CHAPTER 11

Small business financing: The role and performance of the National Development Foundations in the Caribbean

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Most writers and practitioners in the area of small business have identified financing and financial management as the critical factors influencing the development of the sector. Commercial banks have, with the exception of a few limited innovative programmes, tended to ignore small businesses in their loan portfolios. State-sponsored development banks and institutions have generally adopted a paternalistic approach to small businesses with the result that their resources dry up very quickly and their portfolios show a high percentage of bad loans.

This chapter undertakes a preliminary assessment of the role and performance of National Development Foundations (NDFs) – private, non-profit organisations established in most Caribbean countries between 1981 and 1988 to provide credit and technical assistance to small businesses. It begins with a general overview of the financial environment in which small businesses operate, focusing on the ways in which access to finance and financial management determine the establishment and/or expansion of a small business. It then examines the objectives, functions and performance of the NDFs in the short period of their existence, and ends by identifying ways of enhancing the role of the NDFs in the future.

Overview of the financial environment facing small businesses

The majority of small businesses are started with the personal funds of the owners or funds borrowed from family members and friends. Failing these, the prospective business person may seek funds from the informal financial market (local money-lenders), approaching a commercial bank only as the last resort. (Sometimes the order is reversed with respect to the banks and

money-lenders.) The general perception that banks are unsympathetic to small business applicants can be traced to the following factors:

- the administrative costs of small loans are disproportionately high;
- small businesses lack adequate collateral (land title deeds, property, fixed incomes, etc.);
- small business persons do not usually have verifiable credit histories;
- small businesses lack audited financial statements and proper business and financial projections;
- small business loans are generally high risk with relatively little salvage value if the project collapses; and
- credit restrictions on bank lending may cause attention to be focused on other more profitable sectors.

At the same time, it may be argued that the small business person is often reluctant to approach the bank either because of past experience or a perception that the banks are unhelpful. This attitude derives from:

- the size of the equity contribution required by the bank;
- the rate of interest charged which is generally higher for small than for large businesses (except where special funds are available);
- the reluctance of the bank to fund working capital even though this is a short-term requirement;
- the relative inflexibility of bank loan arrangements and funds which impedes quick changes in the operations of the business; and
- the lack of knowledge of the services and facilities available at the bank.

Unless the banker is well-known to the small business person, or *vice versa*, start-up or expansion funds will not be forthcoming and the project may be dropped or modified.

Public-sector financing institutions (whether specifically established to cater to the needs of the small business sector, to guarantee small business loans or to make funds available to the sector through intermediaries) are generally deficient in their portfolio management, exhausting what were intended to be revolving funds. The Caribbean is replete with examples of such institutions – the Small Business Loan Board (1956) and later the Small Enterprise Development Company and the Small Industry Finance Company in the 1960s in Jamaica are examples of the lack of recognition of the full costs (operational and developmental) of concessionary lending to small businesses.

It should be mentioned also that a number of private voluntary organisations and public welfare agencies are present in the financial market catering to the needs of the small business person. Their funds, though flexible in terms of usage by the small business person, are essentially for micro-enterprise operations and do not generally 'revolve'.

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Apart from these institutional and subjective factors, one also has to consider the financial management competence of the small business borrower. His credit and collection systems may be very suspect and lax; record-keeping and budgeting may be absent or minimal ('Why keep records when the business is making money?' or 'I have no time for that' are common excuses) and his purchasing policies (e.g. securing new or additional machinery at full cost while hire purchasing may be more appropriate) could drain away the resources of the business.

One can identify a clear need for a financing institution which:

- provides funds at reasonable cost (that does not include a subsidy to the borrower);
- *has a balanced portfolio of projects;*
- provides guidance and technical assistance to the small business manager; and
- ensures that the loan funds are revolving.

Policies and performance of the NDFs

Objective and functions

At present, NDFs have been established in 11 Caribbean countries – Jamaica and Dominica (1981), Barbados (1982), St Lucia and Belize (1983), Grenada, Antigua and St Kitts (1985), St Vincent and Guyana (1986), and Montserrat (1988). The NDFs are private limited liability non-profit organisations whose mission is to strengthen and develop entrepreneurial skills and practices in the region through the provision of credit, business guidance and technical assistance to individuals and groups which are unable to access traditional commercial sources. Initial capital for their operations came from donor agencies such as the Pan American Development Fund (PADF), USAID, the Canadian International Development Agency (CIDA) and the German Technical Co-operation Agency (GTZ), and from domestic banks, business houses and national governments. The NDFs in the East Caribbean – including the Women in Development Project in Barbados – are recipients of a five-year US$10 million programme of technical assistance, credit funds and training from USAID called the Small Enterprise Assistance Project. This will expire in 1991.

NDFs are permitted to charge such fees and interest rates as necessary to ensure the revolving nature of the funds they manage. Sometimes, however, specific allocations are made by the donor agencies for particular sectors and activities.

NDFs are one-stop entrepreneurial centres offering loans, advice, training and technical assistance. Every prospective client must undergo a certain period of basic management training while his application is being processed. Lending limits vary from US$10,000 loan per individual in the East Caribbean to US$85,000 in Jamaica. Average loan sizes, however, have been much lower – about US$2,000 in the East Caribbean and US$3,000 in Jamaica.

NDFs accept intangible collateral in lieu of physical assets or where owner equity is minimal. For example, good character and community standing, sound business intentions and experience, commitment and initiative have, at various times, been accepted as sufficient guarantee by the NDFs.

*For costing and strategic purposes, the functions of banking and tech*nical services and training (TST) are separated since it is generally expected that banking operations (loans and repayments) will cover the current expenses of the NDFs while TST, being a developmental activity, will have to be met from external sources. However, NDFs regard TST as an integral part of their credit programmes, the success of the latter being dependent on the effectiveness of the former. Banking operations cover:

- project development and analysis;
- loan packaging and monitoring; and
- business advice.

TST activities cover:

- business counselling and 'trouble-shooting';
- agricultural extension services;
- seminars and workshops;
- information gathering and monitoring; and
- institutional support to other small business agencies.

The NDFs' portfolio

The analysis below covers data on the NDFs in the East Caribbean and Jamaica (which has four branches).[1] The NDF of Jamaica's (NDF/J) operations are summarised in Table 11.1 The NDF/J receives about 3-4,000 loan enquiries per year with approximately 70% of these becoming loan applications. Approvals, however, are 12 to 15% of total applicants. Between 1981 and 1989 there has been a rapid increase in both the value and number of loans approved annually. While the ideal loan period is about 36 months, most loans are repaid between 24–30 months with those in agricultural crops being retired in six months. Perhaps the most gratifying aspect

Table 11.1 National Development Fund of Jamaica.

Summary data, November 1981 – September 1989	
(i) Loans approved	2,524
(ii) Percentage of applications	12%
(iii) Value of disbursements	J$40.9 million
(iv) Average loan size	J$16,197
(v) Sectoral distribution	23% manufacturing (crafts, food processing, footwear, garments, furniture, building materials); 55% services (pantry/retail outlets, groceries, meatshops, transport, hairdressing, education); and 22% agriculture (agricultural business, livestock, aquaculture);
(vi) Jobs created/saved	6,500
(vii) Number of businesses expanded/established	1,700
(viii) Number of persons trained	13,300
(ix) Loan write-offs (i.e. delinquencies)	4.2% of disbursements at (iii)
(x) Loan arrears (i.e. up to 90 days)	5.4%

Source: Annual Reports of NDF, Jamaica 1981–9.

of the credit operations is that write-offs averaged 4.2% and totalled less than J$2 million over the period 1981–9.

In terms of sectoral destination, the greatest demand and the most favourable repayment capacity is in the area of commerce and services, which accounts for 55% of funds disbursed while manufacturing received 23% and agriculture 22%. The NDF/J, however, maintains that it is not biased towards services as the interest rate here is approximately 20% while the rate for agriculture is 10–14%.

Data for the NDFs (and Women in Development, WID) in the East Caribbean are given in Tables 11.2 and 11.3. Over the period 1986 to June 1989 the eight NDFs and WID had disbursed 2,019 loans valued at US$4.02 million. Average loan size was US$2,000 and arrears about 5% of loans disbursed. There were 4,105 jobs created or saved, of which 2,481 were male and 1,624 female. Manufacturing received the largest share of loans with 30%, followed by services (22%) and retailing (20%). Of all disbursements 54% was spent on projects in the rural areas, compared with 45-48%

Table 11.2 NDFs in the East Caribbean: Summary data, 1986–June 1989.

Indicators	*1986*	*1987*	*1988*	*1989 (Jan-June)*	*Total*
Enquiries/applications	1,912	n.a.	2,563	1,391	
Approvals					
– number	428	n.a.	751	327	
– value (US$)	904,910	n.a.	1,600,000	671,300	
– % enquiries	22	n.a.	29	24	
Disbursements					
– number	409	613	701	296	2,019
– value	858,653	1,072,071	1,499,000	591,900	4,022,624
Average loan size (US$)	2,099	1,762	2,139	2,000	
Arrears (30 days+)	14.72%	3.73%	5.16%	5.18%	
Jobs created	1,088	1,205	1,283	529	4,105
– Male	769	675	741	296	2,481
– Female	319	530	542	233	1,624
Cost					
– per loan	2,040	n.a.	1,515	1,440	
– per job created	816	805	828	806	
Sectoral distribution					
– agriculture	71	88	155	68	382 (19%)
– fishing	18	22	33	13	86 (4%)

Table 11.2 (continued) NDFs in the East Caribbean: Summary data, 1986–June 1989.

Indicators	1986	1987	1988	1989 (Jan-June)	Total
– manufacturing	130	188	226	83	627 (30%)
– services	90	130	142	98	460 (22%)
– retailing	80	152	129	47	408 (20%)
Geographical distribution					
– urban	173	291	337	142	943 (46%)
– rural	236	331	368	173	1,108 (54%)
Distribution by sex					
– male	237	379	425	185	1,226 (60%)
– female	164	207	235	99	705 (34%)
– partnership	8	39	46	32	125 (6%)

Source: Caribbean Association of Industry and Commerce, Barbados, Small Enterprise Assistance Project, 1989.

Table 11.3 Caribbean Association of Industry and Commerce Small Enterprise Assistance Project, Micro-Enterprise Performance, January – December 1987 US$

Summary	Loans disbursed			Portfolio			Jobs affected			Technical assistance	
Location	Number	Amount '000	Average size	Amount receivable '000	Recovery rate (%)	Arrears (over 90 days) %	Male	Female	Cost per job	Over 3 hrs.	Total reached
NDF Antigua	64	172	2,688	200	80.70	1.68	108	86	575	6	49
NDF Barbados	75	119	1,590	312	66.20	3.75	90	77	969	69	174
WID Barbados	67	94	1,400	162	73.00	2.13	33	173	653	0	76
NDF Dominica	80	129	1,610	228	24.00	5.20	97	41	1,091	29	81
NDF Grenada	79	152	1,929	315	80.00	6.12	80	31	979	n.a.	n.a.
NDF St Kitts	150	214	1,423	206	77.00	3.03	90	50	636	16	83
NDF St Lucia	68	159	2,333	191	68.00	3.07	91	49	1,046	85	n.a.
NDF St Vincent	30	34	1,124	45	57.00	4.87	86	23	493	18	48
Total Jan – Dec. 1987	613	1,072	1,762	1,659	66.74	3.73	675	530	805	223	511
Regional total Jan – Dec. 1986	409	858	2,099	692	73.50	15.75	769	319	n.a.	n.a.	1,150

Source: Caribbean Association of Industry and Commerce, Barbados, Small Enterprise Assistance Project, 1989.

in Jamaica. In Jamaica the distribution of loans between the sexes is even, but in the East Caribbean, males received approximately twice the number of loan disbursements as did females.

Main findings

(a) As agencies designed to finance small businesses exclusively, the NDFs start off at an immediate disadvantage since they cannot target low-risk, high-return ventures in their portfolio as favoured by commercial banks. That the NDFs have been able to show sustained annual growth in their assets, clientele, job impact and TST activities is indeed a laudable achievement especially in view of the fact that the delinquency rate (which plagues commercial banks and state-sponsored financing institutions) is quite low.

(b) Operating deficits are large but declining. While NDFs are almost self-sustaining in their banking operations (interest and principal repayments vs. disbursement costs), TST activities are quite costly and generally account for 40% of all operating costs. Since no fees are charged for these activities, the strain is placed on strict portfolio management to keep costs under control. TST activities are developmental and while their positive impact generally guarantees the repayment of loans it will become necessary to achieve a better balance between the costs and benefits of such activities.

(c) As private, non-profit-making organisations, NDFs are subject to a minimum of interference from governments but they are too dependent on external grants and loans for their existence. This dependence has led sometimes to the tying of grants and loans to specific sectors and activities which the NDFs may have been reluctant to get into. Such conflicts of purpose do not appear to have impeded the progress of NDFs.

(d) NDFs have concentrated on 'quality' loans, in keeping with their financial resources and expertise – and have proven to be quite effective and efficient. Repeat borrowers number no more than 10% of NDFs' clients, so that the role of NDFs in job creation and the establishment of new businesses, given their limited resources, and their geographical and gender distribution of loans, has been positive, increasing and well-managed.

Issues and considerations on NDFs' policies and programmes

Venture capital

In addition to the current operations, the NDFs are now considering a venture capital window. A venture capital company brings together potential investors and entrepreneurs who need financing. Since NDF clients can often bring very little capital of their own to a venture, it might be difficult to convince investors to place large sums of money at the disposal of a partner who has a much smaller financial commitment. The success of a venture capital window will depend upon the ability of the small businessman and the NDFs to convince potential investors that small businesses need not be high risk ventures.

A question also arises as to whether a venture capital facility is best operated by the NDFs or by some other small business organisation. The service would involve additional costs for staff and training, and perhaps more extensive physical facilities. In view of their financial limitations it may be unwise for the NDFs to attempt to provide this facility. Instead, the matter should be explored with other small business development agencies and development banks that may be better equipped to provide the service.

Small business lobby

Another problem facing the small business sector is the absence of an effective lobby to represent its interests. For example, the Small Businesses Association of Jamaica, established in 1974, is the primary organisation in this role, but it has not persuaded the government to articulate a national policy for small business development. The NDFs do not see lobbying as part of their function although they acknowledge the need to create a favourable environment for the development of small-scale operations.

After years of successful lending to clients who are ineligible for commercial bank loans, the NDFs are now in a position to assist commercial banks by providing them with information about non-lending services to reduce the riskiness of loans to small enterprises. NDFs have earned the respect of governments and institutions in the public and private sector. They should bring their reputation to bear and to influence small business policy nationally and regionally.

Graduation of customers

Once a business has developed the size and asset structure that makes it eligible for a commercial loan, it becomes ineligible for further assistance from the NDFs. The NDF's information on the client from its initial investigation when the loan application was first made through the duration of the relationship, is not available to the commercial bank, which must carry out its own investigation.

The NDF's target of self-sufficiency forces it to give up its best clients. As the NDF increases its reliance upon loan interest and capital repayment to fund its operations and provide new loans, it needs to include in its portfolio loans that are made with profit as the primary goal. The establishment of 'second windows' in Jamaica, Dominica and St Lucia where funds are loaned at slightly higher terms to 'graduate' clients is to be supported.

Sectoral focus of the NDF of Jamaica

The Foundations deny any bias towards the service sector, and attribute its relatively large share of their portfolios to the high demand and favourable repayment capacity of the sector. Donors are often biased against the service sector whose activities are not considered to be developmental. However, services do contribute to employment, greater popular participation in management and a more equal distribution of income.

The NDFs provide special incentives for agriculture in the form of lower interest rates, and they secure low-cost funds specifically for this sector. For example, in December 1986 the Jamaica Agricultural Development Foundation approved loan and grant funds amounting to J$1.3 million for the purpose of providing financial and technical assistance to small farmers. The NDF of Jamaica has also collaborated with the IAF, the GTZ and the ACB to secure funds for the provision of credit and TST to persons engaged in agricultural activities. As part of its Hurricane Relief Assistance, the Foundation donated tools which were secured in collaboration with the PADF, to individual farmers and related organisations island-wide. The NDFs provided a wide range of services to farmers who have secured loans from the Foundations through the activities of their field extension officers.

The demand for the services of the NDFs is high in all sectors; effective portfolio management suggests that the Foundations should not arbitrarily or altruistically divide their portfolio equally among sectors but respond readily to good, bankable projects from all sectors.

The need for self-sufficiency

All indicators point to the need for self-sufficiency of the NDFs in the region. USAID, which has been a major contributor to the NDFs, has been forced by US budget stringency to cut back its contributions for future operations. For Jamaica, in 1986 USAID grants amounted to 51.9% of the funding for Operational and Technical Assistance and Training costs, and USAID loans accounted for 15.7% of sources of funding for lending. The executive director of the NDF/J, Dr. Blossom Stokes admits that although special grants were made available to the Foundation due to the abnormal situation created by Hurricane Gilbert in 1988, USAID funds had been declining and were generally more difficult to access. Other sources from

which the Foundation received funding are: CIDA, the PADF, Inter-American Development Bank, and the National Development Bank (NDB) and the Jamaica Agricultural Development Foundation (JADF).

In an effort to become self-sufficient the NDF/J instituted a Strategic Development Plan in 1987, 'designed to put itself in a position of self-sufficiency within five years'. It calls for the separation of cost and profit centres (administration will be a cost centre and the branches will be profit centres) and the separation of banking and TST functions, each generating the resources necessary for its needs (NDF/J 1987 Annual Report). The NDF/J also underwent a USAID-sponsored operational review in 1988 which established a break-even portfolio size, target loan size and disbursement levels.

In 1987 it was decided to establish an Endowment Fund to attract substantial contributions from local and overseas sources. The income from the investment of these contributions is used exclusively for technical assistance and training (now called technical services and training) costs. By November 1989 the Endowment Fund had attracted J$4.4 million from CIDA, GTZ and local contributions including all fund-raising proceeds – at this rate it is unlikely that the target of J$13.763 million set for the end of 1989 will be met. While TST has been offered free of charge in the past, the NDF/J has decided to offer free training of up to 9 hours, and up to 20 hours free business counselling, after which clients will be charged. The NDF/J will also try to raise money by holding seminars and workshops.

The trend towards self-sufficiency at the NDF/J pre-dates this Strategic Development Plan. In its relatively short lifetime the NDF/J had made significant progress in this direction. In 1985, loan interest was the source of 20% of the Foundation's funding. In 1986 loan interest represented 39.6% of funding for operating and TST costs, and loan repayments represented 40.7% of funding for lending; in 1987 loan interest funded 39.55% of operating and TST costs, while loan repayment provided 37.5% of loan funds generated (See Table 11.4).

The Foundation has been operating at a deficit, which has increased annually, from $779,514 in 1984 to $2,503,521 in 1987. However, the percentage annual increase has been decreasing dramatically from 106% between 1984 and 1985, to only 8.61% between 1986 and 1987. TST costs amount to approximately half of the annual operating deficit (See Tables 11.5 and 11.6).

With the separation of the TST operations, the main sources of funding or saving will be:

- the Endowment Fund established in 1988;
- limiting the amount of TST available free of charge; and
- offering seminars and workshops as income-generating activities.

Table 11.4 NDF, Jamaica: Per cent of funding for operations (including technical services and training), 1986–7 (J$ M)

Year	USAID	CIDA	Loan interest	Other	JADF	IDB
1986	51.9	4.0	39.6	4.5	–	–
1987	39.0	7.1	39.55	7.62	5.65	1.10

Source: Annual Reports, NDF Jamaica.

Table 11.5 NDF, Jamaica: Performance, 1984–7 (J$ M)

Year	Assets	Deficit ($)	% Increase deficit
1984	4.2	0.8	n.a.
1985	5.1	1.7	106
1986	6.7	2.3	43.6
1987	9.3	2.5	8.6

Source: Annual Reports, NDF Jamaica.

Table 11.6 NDF, Jamaica: Expenses, 1984–7

	Expenses			TST as % of	
Year	Deficit	TST	Operations	Expenses	Deficit
1984	0.8	0.5	0.8	38.9	61.9
1985	1.7	0.9	1.4	40.5	59.1
1986	2.3	1.1	2.1	34.9	47.8
1987	2.5	1.2	2.1	29.4	49.4

Source: Annual Reports, NDF Jamaica.

It is, however, unlikely that plans outlined for the funding of TST operations will generate sufficient income. The NDF/J must adopt a joint approach with other institutions that provide technical assistance and training: technical schools, youth camps, Boys' Town, Girls' Town, the Social Development Commission, the government-sponsored HEART training programme, the official promotional agency JAMPRO and the SBAJ. They must jointly:

- eliminate duplication of services;
- reach as many small businessmen as possible;
- secure maximum financial assistance from the government; and

- reduce the cost of providing the services by increasing co-operation between agencies.

In other NDFs, the situation is quite similar.

Currently self-sufficiency stands at 38% (the ratio of loan revenues to expenditure). It is targeted, in the strategic plan, for this figure to increase to 45% by 1990. NDFs should diversify their portfolios, subsidising less profitable loans with income earned on more profitable loans. The Foundations should also continue to respond favourably to demands in the service sector, which has the most favourable repayment capacity. The governments should provide special incentives to the agriculture and manufacturing sectors.

As NDFs expand their client base and activities, dependence on donors should be reduced. Each NDF needs a strategic mix of loan funds mobilisation, portfolio expansion management, services pricing, collections, cost savings, training fees, second window facilities and new services to reach sustainability by the targeted dates.

The NDFs, the governments and the need for small business policy

Governments have demonstrated keen interest in the role of the NDFs in promoting small businesses, and they may enhance this role by making grants to the NDFs, and offering guarantees to donor agencies. However, if the NDFs court governments' assistance, they may also have to endure a certain amount of government interference.

The articulation of a policy for small business development is necessary to confirm the governments' commitment to the sector and to ensure that macro-economic and adjustment measures (tariffs, incentives, foreign exchange, etc.) do not discriminate against the sector.

An official small business policy might incorporate the following:

- establishment of priority sub-sectors within the small business sector and providing incentives to firms in these sub-sectors;
- reduction of the bureaucracy involved in establishing and operating a small business;
- easier access to imported raw materials and foreign exchange;
- encouragement through fiscal incentives of production using local raw materials where possible;
- assistance with the sale of the finished product, for example, setting aside some portion of state procurement contracts for small businesses;
- encouragement of expansion and linkages with large firms; and
- provision of grants for training and R&D for the sector.