany and about 40 developing countries. Such linkages include: joint ventures, licence and franchise agreements, sub-contracts, the sale of capital equipment from Germany, the export of goods and products to Germany and also focuses on small enterprises. The Caribbean programme for small enterprises costs about Dmlmn per annum, since 1981. (It is executed by a small German consultancy firm located in Jamaica within the Jamaica Manufacturers Association). As part of this programme, under a Craftsmen Guilds Co-operation Programme, the German government sponsors partnerships whereby master craftsman guilds in Germany provide hands-on assistance to their small business counterparts in developing countries.

GTZ's services for small firms also include such aspects as stock management, product planning, quality and design, costing, price setting, assisting with bank credit applications and setting up of credit and credit guarantee funds.

The <u>German</u> government operates a special programme to promote investments of German small firms in small firms in developing countries, usually in the form of joint ventures. The German government extends loans for such investment to German firms at 3.5% interest (for investments in LDCs with 2.5% interest) with a maturity of 15 years (including 5 years' grace) and a ceiling of $1mn per loan, covering up to 50% of the investment value. There is also an "in-plant training programme" for skilled workers, low and middle-level management.

A recent initiative by the German government aims at promoting in developing countries the establishment of local private handicraft and small industry self-help institutions, modelled in structure and function after the German Handicraft Chambers. These institutions are eligible to receive limited official financial support form Germany and are to work essentially in partnership with private German Handicraft Chambers. The intention is to develop self-help initiatives by local small-scale enterprises which would make them less dependent on the limited official finance available from their governments. Their activities would include the collective use of machines, co-operative sales and purchases of products and materials, collective liabilities for credit incurred, the introduction of common quality standards, joint marketing, etc.

Germany and the Netherlands have launched - with official support - partnerships between their commercial banks specialised in rural and small-scale business banking with local banks in rural and selected urban areas in developing countries to further the extension of lines of credit to farmers and small-scale agro-industries (a German Savings Bank Federation recently started its activities in Sri Lanka.)

UNDP has drafted a Project Profile for Caribbean small businesses. The four-year project has the following elements:

- provision of 50 experts under UNDP's new mechanism for Short Term Advisory Services to assist enterprises for short periods in designated priority sectors

- secondment of Caribbean employees to undergo on-the-job training with European firms

- provision of UN Volunteers to provide middle management training for individuals or small firms

- establishment of a Women's Entrepreneurship Revolving Fund of $100,0000 for small loans of maximum $2,000 repayable over 12 months.

Both ILO and UNIDO are active in the small business entrepreneur development arena. ILO is considering the possibility of establishing a regional facility, in collaboration with Caricom, for small enterprise development. Such a facility would:

- strengthen the co-operation between Caribbean countries in the field of small enterprise development

- provide, at a regional level, services that were too difficult and too costly to be provided in each country.

The Centre for the Development of Industries (CDI), a European institution based in Brussels, seeks to promote joint ventures between European and small ACP companies and the export of manufactured goods from ACP countries. It provides and finances technical assistance in various forms - market surveys, feasibility studies, training, equipment evaluation, partner identification etc.

The <u>EEC</u> is not a major source of aid for small business. It is however beginning to make a modest contribution by providing lines of credit to the National Development banks for small and medium-scale enterprises of a non-agricultural nature e.g. bakeries, fast food outlets, tyre repairs etc. Loans are in the range of $2-30,000.

<u>The Inter-American Development Bank</u> extends credit for small project financing in the poorest areas of the Latin American region. The programme reaches local small business institutions, co-operatives and similar entities with low-cost loans of up to $500,000 per project (local currency repayable) together with a maximum of $250,000 for technical assistance grants. A newly-created affiliate, the Inter-American Investment Corporation, has recently become operational. It will focus on small and medium-scale enterprises.

<u>Japanese</u> assistance for small enterprises concentrates on training programmes at all levels as well as on strengthening training institutions. Recent examples include in Kenya, the Kilimanjaro Agriculture and Development Centre, which aims at research and development, technology diffusion and training in agriculture and industry (main categories are metal casting, forging, ceramics); and the Kenyatta Agriculture and Industry University which aims at training at the managerial level. In Sri Lanka, Japan has aided the Appropriate Technology Research and Development Centre which provides general technical advice for such projects as farm machines, wind power pump, ceramics and building materials. In Tanzania, Japanese assistance has led to the establishment of the medium and small-scale Industrial Development Centre.

Some of the Public Development Finance Corporations like the Commonwealth Development Corporation in the UK, the German Finance Company for Investments in Developing Countries (FMO) have special programmes for promoting small enterprises.

CDC has recently started a one-man venture capital operation in Papua New Guinea and one in Kenya to evaluate and fund small-scale risky projects. They hope to duplicate the projects elsewhere if they are successful.

Swedfund, the Swedish Fund for International Co-operation with Developing Countries, established in 1978, provides financial support for small companies, helps in identifying projects and provides technical advice in project implementation, operation and marketing. The aim is to foster industrial partnerships between small and medium-scale enterprises in home and host countries.

## Technical Assistance

Overwhelming research suggests that help for small enterprises should not be confined strictly to the provision of finance. Small enterprises suffer not only from a lack of access to finance, but also the ability to utilise any finance effectively should it be made available. They need suitable technical and managerial assistance to prepare projects for investment and overcome operating problems. Multilateral technical assistance has mainly taken the form of financing foreign advisers or local experts or by setting up service centres in different industrial sub-sectors or through small, local, independent agencies with strong links to large industry, financial institutions and universities for delivering such assistance. The latter kind of organisations have been successful even in countries such as Jamaica where the experience with a variety of publicly financed institutions has been otherwise poor. A small unit provided technical assistance to the garment industry in Jamaica apparently with some success.

The Caribbean Project Development Facility was established in 1981 under the auspices of the UNDP (with the IFC acting as an executing agency), to assist small and medium entrepreneurs in the preparation of development projects and for identifying sources for financing. The Facility has been able to arrange funding for about 60 per cent of the 82 projects it has helped prepare in the different countries of the region but none of these were really small projects. In 1989, a new office was established in Barbados to help increase private investment in the Eastern Caribbean region. For the period 1988-92, the facility has been able to secure sufficient funding to extend its services, as planned, to six Central American countries.

Apart from the much needed support for project preparation, the major deficiency in the IFC is its inability to fund small projects (total costs of less than $5 million) directly because of its large overhead costs. In the past, it has like the World Bank used agency lines (local commercial banks) to onlend to small and medium term projects. But this approach has not been productive as many of these intermediaries were unable to meet the IFC stipulation that they should join in as equal partners. To overcome the difficulty of lending to small and medium sized enterprise, the IFC set up in 1988 a three-year $60 million African Enterprise Fund, wholly financed by itself, to fund projects costing less than $5 million, with individual stakes of between $100,000 and $750,000. The IFC will meet up to 40 per cent of the project's cost. There are indications of strong support from donors to expand the facility and to extend it for a five-year period beyond 1990.

The Africa Enterprise Fund concept is to be strongly commended. Over time it should be able to attract financing from other foreign sources for small and medium sized projects. There is talk of a similar facility for the Pacific. Serious consideration should be given to an enterprise-fund for the Caribbean, which would complement the existing project facility as well as focus it more effectively to help the really small entrepreneurs.

This section on Technical Assistance would not be complete without referring to the activities of the Commonwealth Secretariat's Industrial Development Unit. Its small team of engineers, economists, industrial managers and computer specialists focus predominantly on small and medium enterprises in small countries. Their advice covers manufacturing processes project design, appropriate sources of materials, and technology and how to make projects bankable. This year itself the unit has assisted several small firms in OECS states in developing building materials, furniture and foundries. It also arranges technology exposure visits and training in management or accounting for managers of small industries.

Finally, there appears to be growing international awareness and interest in providing training and financial assistance for self-employment and getting small enterprises off the ground. In this connection attention could be drawn to a Commonwealth Expert Group report, prepared in 1987, on Jobs for Young People. This highlights several interesting training cum financing schemes for self-employment which exist in both developed and developing countries and makes recommendations for international co-operation in generating more entrepreneurship.

Other Sources of International Finance

Even if small enterprises can mobilise loan finance through DFCs and commercial banks as well as technical assistance, most experience suggests that there is an equity gap for rapidly expanding small companies. This raises the question how do you raise equity where no organised securities markets exist and the main resource of owners of small firms is their private savings? One option might be for DFCs to take on an equity or venture capital role. However, the problems raised earlier in relation to DFC lending probably make this a less than attractive proposition with the additional problem of reluctance of small firms generally to get involved with official agencies and their bureaucratic requirements. We have also noted the inherent limitations of commercial banks and their reluctance to transform short-term liabilities into assets with longer maturities. Are there any other ways of mobilising funds to raise equity?

Some of the new sources of equity capital, currently part of a menu of financing options for cash-strapped developing countries, perhaps are worth a mention because they could indirectly provide finance for small businesses.

Debt-Conversion Funds. For many indebted countries, a major potential source of new foreign investment is the conversion of existing commercial debt into equity. In the secondary market for developing country debt that has mushroomed in 1980s, developing country loans often trade at substantial discounts to face value. Foreign investors interested in a particular developing country either for new or existing business, are therefore able to purchase debt paper well below its face value at substantial discounts and present it to the debtor country central bank for exchange into local currency at its face (full) value.

11 developing countries including Jamaica have established, or currently are considering, some form of debt/equity conversion scheme. The Jamaican scheme (introduced in July 1987) has designated certain priority

sectors for eligible investments: hotels, free trade zones; construction of factory space; exports; employment generating activities. While these investments in Jamaica may or may not lead to equity injection in small businesses, what might be more relevant is the idea of conversion funds. These are 'closed end' funds which pool the proceeds of debt sales to invest in a variety of shares in existing or new ventures, and could act as venture capital for small enterprises.

Conversion funds have been put together for the Philippines, Chile and Brazil. The IFC which is involved in both the Philippines and Chile Fund is actively promoting the concept of conversion funds or trusts that can provide a diversified portfolio of investments for "swappers" and at the same time enable host countries to direct the equity to priority sectors, which could include small entrepreneurs, depending on the political will of the government.

## Venture Capital Financing

Most Caribbean countries are too small for meaningful equity markets to develop. And even where there are markets as in Barbados, Trinidad and Tobago, Jamaica, Dominican Republic, it would be difficult to raise finance for small companies through a capital issue as most of these enterprises do not offer publicly traded shares. For countries with well developed markets it is possible to create an unlisted securities market for such companies - as Singapore did in 1987. But, even in Singapore, only eight companies came forward in the first year; others were discouraged by disclosure requirements. This situation has led policy-makers in developing countries to adopt the model of venture capital institutions, a type of funding common in leading industrial countries, where it is used for high risk, usually high-tech companies.

Such venture capital is distinct from other forms of investment finance. It entails the provision of scarce risk capital by financial intermediaries to enterprises based on their growth and profit potential rather than an established record. Unlike conventional investors, venture capitalists need particular expertise in spotting potentially high growth, early stage, investment opportunities. What also distinguishes venture capitalists is the "added value" they provide to the companies in which they invest, by way of management time and expertise in the areas of strategic and product planning, financial issues and recruitment of key executives etc. In short, a venture capitalist is not a mere financier but also a significant partner in the assisted venture.

The concept of venture capital funds is now being enthusiastically promoted by specialist firms and international agencies both in the more advanced developing countries and in small states. Such funds have been started in Thailand, Mexico, Korea, India, Kenya as well as in the Caribbean. Development agencies are helping to attract commercial and investment banks by underwriting the development costs. Recently established funds include:

* a Caribbean Venture Capital Fund supported by the US Agency for International Development (USAID) (which has also backed the Thai Venture Capital Fund and similar proposed schemes in Sri Lanka and Kenya). It has launched nine projects in the first year of operation including several in the smaller East Caribbean states;

* the Credit Capital Venture Fund (in India) set up by private investors and a major Indian bank with participation from the Asian Development Bank, the CDC and the West German KFW;

* another Indian venture - the Indian Investment Fund - has been launched by Grindlays Bank and Investors In Industry (3I's) combining a venture capital role (for start up companies, potentially profitable corporate resources) plus capital expansion by established companies. The fund includes some unlisted shares;

* the Japan-Asean Investment Company channels Japanese private venture capital to small and medium sized companies in the Asean region.

* A French venture capital company Sofinasia, owned by the Banque Nationale de Paris, La Caisse des Depots and BFCE, is to invest in Euro-Asian joint ventures along with EC financial participation.

* In Kenya, USAID paid Equator Bank to develop and design the Kenya

Equity Fund. To attract Kenya's financial institutions, USAID has agreed to provide loan finance at below commercial rates.

There are obvious constraints facing straight international venture capital financing by foreign firms: investors want a high growth, high profit, low tax environment and a good local stock market to float the shares of sponsored companies, once successfully established. In practice these conditions often do not exist and externally-supported venture capital institutions may therefore have to be established with the help of aid funds (the USAID model) or with the help of a 'line of equity' from an international institution (as the Asian Development Bank and IFC is doing in their support of local venture capital companies).

Venture capital financing represents an important area of future expansion for many developing countries, especially for small states where the inherent limitation of size prevents the emergence of equity markets and where specialised institutions may be necessary to meet the needs of small and medium-sized companies.