BARBADOS PRIVATE SECTOR TRADE TEAM

BARBADOS PRIVATE SECTOR ASSOCIATION

FINAL REPORT

A POLICY FRAMEWORK TO INCENTIVIZE THE MICRO BUSINESS SECTOR IN BARBADOS

Prepared for
The Barbados Private Sector Association

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LIST OF ACRONYMS AND ABBREVIATIONS

ACEP	Agence de Credit Pour l'Enterprise Privée in Senegal
ADF	Agricultural Development Fund
AEO	Association of Enterprise Opportunity
ADEMI	Asociación para el Desarollo de la Microempresa in the Dominican Republic
AGS	Asociación Grupos Solidarios in Colombia
AIDS	Acquired Immune Deficiency Syndrome
ASA	Association for Social Advancement in Bangladesh
BDB	Barbados Development Bank
BIDC	Barbados Investment and Development Corporation
BNSI	Barbados National Standards Institution
BPSA	Barbados Private Sector Association Inc.
BRAC	Bangladesh Rural Advancement Committee
BSBA	Barbados Small Business Association
BYBT	Barbados Youth Business Trust
CARICOM	Caribbean Community
CBB	Central Bank of Barbados
CEE	Central and Eastern Europe
CGAP	Consultative Group to Assist the Poorest
CRL	Collection, Recoveries, and Liquidation Limited
CSME	Caribbean Single Market and Economy
EDD	Entrepreneurial Development Division of the BIDC
EE	Energy Efficient
EGFL	Enterprise Growth Fund Limited
EIB	European Investment Bank
EIF	European Investment Fund
EMN	European Microfinance Network EPMF
	Export Promotion and Marketing Fund
ETD	Energy and Telecommunications Division
EU 27	European Union Group of Twenty-Seven Countries
FIE	Fondo Financiero Privado in Bolivia
FIELD	Microenterprise Fund for Innovation, Effectiveness, Learning, and Dissemination of the Aspen Institutue
FINCA	Foundation for International Community Assistance
FTAA	Free Trade Area of the Americas
FundAccess	Barbados Agency for Microenterprise Development
GDP	Gross Domestic Product
HAACP	Hazard Analysis and Critical Control Points
IDB	Inter-American Development Bank
IIEF	Industrial, Investment, and Employment Fund
K-REP	Kenya Rural Enterprise Programme
LAC	Latin America and the Caribbean
MFI	Microfinance Institution
MIF	Multilateral Investment Fund of the IDB

MIP	Microenterprise Innovation Project sponsored by USAID
MSME Sector	Micro, Small, and Medium-Sized Enterprises Sector in Barbados
NCST	National Council of Science and Technology
NGO	Non-Governmental Organization
NIS	National Insurance Scheme of Barbados
PEU	Project Executing Unit
PRODEM	Fundación para la Promoción y Desarollo de la Microempresa in Bolivia
PROSEM	Promoción y Servicios Empresariales in Guatemala
R&D	Research and Development
RDC	Rural Development Corporation
RE	Renewable Energy
ROSCA	Rotating Savings and Credit Association
SBA	Small Business Administration of the USA
SBAEI	Small Business Association Enterprise Inc.
SBDA	Small Business Development Act
SBDU	Small Business Development Unit of the Ministry of Commerce, Consumer Affairs, and Business Development
SBVCI	Small Business Venture Capital Inc.
SDI	Subsidy Dependence Index
SEDI	Small Enterprise Development Initiative
SEWA	Self-Employed Women's Association in India
SHBI	Small Hotels of Barbados Inc.
SHIF	Small Hotels Investment Fund
SMEs	Micro, Small, and Medium-Sized Enterprises in the EU 25
SME Sector	Small and Medium-Sized Enterprise Sector in Barbados
STAP	Special Technical Assistance Programme of BIDC
SUM	Special Unit for Microfinance
TLF	Tourism Loan Fund
TRLF	Trade Receivables Liquidity Facility
UDC	Urban Development Corporation
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNFPA	United Nations Fund for Population Activities
UNICEF	United Nations International Children's Emergency Fund, now known as the United Nations Children's Fund
UNIFEM	United Nations Development Fund for Women
USAID	United States Agency for International Development
VAT	Value-Added Taxes
WTO	World Trade Organization
YES	Youth Entrepreneurship Scheme

1 EXECUTIVE SUMMARY

The last twenty years or so witnessed a significant expansion and improvement in the Government's policy framework for the Micro, Small, and Medium-Sized Enterprise (MSME) sector in Barbados. Despite the significant progress that was achieved as a result of the initiatives, the micro business sector, on which this Study focuses, has still not come close to realizing its full potential.

The vast majority of microenterprises cater to the domestic markets, and a major feature of those markets, whether formal or informal, is that, with few exceptions, they are highly competitive. Coupled with the small size of the microenterprises, the highly competitive nature of the markets make microenterprises especially sensitive to changes in the general business climate. Thus, market forces play a dominant role in determining the success of those microenterprises that cater to the domestic market. In the context of highly competitive markets and given the role that microenterprises have been expected to perform, there have been four basic areas that have continued to present challenges for microenterprises despite significant improvements. These four areas can be said to constitute the facilitating or enabling environment, and they are:

- The regulatory environment;
- Access to finance;
- Access to business development services; and
- Resources to the sector as a whole.

Microenterprises catering to the export market were faced with an additional challenge; the relatively high costs of production in the island that could stem from the high costs of labour and other inputs.

The primary objective of micro entrepreneurs is to earn income and to be profitable. When considered from the perspective of the Government of Barbados, the role of microenterprises is wide ranging. Microenterprises are important from an official governmental perspective because they have the potential to:

- Reduce poverty through income-generating activities;
- Generate employment;
- Contribute to national income and economic growth;
- Improve income distribution;
- Strengthen civil society;
- Develop the private sector; and
- Promote the entrepreneurial spirit.

It is those far-reaching benefits that make microenterprise development a critical component of development efforts in the island. If micro entrepreneurs are to achieve their objectives and at the same time fulfil the role assigned to them by the Government, then renewed efforts must be undertaken to promote the conditions necessary for further growth and development of the microenterprise sector. A central element of any attempt to promote the development of the sector must include the removal of the various obstacles and impediments facing micro entrepreneurs. Thus, in devising an enhanced policy framework for incentivizing the sector,

special attention must be paid to the strategies designed to address the facilitating or enabling environment. In addition, special attention should be paid to the formulation of strategies designed to assist those microenterprises that cater to the export market.

Based on the approach we have adopted in addressing our task, we have proposed an explicit integrated policy framework for incentivizing the micro business sector, and our proposals represent both a refinement and an extension of the existing framework for the Micro, Small, and Medium-Sized Enterprise sector. The benefits of the explicit integrated framework we have proposed include better information flows on the micro business sector; more coherent, coordinated, and targeted policies for the sector; and the creation of an environment that makes implementation of the policies easier as well as facilitates the use of objectively verifiable indicators for evaluating the results of the policies. Based on a combination of the preceding three benefits, the Government will be better positioned to help the microenterprise sector realize its full potential.

A summary of the specifics of our proposed policy framework is as follows;

1. The Small Business Development Act (SBDA) should amended and be renamed the 'Microenterprise, Small Business, and Medium-Sized Business Development Act'.
2. The general definition of a microenterprise, small business, or medium-sized business under the amended Act should be 'any entity engaged in an economic activity irrespective of its legal form'. That is, the economic activity would be the determining factor with regard to the general definition of a microenterprise, small business, or medium-sized business, not the legal form.
3. A microenterprise should be specifically defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is less than or equal to ten (10); and
   ii. Annual turnover or sales revenue exclusive of Value-Added Taxes (VAT) is $0.5 million or less **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is $0.1 million or less.
4. A small business should be defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is greater than ten (10) but less than or equal to fifty (50); and
   ii. Annual turnover or sales revenue exclusive of VAT is greater than $0.5 million but less than or equal to $4.0 million **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is greater than $0.1 million but less than or equal to $2.0 million.
5. A medium-sized business should be defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is greater than fifty (50) but less than or equal to two hundred (200); and
   ii. Annual turnover or sales revenue exclusive of VAT is greater than $4.0 million but less than or equal to $7.5 million **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is greater than $2.0 million but less than or equal to $4.0 million.
6. The amended Act should state explicitly that incorporated microenterprises, or incorporated small businesses, or medium-sized businesses can apply for approved microenterprise, small business, or medium-sized status under the amended Act.

7. The turnover limits, and the amounts for market values of fixed assets or stated paid up capital for the three categories of enterprises should be governed by the Regulations to the Amended Act. The relevant Minister of Government should have the authority to adjust those values in accordance with market conditions and inflation.
8. Approved microenterprises should be current in their contributions to the National Insurance Scheme in order to be eligible for benefits under the Amended Act.
9. With regard to the proposed amendment of the SBDA, it is imperative that the sponsoring Ministry for the Act should have discussions with the relevant stakeholders in the MSME sector, e.g. the Barbados Small Business Association (BSBA), Enterprise Growth Fund Limited (EGFL), FundAccess, and the Barbados Private Sector Association Inc. Such discussions are absolutely necessary if agreement is to be reached on amendments that have the potential to address the deficiencies of the existing Act and to provide a catalyst for the further development of the MSME sector.
10. In an effort to reduce the burden of reporting requirements for enterprises in the MSME sector, the threshold for the registration of VAT should be raised to $100,000.
11. Beneficiary export oriented microenterprises under the amended Act should be required to register annually with the Export Division of the Barbados Investment and Development Corporation (BIDC), and that Division should be responsible for providing the relevant business development services and technical assistance to the beneficiary microenterprises.
12. In those cases where the financing needs of beneficiary export oriented microenterprises under the Act exceed the maximum amount of $0.1 million lent by FundAccess, the Export Division of BIDC should refer the microenterprises to EGFL for financing. Alternatively, EGFL and FundAccess could consider the possibility of joint financing of the microenterprises.
13. In Barbados, FundAccess is the only dedicated microfinance institution serving microenterprises. For Barbados, there have been no studies, to the knowledge of the Consultant, documenting the penetration rates for micro-financing. However, what is known for sure is that, in general, continued access to financing has been one of the major obstacles that has impeded the sustained development of the microenterprise sector. Although it is a limited liability company, FundAccess is wholly owned by the Government of Barbados. In addition, the rate of interest charged on loans to microenterprises has been less than the typical market rates of interest, particularly since July 2003. Specifically because of those two characteristics of FundAccess, the institution has not been able to access funds from the Inter-American Development Bank (IDB), the major multilateral financial institution that has been providing funds for on-lending to microenterprises in the Latin America and Caribbean (LAC) region. The general policy of the IDB with regard to the provision of funds for on-lending to the microenterprise sector in the LAC region has been that beneficiary micro-finance institutions must adopt commercially driven, market-oriented lending policies. This policy is at variance with the one adopted by the Government of Barbados for FundAccess. It is therefore critical that the Government continues to provide, on a timely basis, injections of capital into FundAccess to ensure that the institution is able to continue financing microenterprises on the scale that it has done in the past. The importance of timely injections of capital into FundAccess cannot be underestimated, particularly in an environment where the Government has no control over the lending

policies and practices of other financial institutions, particularly commercial banks and credit unions.

14. When viewed from a holistic perspective, the growth and development of the microenterprise sector is an essential building block for the continued growth and development of the entire Micro, Small, and Medium-Sized Enterprise sector. That is, successful microenterprises have the potential to develop into successful small and medium-sized enterprises. The focus of the financing operations of EGFL is on small and medium-sized enterprises, and as successful microenterprises graduate to small and medium-sized enterprises, one would anticipate that they would seek financing from EGFL. In terms of institutional characteristics and lending policies, there is great similarity between EGFL and FundAccess. Thus, EGFL has not been able to directly access funds from the IDB for general on-lending to or for making equity investments in the small and medium-sized enterprises that the institution serves. Just as for FundAccess, it is therefore critical that the Government continues to provide, on a timely basis, injections of capital into EGFL to ensure that the institution is able to continue financing small and medium-sized enterprises on the scale that it has done in the past. Note, however, that recently, EGFL was designated as executing agency for Component One of the Smart Fund, a Fund established to provide financial and technical support to renewable energy and energy efficiency projects in Barbados. To capitalize the Smart Fund, the Government obtained a loan of $20.0 million from the IDB under an agreement for the Sustainable Energy Investment Programme known as the Smart Fund. Under Component One, EGFL is responsible for managing and disbursing approximately $18.0 million out of the total IDB loan of $20.0 million.

15. The provision of adequate business development services and technical assistance to microenterprises constitutes perhaps the major obstacle that must be overcome in the pursuit of further growth and development of the sector. Under the existing MSME policy framework, various Government agencies plus the Barbados Small Business Association (BSBA) and the Barbados Youth Business Trust have been providing business development services and technical assistance to microenterprises. As could be expected, the conditions and/or arrangements under which the services and technical assistance have been provided by the different institutions would not be the same. Similarly, it is unlikely that the quality of the business development services and technical assistance provided by the various institutions would be the same. Hence, from an overall perspective, there is a considerable challenge with regard to the provision of adequate business development services and technical assistance to microenterprises. We have proposed, therefore, that a strengthened Small Business Development Unit (SBDU), or some other substitute agency of the Government, should, through discussion and collaboration with the other institutions serving the microenterprise sector, be responsible for developing the appropriate mechanisms and modalities for providing the business development services and technical assistance that are warranted based on careful and systematic analysis of the requests for such services. At a minimum, partial cost recovery mechanisms should be instituted for the provision of the services.

16. A strengthened SBDU, or substitute Government agency, should also be responsible for working closely with the relevant stakeholders to facilitate the creation of a more enabling regulatory environment for small businesses and microenterprises in particular.

17. As a Unit within a Ministry of Government with the significant mandate for policy

formulation and implementation for the MSME sector, with a special emphasis on the micro business sector, and for the coordination of business development services and technical assistance to the micro business sector, the SBDU should not be responsible for administering a National Microenterprise Programme that involves the provision of grants to individual microenterprises.

18. To date, the Innovation Fund has made a useful contribution to the development of entrepreneurship in the island. The Fund should therefore be maintained, and, if feasible, additional financial resources should be allocated to the Fund.

19. The BSBA has made an invaluable contribution to the development of the MSME sector in the island. In particular, it has succeeded in highlighting the important role of microenterprises in the island. Thus, the Government should do whatever it can to strengthen the BSBA so that the institution can perform a more effective role on a larger scale.

20. As a membership organization that is not a financial intermediary, the BSBA is not a suitable institution for providing financial services to its members. This observation is supported by the experience of Small Business Venture Capital Inc., the wholly owned subsidiary established by the BSBA to provide equity financing to qualifying members of the Association.

21. Within the overall integrated framework that we have proposed for incentivizing the micro business sector, and by extension the small business sector, the SBDU, or some other substitute agency of the Government, will be responsible for policy formulation and implementation for the small business sector, inclusive of the micro business sector, based on ongoing and systematic analysis of developments in the sector and on collaboration with the various agencies working in or providing services to the sector. Effective performance of that role will involve the collection and analysis of information relating to the MSME sector, and to the micro and small businesses sector in particular. In the performance of that role, a strengthened SBDU will need to collaborate closely with the Youth Entrepreneurship Scheme, FundAccess, EGFL, BIDC, and the BSBA. For that reason, we believe that the Trade Receivable Liquidity Facility, an invoice financing facility, recently established for microenterprises and small businesses should be administered by FundAccess and by EGFL.

22. After almost fourteen years of operation, it would be appropriate for FundAccess to consider the feasibility of introducing new microfinance products so that it can more effectively serve the microenterprise sector in the island.

2 INTRODUCTION

The focus of this Study is the further development of the micro business or microenterprise sector in Barbados. Thus, the major output of the Study is recommendations that have the potential to stimulate the further development of the sector.

This Study has been made possible as a result of an agreement between the Barbados Private Sector Association Inc. (BPSA) and the Inter-American Development Bank (IDB). Under that agreement, the BPSA secured funding from the IDB's Multilateral Investment Fund (MIF) for a Programme titled "Supporting the Barbados Private Sector Association to Take Advantage of Regional and Global Integration". That Programme entailed the execution of four sub-programmes or sets of activities that will strengthen the role of the BPSA as a key participant in public policy debates affecting private sector development, while increasing awareness of the changes and challenges that confront the private sector. This Study has been carried out under the sub-programme, "Improving the Technical Capacity of the BPSA to Present Business-Friendly Policy Reforms".

Section 3 of the Report traces the developments that led to the substantial interest that has been attached to the micro business sector as one with significant potential for the creation of economic opportunities for the more disadvantaged segments of the populations in both developed and developing countries.

In Section 4 of this Report we have sought to establish the groundwork for the recommendations that will eventually be made for Barbados. An important part of that foundation has been the outlining of the existing Government policy framework for the Micro, Small, and Medium-Sized Enterprise (MSME) sector in the island. Documentation of that overall framework was important since discussion of the micro business sector in isolation would not be very meaningful. In our documentation of that framework, we have identified the initiatives for the MSME that have been undertaken by the Government since the mid 1990's. Our research has shown that those initiatives were substantial. In addition to the documentation of the policy framework, we have also provided information on the outcomes of the policy initiatives so that a full assessment of the policies could be made.

Section 5 of the Report discusses the activities of the Barbados Youth Business Trust (BYBT), a charity established in 1996 for the purpose of promoting entrepreneurship in the eighteen to thirty-five age population age group. Section 6 of the Report discusses the micro business sector in Barbados, and Section 7 discusses the challenges faced by the sector. In Section 8 of the Report, we have provided information on comparative approaches used in other countries for addressing the micro business sector. Section 9 of the Report outlines our proposed policy framework for the micro business sector, including an assessment of the estimated costs and benefits of the proposed framework. In Section 10 of the Report, we have provided our conclusions.

3 UNDERSTANDING THE MICRO BUSINESS SECTOR

3.1 Background

The development of the microenterprise or the micro business sector refers to the process by which entrepreneurs starting out on a small scale establish and grow their businesses. Quite often, the terms microenterprise and self-employment have been used synonymously, partly because small-scale enterprises have been seen as forms of businesses (microenterprises) and as forms of employment (self-employment). Self-employment refers to a situation in which individuals work for themselves rather than for a separate public, private, or non-profit enterprise. Many, although not all, of the businesses owned by self-employed individuals are microenterprises. While many entrepreneurs who lack access to commercial credit may be poor or struggling economically, not all are. Thus, the trend in the microenterprise development field has been to focus largely on the issues confronting low-income entrepreneurs and the organizations that seek to assist them.

3.2 Developing World

In the developing world, particularly in several countries in South and Central America, Asia, and Africa, the microenterprise or micro business sector has traditionally been associated with the poor who lacked access to formal financial institutions for credit to finance income generating activities.[1] Thus, in the past four decades or so, microcredit, the provision of small loans to the poor who otherwise lacked access to formal financial resources, has emerged as a developmental approach with significant potential for aiding poverty alleviation. Writing on India, Bharti and Shylendra have made the distinction between poverty alleviation programmes and microenterprise development programmes.[2] The authors have asserted that the objective of microenterprise development has been to make the poor self sufficient, whereas anti-poverty programmes have been the means to support the poor in their fight against poverty. Hence, microenterprise development programmes need a self sufficient and sustainable approach.

A major event in the promotion of the microenterprise sector as a major developmental approach was the 1997 Microcredit Summit, convened in Washington, DC, USA. That Summit attracted a high level of attention from a range of institutions involved in the field of economic development. Those institutions included governments, non-governmental organizations (NGOs), bilateral and multilateral assistance organizations, existing microfinance institutions, private donors, and the media, among others. A major outcome of that Summit was the establishment of concrete goals for the further expansion of credit access to the poor.[3]

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[1] This Sub-Section of the Report draws heavily on the article written by Maria Sophia Aguirre and Theresa Prosser, Micro-Credit Strategies and Funding; Lending to Sustainable Development?

[2] Bharti, Nisha, and Shylendra H. S. 2005. Microfinance and Sustainable Micro entrepreneurship Development. Institute of Rural Management, Anand, Gujarat. Lexico Publishing Group, LLC.

[3] The "poor" were generally identified as those persons living below the poverty line established by a country, and the "poorest" or "very poor" were those at the bottom 50.0% of that group. These definitions, cited in the Microcredit Summit Declaration, have been determined by the Policy Advisory Group of the Consultative Group to Assist the Poorest (CGAP).

Some microfinance institutions or organizations, including the often-cited ACCION International in Latin America, Grameen Bank in Bangladesh, and Bangladesh Rural Advancement Committee (BRAC), have been providing credit to the micro business sector since the mid-1970's or early 1980's. Only in the last twenty years or so, however, has the popularity of microfinance as a development approach attracted significant energy and resources from high profile donors. Among these donors have been governments, through the support of bilateral development agencies, as well as multilateral sources such as the United Nations (UN), the World Bank, regional development banks, and international NGOs.

The lack of economic opportunity caused in part by the lack of access to credit and formal financial services has been a serious hindrance to initiatives made by the poor to improve their quality of life. By supporting their own initiatives, microcredit has provided a means of helping to give the poor an opportunity to help themselves and their families while potentially gaining both economic and personal development in the process. Thus, microcredit has become a valuable source for generating human and social capital.[4] Rather than temporarily providing poor persons with donor-contributed or government-dependent capital at subsidized interest rates, sustainable microcredit institutions, as distinct from social welfare institutions, have successfully provided loans to the poor at sustainable commercial interest rates.

In the past, the track records of several microcredit institutions were not viable due in part on their heavy reliance on donor funding. Currently, however, the emphasis among those institutions in the field has been to aim for wide-scale institutional sustainability based on sound business practices. To help accomplish this objective, the Consultative Group to Assist the Poorest (CGAP) was established in 1995 as a consortium of bilateral and multilateral donor agencies organized to promote mainstreaming microfinance as a development tool. CGAP provides technical support and capacity building to expand the outreach and sustainability of micro-finance institutions. Shortly after, there were some other major developments that reflected the increasing efforts of major institutions to mainstream sustainable microfinance as a wide-reaching development tool for the poor. Those developments included the coordinated effort of the United Nations Development Program (UNDP) and the United Nations Capital Development Fund (UNCDF) in 1997 to establish the Special Unit for Microfinance (SUM) and MicroStart Program, the Inter-American Development Bank's (IDB) integrated Microenterprise Development Strategy that was implemented in 1997, and the Microenterprise Innovation Project (MIP) of the United States Agency for International Development (USAID).

While microcredit has not been the answer to all the many and various problems faced by the poor in developing countries, it can be a good tool with real potential for helping to lift the economic resources trap faced by these individuals due to their inability to qualify for services from formal financial institutions. All the same, without denying the need for a holistic approach to poverty and acknowledging that lack of access to credit has not been the sole problem faced by the poor, it has not been necessary to assert that microcredit programmes must be the source of all types of development services for the poor. Microcredit on its own can be used to help open doors of opportunity for the poor and their families, and can even work in tandem with the

[4] Social capital has generally been understood to represent "an instantiated informal norm that promotes cooperation between two or more individuals, e.g the norm of norm of reciprocity between two friends." Human capital has generally been understood to be the physical and technical efficiency of the population.

provision of social needs and services beyond financial and technical services without attaching them as a *sine qua non* to credit access.

3.3 Developed World

The terms microenterprises (micro businesses) and microcredit originated in the developing world, and were associated with efforts to provide financing for the economic activities of the poor who lacked access to formal financial institutions. Since the late 1970's, those terms were in common use internationally when discussions took place about economic development and developmental approaches in the developing world. In the developed world, however, the history of microenterprises and microcredit has been much shorter. In the following paragraphs, we have presented some background information on the United States of America (USA) and Europe.

In the USA, the business sector had been traditionally categorized into three groups; large, medium, and small.[5] Since its establishment in July 1953, the US Small Business Administration (SBA) had been responsible for formulating and implementing programmes for the promotion and development of small businesses.[6] For the SBA, a small business was one that was independently owned and operated, was organized for profit, and was not dominant in its field. With regard to the number of employees and annual sales, the criteria typically used to determine which category a business fell into, the SBA specified different ranges of values depending on the industry or sector in which the small business operated.

In 1991, the SBA recognized microenterprises as a separate category of business. Three socioeconomic trends that had emerged in the 1980's and that converged in the 1990's constituted the catalyst that led to the classification by the SBA of microenterprises as a separate business category. Those trends were:

- The political debates over the effectiveness of government entitlement programmes designed to help the poor and disadvantaged segments of the population escape poverty;
- The growing disparity in income distribution and the loss of blue-collar jobs; and
- Demographic changes that encouraged self-employment as an option.

For quite some time, the United States Government had implemented a variety of programmes that were intended to help the poor and the disadvantaged segments of the population escape poverty. The costs of these programmes, which were labelled as entitlement programmes, were significant. Fearing that in the absence of welfare reform the costs of those programmes would continue burgeon, an intense political debate ensued with regard to the best way to reign in the costs of the programmes as well as to lessen the dependency of the poor and disadvantaged segments of the population on the state. The debate peaked during the presidential campaign of 1992, and culminated in the subsequent passage of a landmark welfare reform bill during the first Clinton Administration. An important tenet of that bill was that individuals should be

[5] The information presented on the emergence of microenterprises in the USA was based on the document, Innovations in Microenterprise Development in the United States, by William Burrus, President and CEO, Accion USA.

[6] The information specific to the SBA was obtained from the SBA's website.

encouraged, if not required, to support themselves through employment including self-employment.

The decade of the 1980's in the USA was characterized by a growing disparity in the income of those individuals at the top of the income scale and those at the bottom. Individuals with lower levels of education employed in traditional blue-collar jobs and/or single-parent heads of households were the ones who were most negatively affected by this trend. The shift of jobs from the relatively high-paying manufacturing sector to the minimum-wage service sector made it more difficult for many families to stay above the poverty line. Corporate downsizing and the related trend of outsourcing jobs outside the United States also meant that many middle-class families faced a more uncertain economic future. In light of this trend, policy makers became even more aware of the importance of small business and self-employment as a strategy for creating income and employment for those who lost their jobs or were unable to secure traditional jobs.

The shift in emphasis to the importance of small business and self-employment as a strategy for creating income and employment was buttressed by the reports of the SBA. In 1993, the SBA reported that small firms created a disproportionate share of jobs in virtually every industry in the late 1980's and early 1990's. During that period, those firms with less than 20 employees created almost 4.1 million new jobs against a loss of jobs in medium and large firms of 0.85 million and 0.5 million, respectively.

During the 1980's, certain demographic developments that encouraged self-employments as an option became more evident. These changes included:

- The increasing percentage of women in the workforce and the option of self-employment as a way to balance the demands of work and family;
- The growth in immigration, both legal and illegal, in which many recent immigrants, faced with language barriers and other challenges, turned to self-employment;
- The aging of the population in which workers over 50 increasingly turned to self-employment as a way to generate income well into their 60s; and
- The decline of many rural economies in which some individuals and families, bound by their rural roots, chose self-employment as a way to remain in their communities.

Those three socioeconomic trends created an environment for self-employment to thrive in the United States. At the same time, there was growing awareness of the much more developed microenterprise field in developing countries. The increased recognition of the importance of the informal economy in developing countries, and the success of numerous programmes in the developing countries that were lending to micro entrepreneurs, gave a direction and a methodological framework for the emergence of the microenterprise field in the U.S. The socioeconomic trends and the awareness of the international models combined to increase the visibility of self-employment as an economic and poverty alleviation strategy and gave birth to the microenterprise field in the United States.

In Europe, the promotion of microenterprises as an economic approach for assisting the poor and the marginalised began in Central and Eastern Europe (CEE) after the fall of the Berlin Wall in

November 1989.[7] In terms of economic growth and development, the Communist countries of CEE had lagged considerably behind the Western European countries that practiced the democratic model of governance. Although known for some time, it was the collapse of the Berlin Wall that fully exposed the absence of vibrant economies in the former countries of CEE, as well as highlighted the substantial poverty that existed in those countries.

Thus, in the countries of CEE, microenterprises emerged as an economic approach in turbulent times, with the implicit objectives of the promotion of microenterprises being:

- To provide potentially viable economic opportunities for the poor and disadvantaged segments of the populations of the former Communist countries of CEE; and
- To foster the development of an entrepreneurial culture in those countries.

The emergence of microenterprises as a potentially viable approach for fostering the development of an entrepreneurial culture as well for providing economic opportunities for the poor and disadvantaged was accompanied by the establishment of Microfinance Institutions (MFIs) and NGOs in Eastern Europe that catered exclusively to the microenterprise sector. Also in Eastern Europe, some commercial banks began to downscale in order to provide microloans. Within five or six years of the collapse of the Berlin Wall, MFIs in CEE and in the New Independent States had attracted more than 1.7 million borrowers and 2.3 million depositors, with an average client growth rate of 30.0% per year.

In comparison with the countries of the CEE, the growth of the microenterprise sector in Western Europe has been more limited despite increasing interest in its potential. In general, the microenterprise sector has been of more recent vintage in Western Europe even though there have been instances of a few enterprises that have been around for some time due to the provision of micro-financing from institutions such as the Raiffeisen and Savings Banks in Germany, the lending charities in England, and the cooperative model of the 'Casse rurali' in Italy. In Western Europe, microenterprises, and by extension, microfinance, have mainly been perceived as tools for economic growth and social cohesion. Many small businesses and families lacked access to financial services in spite of the existence of a dense and competent banking network. In addition, financial exclusion has been mainly concentrated among those suffering from poverty and social marginalisation.

3.4 Definitions of Microenterprises and Practices Applicable to Microenterprises in Some Countries

3.4.1 General

Since the emergence of the microenterprise sector as a potential area of economic opportunity for those who could be considered as members of the non-mainstream sub-populations, there has never been a universal definition of the microenterprise. In general, microenterprises tend to be more labour than capital intensive and have high relative production costs. In many cases, they

[7] The information on the emergence of microenterprises in Europe was based on the following document: Microfinance in Europe: A Market Overview, by Helmut Kraemer-EIs and Alessio Conforti. Working Paper 2009/001, European Investment Fund Research and Market Analysis.

lack technical experience in production, accounting, administration, and stock control. Quite often, they are unregistered (or partially registered) and family-based.

3.4.2 Developing Countries

In some developing countries, a microenterprise has simply been associated with the economic activity being undertaken by a given individual or family unit, and no additional economic criteria may have been spelt out. For example, there may be no reference to the number of employees of the microenterprise, nor to the annual sales or the value of its fixed assets of the enterprises. More often than not, the economic activity could be considered to be informal.

In general, therefore, the microenterprise sector can be considered to be an extremely heterogeneous one that varies dramatically in relative size and composition in different countries. At the lower end of the spectrum, there exist subsistence level household businesses that depend exclusively upon family labour, with no distinction between the finances of the households and those of the businesses. At upper end of the scale, there are small enterprises with as many as ten employees, utilizing relatively sophisticated production technologies and that are directly linked with larger firms in the modern sector of the economy through divers supplier-client relationships.

In its Microenterprise Development Strategy, the major regional multilateral financing agency servicing Latin America and the Caribbean (LAC), the IDB, has focussed on businesses that lack adequate access to financial and business services, with those businesses encompassing all areas of economic activity, including commerce, agriculture, manufacturing, and services.[8]

The Microenterprise Strategy and the programme for its implementation focuses on businesses with ten (10) employees or less and total assets equivalent to less than US$20,000.[9] Businesses in the professional practices such as medicine, dentistry, and law have been excluded. Although the IDB's Microenterprise Development Strategy has established size parameters for microenterprises that serve as guidelines for the types of businesses targeted by the Strategy, the quantitative criteria have not been relied on exclusively. The qualitative aspects of microenterprises, particularly their lack of access to services, their existence at the margin of legal and regulatory frameworks, and the overlap of consumption and production activities within the enterprises have also been important factors that have shaped the policies and programmes of the Bank for this segment of the private sector.

In India, the microenterprise sector has grown dramatically since the country gained its independence from the United Kingdom in 1947. The rapid growth in the sector was due to the twin challenges of unemployment and poverty that have confronted the country for several years, even before it gained its independence. Barthi and Shylendra have noted that the poor in India have been the most disadvantaged in terms of access to credit through formal sources since both

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[8] See Inter-American Development Bank. February 1997. Microenterprise Development Strategy. Social Programs and Sustainable Development Department, Microenterprise Unit. No. MIC 103. Washington, D. C.

[9] Unless otherwise indicated, all monetary values have been denominated in Barbados dollars.

the government and the market failed to provide adequate financial resources.[10] The authors also noted that the growth of microfinance in India has been in response to the failure of institutional initiatives of rural credit and exploitation attached with informal system of credit.

Borrowing on the work of Schreiner and Leon (2002), Bharti and Shylendra have asserted that microenterprises can simply be defined as firms owned by the self-employed poor that use microfinance.[11] Alternatively, and again borrowing on the work of Schreiner and Leon, Bharti and Shylendra have asserted that a complex definition of a microenterprise should have three components, i.e. type of activity, investment limits, and number of employees. Thus, the authors defined a microenterprise as an informal economic activity operated by the poor with an investment limit of less than 0.1 million rupees and employing less than five workers, including the owners of the business.

For 2009, the average microloan in the LAC region was US$1,200, bearing an interest rate of 29.0%.[12] Based on that figure, we have estimated that the average size of loans required by or provided to microenterprises in developing countries as of 2010 has been US$2,000 or less.[13]

3.4.3 United States of America

In the United States, the microenterprise development industry, along with its trade association the Association of Enterprise Opportunity (AEO), has defined a microenterprise as a business with five or fewer employees, including the owners of the business, that requires five or fewer employees and that does not have access to the traditional commercial banking sector.[14] In addition, such microenterprises generally require less than US$35,000 in loan capital.[15] The Microenterprise Fund for Innovation, Effectiveness, Learning, and Dissemination (FIELD) of the Aspen Institute has often used an additional qualifier in its efforts to convey a fuller concept of a microenterprise.[16] That is, FIELD has focussed on micro entrepreneurs, or potential micro entrepreneurs, who are low-income or struggling to make ends meet.

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[10] Bharti and Shylendra. *Op Cit.*

[11] Schreiner, M. and Leon, J. 2001. Microfinance for Microenterprise: A Source Book for Donors. Savings and Development, Vol. 26(4), pp. 329-354.

[12] Inter-American Development Bank Website. 2011. Microfinance by the Numbers.

[13] Comprehensive information on the approaches and other practices adopted towards microenterprises in the developing countries by the multilateral, bilateral, and regional international institutions and the microfinance institutions they supported can be found in Section 7 of this Report.

[14] See Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States. By Elaine L. Edgcomb and Joyce A. Klein. February 2005. Aspen Institute, USA.

[15] See Innovations in Microenterprise Development in the United State by William Burrus.

[16] FIELD is a research and development organization dedicated to the expansion and sustainability of microenterprise development efforts, particularly those aimed at low-income Americans. Its mission is to identify, develop, and disseminate best practices, and to broadly educate policy makers, funders, and others about microenterprise as an anti-poverty intervention.

During the 1990's the microenterprise sector in the United States grew rapidly.[17] Starting with a small number of non-profit organizations testing developing country models, the sector now has service providers in every state, a national trade association (AEO), a growing number of state-level associations and financing intermediaries, and several research and policy organizations. FIELD has collected data on the organizations in the sector since 1992. The first directory, compiled in 1992, listed 108 organizations that identified themselves as working in the sector. By 2002 this number had grown to 650 organizations. Of the 650 organizations, 554 were organizations that provided direct services and the remaining 96 were support organizations that offer funding, training, and technical assistance to these practitioner organizations.

From a general perspective, it could be said that the microenterprise sector in the United States developed in a very organic, grassroots way. There were a very large number of diverse and often small organizations providing services to micro entrepreneurs in their local communities. Almost all were not-for-profit entities. These organizations ranged from those that focused exclusively on the microenterprise sector such as ACCION USA, to credit unions, community development corporations, universities, immigrant and refugee organizations, and others.

In the USA, the microenterprise sector has been sub-divided into two general groups of service providers; those that primarily offer credit and financial services (credit led) and those that primarily offer training and technical assistance (training led). Of the 554 organizations that provided services in 2002, the majority identified themselves as falling under the latter category.

Among the 198 organizations that offered credit and financial services, 182 offered individual loans while only 36 offered some type of peer group loan, demonstrating that the peer lending model imported from abroad had found only limited success in the USA. While microloans remain the primary financial product offered to micro entrepreneurs, some organizations offered small seed grants, micro-equity investments, and Individual Development Accounts (special savings that could be used for education, the purchase of a house, or for starting a business). For those organizations that were training led, the core product was the preparation of a business plan. Organizations usually sponsored business plan development courses that helped micro entrepreneurs organize their ideas, test the feasibility of their business proposals, and perhaps prepared them for receiving a loan. These institutions also offered courses and direct one-on-one technical assistance in tax preparation, marketing, use of technology, business financing, and other topics.

Finally, there have emerged more organizations dealing with more specialized purposes such as training services for specific population segments. For example, there are organizations that provide services to immigrants, refugees, the physically disabled, and women transitioning from welfare to self-employment.

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[17] The information on the microenterprise sector in the USA in this and subsequent paragraphs was taken from Edgcomb, Elaine L., and Klein, Joyce A. February 2005. Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States. Aspen Institute, USA and from Burrus, William. Innovations in Microenterprise Development in the United States.

3.4.4 European Union

From the perspective of policy formulation and implementation, within the EU Group of twenty-seven countries (the EU 27) microenterprises have been placed in an enterprises category known as Micro, Small, and Medium-Sized Enterprises (SMEs). In the EU 27, microenterprises have been seen as the engine of the European economy. They have been an essential source of jobs, have created entrepreneurial spirit and innovation in the EU, and have therefore been crucial for fostering competitiveness and employment. For 2008, it was estimated that in the EU 27 there were some 20 million SMEs that provided around 65 million jobs and represented 99.0% of all enterprises.[18]

According to Kraemer-Eis and Conforti, typical microenterprises in the EU 27 have sought loans smaller than €25,000. For the better part, such microenterprises did not have access to traditional banking services. Kraemer-Eis and Conforti have also indicated that 99.0% of start-ups in Europe have been micro or small enterprises, and one-third of those enterprises have been launched by people who were unemployed. The authors also noted that not only was financial support for the microenterprise sector crucial, non-financial support measures, e.g. mentoring, training, and counselling were also important for the microfinance sector in Europe as well. Based on a survey by the European Microfinance Network (EMN), the authors estimated that two-thirds of clients of microfinance institutions were benefitting from assistance in helping them develop their businesses.[19]

Kraemer-EIS and Conforti also indicated that the major institutions disbursing microloans in the EU were credit unions, state banks, ethical banks, savings banks, and non-bank financial institutions. The vast majority of microfinance institutions in the EU 27 were not-for-profit organizations in the form of NGOs, foundations, or government bodies. The best financially performing institutions were located in Eastern European countries, especially in Romania and Bulgaria, where most microfinance institutions were established as for-profit entities. The absence of profit driven microfinance institutions in Western Europe was largely due to the perceived underlying risks associated with lending to microenterprises. The authors stated that, to the best of their knowledge, not a single microfinance institution in Western Europe had achieved financial stability, and market experts doubted whether this sustainability was possible. Thus, subsidies of some sort would be required indefinitely[20]

In general, SMEs in the EU 27 have often been confronted with market imperfections. Frequently, they have had difficulties in obtaining capital or credit, particularly in the early start-up phase. Their restricted resources would also have reduced their access to new technologies or innovation. In an effort to overcome these imperfections, the European Commission has therefore prioritised support for SMEs in its thrust to promote economic growth, job creation, and economic and social cohesion.

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[18] Kraemer-Eis, Helmut, and Conforti, Alessio. 2009. Microfinance in Europe: A Market Overview. European Investment Fund Research and Market Analysis, Working Paper 2009/001.

[19] Kraemer-Eis, Helmut, and Conforti, Alessio. 2009. Microfinance in Europe: A Market Overview. European Investment Fund Research and market Analysis, Working Paper 2009/001.

[20] Kraemer-Eis, Helmut, and Conforti, Alessio. 2009. *Op Cit.*

As part of the overall process of creating a more enabling business environment, the European Commission introduced a new definition for SMEs that took effect from 1st January 2005. That new definition has been seen as a major step that has the potential to promote an improved business environment, entrepreneurship, investments, and growth. Within the context of the EU, a generally accepted common definition of SMEs has tremendous significance. In a single market with no internal frontiers, it is essential that policy measures supporting SMEs are based on a common definition so as to improve the consistency and effectiveness of the policies and to limit distortions in competition. This approach has become all the more necessary given the extensive interaction between national and EU measures to help SMEs in areas such as regional development and research funding.

The European Commission first adopted a common definition of SMEs in 1996, and that definition was widely applied throughout the EU up to the time the new definition took effect. However, during the early 2000's, the Commission had agreed to review the 1996 definition because of changes in the economic landscape. On 6th May 2003, the Commission accepted the recommendation for the new definition. For EU Member States, use of the new definition is voluntary, but the Commission has encouraged the States, as well as the European Investment Bank (EIB) and the European Investment Fund (EIF), to apply it as widely as possible.

Exhibit 1 below provides the details of the 1996 definition and of the new definition that came into force on 1st January 2005. Since its introduction, the new definition has been applied to all the policies, programmes, and measures that the Commission has operated for SMEs.

Exhibit 1: Definition of SMEs in the European Union

Enterprise Category	1996 Definition			Definition in Force Since 1st January 2005		
	Headcount: Annual Work Unit (AWU)	Financial Performance – Annual Turnover OR Balance Sheet Total		Headcount: Annual Work Unit (AWU)	Financial Performance – Annual Turnover OR Balance Sheet Total	
		Turnover	Balance Sheet Total		Turnover	Balance Sheet Total
Micro	< 10	NA	NA	< 10	≤ €2 million	≤ €2 million
Small	< 50	≤ €7 million	≤ €5 million	< 50	≤ €10 million	≤ €10 million
Medium-sized	< 250	≤ €40 million	≤ €27 million	< 250	≤ €50 million	≤ €43 million

Source: European Commission. 2006. The new SME definition: User guide and model declaration. Enterprise and Industry Publications

Notes; NA means 'Not Applicable'.

The new definition was the result of wide-ranging discussions between the Commission, Member States, business organizations, and experts, as well as two open consultations on the Internet. In particular, the changes embedded in the new definition reflected the general economic developments since 1996, as well as the growing awareness of the specific hurdles that confronted SMEs. From the perspective of the various stakeholders, the new definition has been considered as more appropriate for the different categories of SMEs. In addition, the new definition has taken better account of the various types of relationships between enterprises.

Among the various stakeholders, it has been felt that the new definition has more potential to promote innovation and foster partnerships, while ensuring that only those enterprises that genuinely require support are targeted by public schemes.

The specific reasons for introducing the new definition were as follows:

- To update financial thresholds as a result of developments in prices and productivity. It was felt that the significant increase in the thresholds would allow an important number of enterprises to maintain their status of SMEs and thus ensure their eligibility for support measures;
- To promote microenterprises by establishing financial thresholds for them. The establishment of financial thresholds for microenterprises, for the first time, was intended to encourage the adoption of measures that addressed the specific problems microenterprises faced, especially during the start-up phase;
- To improve access to capital since such access has been a perennial problem SMEs in the EU. In the past, several SMEs often encountered difficulties accessing capital because they were unable to give the guarantees traditional lenders required. To help address this problem, the new definition would facilitate equity financing for SMEs by granting favourable treatment to certain investors, such as regional funds, venture capital companies, and business angels without the enterprises losing their status of SMEs. Under the new definition, a similar situation would apply small local autonomous authorities with annual budgets of less than €10 million and fewer than 5,000 inhabitants. Such authorities could invest in SMEs up to a certain percentage without the beneficiary enterprises being at a disadvantage when applying for grants;
- To promote innovation and improve access to Research & Development (R&D). Under the regulations accompanying the new definition, specific provisions have been made that allow universities and non-profit research centres to have financial stakes in SMEs. It was felt that the enactment of such provisions would lead to cooperation beneficial to both parties. The enterprises would be strengthened by having worthy financial partners and access to R&D, and the universities and research centres would have the opportunities for practical application of their research work; and
- To take account of the different relationships between enterprises. One of the main objectives of the new definition was to ensure that support measures were granted only to those enterprises that genuinely needed them. Thus, the regulations accompanying the new definition introduced methods to calculate the staff and financial thresholds of SMEs so as to gain a more realistic picture of the economic situation of the enterprises. To this end, a distinction was introduced between different types of enterprises; autonomous, partner, and linked. The regulations accompanying the new definition also contained safeguards to prevent abuses of SMEs status. Clear instructions have been provided on how to treat particular relationships between SMEs and other enterprises or investors when calculating the financial thresholds and staff headcounts of the enterprises. In essence, the new definition has taken into account the ability of SMEs to draw on outside finance. For example, enterprises that are linked to others with large financial resources could fall above the ceilings and would therefore not qualify for SMEs status.

In the application of the new definition, the first step to qualify as an SME is to be considered as an enterprise. According to the new definition, an enterprise is ‘any entity engaged in an

economic activity irrespective of its legal form'. Thus, the self-employed, family firms, partnerships, and associations regularly engaged in an economic activity may be considered as enterprises. It is the economic activity that is the determining factor, not the legal form.

In the application of the new definition, the staff headcount has been the crucial initial criterion for determining in which category an SME falls. The headcount covers full-time, part-time, and seasonal staff and includes the following:

- Full-time and part-time employees,
- Persons working indirectly for the enterprise (e.g. under contracts for service), but who have been considered as employees under national law,
- Owner-managers, and
- Partners engaged in a regular activity in the enterprise and who have been receiving financial benefits from the enterprise.

Apprentices or students engaged in vocational training with apprenticeship or vocational training contracts are not included in the headcount. Neither is time spent away from work for maternity or parental leave. The staff headcount is expressed in annual work units (AWU). Anyone who worked full-time within the enterprise, or on its behalf, during the entire reference year, is counted as one unit. Work done by part-time staff, seasonal workers, and those who did not work the full year are expressed as fractions of one unit.

The annual turnover is determined by calculating the income that SMEs received during the year in question from their sales of goods and services after any rebates have been paid out. Turnover should not include value added taxes (VAT) or other indirect taxes. The annual balance sheet total refers to the value of the entity's main assets.

In determining which category they fall under, SMEs have been required to establish whether their enterprises are autonomous, partner, or linked. entities. This is done by taking into account the relationships SMEs have with other enterprises. Depending on the nature of the relationships, the SMEs may need to add some or all of the staff headcount and financial data relating to those enterprises to the headcount and financial data of their own enterprises. The calculations for each of the three enterprise categories are different, and they ultimately determine whether enterprises satisfy the various ceilings established in the definition of SMEs. Enterprises that draw up consolidated accounts or that are included in the accounts of another enterprise that does so are usually considered as linked.

A SME has been defined as an autonomous enterprise if:

- It is totally independent, i.e., it has no investment in other enterprises and no enterprises have investments in it; or
- It has a holding of less than 25.0% of the capital or voting rights (whichever is the higher) in one or more other enterprises and/or other enterprises do not have a stake of 25% or more of the capital or voting rights (whichever is the higher) in the enterprise under consideration.

If an enterprise is autonomous, it means that it is not a partner or linked to another enterprise.[21] It therefore does not have to take into account any of the staff headcount or financial data relating to other enterprises.

Under the regulations accompanying the new definition of SMEs, exceptions have been provided for. An enterprise may still be ranked as autonomous, and thus as not having any partner enterprises, even if the 25.0% threshold was reached or exceeded by any of the following investors:

- Public investment corporations, venture capital companies, and business angels; or
- Universities and non-profit research centres; or
- Institutional investors, including regional development funds; or
- Autonomous local authorities with annual budgets of less than €10 million and fewer than 5,000 inhabitants.

Furthermore, the regulations have made it possible for an SME to remain autonomous while having one or more of the investors listed above. Each of these investors may have a stake of no more than 50.0% in the enterprise, provided they are not linked to one another (see footnote 14).

The designation of partner enterprise is made when an SME establishes major financial partnerships with other enterprises, without one exercising effective direct or indirect control over the other. Partners are enterprises which are neither autonomous nor linked to one another.

A SME has been defined as a partner enterprise if:

- It has holding equal to or greater than 25.0% of the capital or voting rights in another enterprise and/or another enterprise has a holding equal to or greater than 25% in the SME under consideration; or.
- It is not linked to another enterprise (see footnote 14). This means, among other things, that the voting rights of the SME in the other enterprise (or vice versa) do not exceed 50.0%.

An entity designated as a partner enterprise must add a proportion of the other enterprise's staff headcount and financial details to its own data when determining its eligibility for SME status This proportion will reflect the percentage of shares or voting rights, whichever is the higher, that is held by the SME under consideration.

An entity is considered to be a linked SME when its relationship with other enterprises is one where a group of other enterprises, either directly or indirectly, controls the majority of voting rights of the SME under consideration or have the ability to exercise a dominant influence on the enterprise.

Two or more SMEs have been defined as linked if:

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[21] It is possible for a SME to have several investors each with a stake of under 25.0% in the enterprise, and yet the SME is autonomous. This occurs when the investors are not linked to each other in the sense that they constitute a group through which they control, directly or indirectly, the majority of voting rights of the SME under consideration through which they have the ability to exercise a dominant influence on the SME.

- One enterprise holds a majority of the shareholders' or members' voting rights in another; or
- One enterprise is entitled to appoint or remove a majority of the administrative, management, or supervisory staff of another; or
- A contract between the enterprises, or a provision in the memorandum or articles of association of one of the enterprises, enables one to exercise a dominant influence over the other; or
- One enterprise is able, by agreement, to exercise sole control over a majority of shareholders' or members' voting rights in another.

A typical example of a linked enterprise is a wholly-owned subsidiary of a parent company.

An entity designated as a linked enterprise must add 100.0% of the staff headcount and financial details of the other enterprises to which they are linked when determining its eligibility for SME status Within the EU, most linked enterprises are generally aware of their status from the outset, since in most Member States such enterprises are required by law to draw up consolidated accounts or that their accounts are included by consolidation in the accounts of other enterprises. Where consolidated accounts are not prepared, but the enterprise to which the SME under consideration is linked also has links to a chain of other enterprises, the SME under consideration must add 100.0% of the data of all the linked enterprises to its own.

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4 BARBADOS - EXISTING POLICY FRAMEWORK FOR THE MSME SECTOR

4.1 Overview

Within the last twenty years or so, the Government of Barbados has paid significant attention to the microenterprise sector. As in several other developed and developing countries, the Government recognised that, given the features of the Barbadian economy, sole reliance could not be placed on the public sector and on the traditional private sector to generate employment opportunities for all those individuals who were interested in joining the labour force. Thus, in a sustained incremental approach, the Government instituted a series of policy measures capable of unleashing the potential of the microenterprise sector to generate significant economic activity. In many ways, the efforts of the Government have been successful; yet, the full potential of the microenterprise sector has not been realized. Thus, there is still the need for the Government to refine its existing policy framework, and to introduce new measures, where necessary, in its efforts to realize the full potential of the microenterprise sector.

The institutional and policy measures that were introduced over the last twenty years or so were not targeted solely at the microenterprise sector; they were directed at what we have labelled as the MSME sector, a sector comprising a heterogeneous mix of enterprises that did not, in the past, receive the attention they deserved in terms of the focus of Government policy. We have, therefore, attached significant importance to the documentation of the policy framework that has evolved over the last twenty years or so for the MSME sector.

4.2 Summary of Policy Developments for the MSME Sector

Over the last several years, the MSME sector in Barbados has grown substantially. Most of the growth in the sector can be associated with the overall economic progress the island has experienced. To some extent, however, the efforts of the Barbados Small Business Association (BSBA) have contributed to that growth.

As a result of both the lobbying efforts of the BSBA and the adoption by the Government of a more positive and focussed approach to the MSME sector, several policy measures favourable to the sector were implemented following the re-establishment of the BSBA in 1993. These measures included the following:

i. Establishment by the Government in 1995 of the Small Business Development Unit (SBDU) within the then Ministry of Commerce, Consumer Affairs, and Business Development;
ii. Establishment by the Government in 1995 of the Youth Entrepreneurship Scheme (YES);
iii. Beginning in FY1996-97, provision of an annual grant to the BSBA to help finance the operations of its Secretariat;[22]
iv. Provision in FY1996-97 by the Government of equity capital of $2.0 million to the BSBA to establish SBVCI;

[22] FY means fiscal year of the Government, which begins on 1st April of one calendar year and finishes on 31st March of the next calendar year.

v. Commencement of operations on 2nd January 1998 of the Enterprise Growth Fund Limited (EGFL) and the Barbados Agency for Microenterprise Development, the latter commonly known as FundAccess;
vi. Opening in 1998 of a Small Business Centre by the Barbados Investment and Development Corporation (BIDC);
vii. Enactment in 1999 of the Small Business Development Act (SBDA);
viii. Establishment of Enterprise Units at the Urban and Rural Development Corporations;
ix. Establishment in 2001 by the BIDC of a Special Technical Assistance Programme (STAP) for small and medium-sized businesses;
x. Establishment by the Government in 2003 of an Innovation Fund;
xi. Re-branding in 2007 of the Small Business and New Enterprise Division of the BIDC as the Entrepreneurial Development Division (EDD); and
xii. Establishment by the Government in 2008 of a National Microenterprise Programme.

4.3 The Barbados Small Business Association

The BSBA is a non-profit NGO that serves as the umbrella body for micro, small, and medium-sized enterprises in the island. The Association was incorporated as a non-profit entity on 31st March 1982 under the Companies Act 303, but after several years of dormancy it was re-established in 1993. It officially opened its Secretariat in December 1995.

Membership in the BSBA is open to all businesses that meet the criteria of:

- Annual sales of less than $5.0 million; and
- Less than fifty employees.

With the official opening of its Secretariat, the mandate of the BSBA was identified as follows:

- To expand business opportunities for members;
- To provide educational and developmental services for members;
- To facilitate access to financing for members; and
- To lobby the Government of Barbados for the formulation and implementation of policies that provides an enabling environment for the growth and sustainability of the MSME sector.

Given its mandate or mission for its members, the BSBA has sought to promote their success through the development of advocacy programmes and through the provision of financial and training opportunities to bring about long-term stability and growth within the sector. In the fulfilment of its mission, the BSBA has sought to create business opportunities for its members; provide services that are conducive to better business practices, e.g. services in the accounting, management, marketing, human resources, and legal areas; and to explore opportunities for additional business financing for its members.

The guiding principle of the BSBA lies in its core philosophy which holds that working together provides the best opportunities for businesses to grow. With this principle in mind, the BSBA has sought to establish committed relationships with business organizations and industry partners to create networking opportunities for members in a spirit of aggressive endeavours, mutual

support, and pooling of resources (skills, time, and finances) in an effort to build capacity and to create wealth.

Over the years, the core philosophy of the BSBA has seen the organization reap considerable success in its efforts lobbying the Government for the creation of an environment in which the micro, small, and medium-sized business sector could continue to grow and develop. Major outcomes of the BSBA's lobbying efforts have been the provision of financing for micro businesses, increased access to equity funding for small and medium-sized enterprises, and the introduction of factoring.

So as to facilitate the implementation of its broad mandate, while at the same time contributing to its own sustainability, the BSBA incorporated two wholly owned subsidiary companies; in 1997 the Small Business Venture Capital Inc. (SBVCI) and in 1998 the Small Business Association Enterprise Inc. (SBAEI). SBVCI provided equity financing to qualifying members of the BSBA, while the mandate of SBAEI was to assist members of the BSBA members develop commercial opportunities and increase their revenue streams. SBAEI fulfilled its mandate by facilitating joint tendering on contracts by members of the BSBA, by developing marketing and promotion programmes for the BSBA's sectoral groups, and by generating commercial projects that could be outsourced to members of the BSBA.

In addition to effectively lobbying the Government and other agencies on behalf of its members, the BSBA provides, for members, access to free education and training, group marketing, financial services, and a substantial programme of discounts for essential business services such as internet communications and advertising.

4.4 Small Business Development Unit

In 1995, the SBDU of the then Ministry of Commerce, Consumer Affairs, and Small Business Development was established. Operations of the SBDU commenced in 1996, and several tasks were assigned to the Unit, including:

i. Advising the Minister on the formulation of policy for the development and expansion of the small business sector;
ii. Review of the operations of the institutions and programmes geared at that time towards the small business sector;
iii. Identification of the main elements of the sector, including the collection and collation of information on the names of the entities; on their locations, start-up dates, and markets; on the numbers of employees; and on the values of capital employed in the operation of the businesses;
iv. The undertaking of research in areas such as project development, marketing and promotion, management, finance, and training;
v. The provision of advice relating to the management and operations of the soon to be established venture capital funds;
vi. Collaboration with the agencies working with small businesses so as to facilitate the delivery of quality services to the sector;

vii. The carrying out of and the facilitation of research relating to the growth and development of small businesses;
viii. The formulation and implementation of planning policy designed to facilitate the development of small businesses; and
ix. The conceptualisation and implementation of projects designed to assist small businesses to become internationally competitive and to adjust to the changes in market forces associated with the implementation of the Caribbean Single Market and Economy (CSME), the Free Trade Area of the Americas (FTAA), and with the implementation of the trading guidelines and policies of the World Trade Organization (WTO).

Following the carrying out of significant preparatory work, the then Ministry of Commerce, Consumer Affairs, and Business Development sought to address some of the challenges of the small business sector by launching a Small Enterprise Development Initiative (SEDI). The SEDI was premised on four planks; viz:
i. Enhanced legislative, regulatory, and fiscal treatment for the small business sector;
ii. Expanded training opportunities for entrepreneurs;
iii. Easy access to business information and to technology services for the sub-sector; and
iv. Expanded access to capital for start-up and emerging small businesses.

4.5 Youth Entrepreneurship Scheme

4.5.1 Background

YES was established in 1995 within the Division of Youth Affairs in the then Ministry of Education, Youth Affairs, and Sports.[23] The main objective of YES was to foster individual entrepreneurial development by targeting potential young entrepreneurs between the ages of eighteen and thirty through the provision of a broad spectrum of business development services that can aid in the nurturing the entrepreneurial spirit.[24] The range of services currently provided by YES to its clients includes the following:

- Entrepreneurial development training;
- Marketing services;
- Accounting services;
- Mentoring;
- Technical assistance and business counselling;
- Financial counselling and referrals; and
- YES juniors.

4.5.2 Entrepreneurial Development Training:

The aim of the entrepreneurial development training programme has been to provide YES

[23] The current parent ministry is the Ministry of Family, Culture, Sports, and Youth.
[24] The staff members initially hired by YES were trained by the Small Business and New Enterprise Division of the BIDC.

participants prerequisite skills necessary for managing and operating a successful business. This training is conducted biannually over two six month sessions. Sessions normally commence in April and October, and the training is conducted on a modular basis. In addition, workshops dealing with selected topics are also conducted. The following basic modules have been typically delivered in each training session:

- How to get the most out of training;
- Business support tools;
- Personal development - The Virtues Project;
- English for business;
- Enterprise development;
- Customer management;
- Steps for entering the market place;
- Accounts;
- The computer as a business tool; and
- Business labs.

The workshops held at each training session usually included:

- Protecting intellectual property;
- Time management;
- Acquired Immune deficiency Syndrome (AIDS) in the workplace;
- Skills development for sales personnel;
- Business etiquette;
- Human resources management;
- Determining the legal structure of business;
- Risk management;
- Taxation;
- The National Insurance Scheme;
- Labour laws;
- Public speaking;
- Negotiation skills;
- Finance planning; and
- Branding and image building.

Participants who successfully completed the training sessions were presented with certificates at the biannual graduation ceremonies.

4.5.3 Marketing Services

YES has been providing a comprehensive package of marketing services for its clients. The marketing services programme strives to effectively market the goods and services of the emerging businesses that fall under the YES developmental programme. This is accomplished through the provision of affordable cost sharing marketing facilities. The current components of the marketing services programme are:

- The business directory;

- The marketing consultancy service;
- The YES! Magazine; and
- The living the dream television series.

4.5.4 Accounting Services

The aim of the accounting services programme is to enable the clients of YES to make informed financial decisions that can positively influence the financial viability of their businesses. The programme provides recording keeping and financial management support to entrepreneurs who are unable to perform their own record-keeping, financial analysis, and accounting functions. In order to qualify for accounting services the entrepreneur must:

- Be a client of YES;
- Have a company, be a member of a partnership or other business association, or have registered a business name, and the relevant business entity must be in operation;
- Be operating solely or jointly a business entity that has a consistent and satisfactory level of monthly sales; and
- Establish, to the satisfaction of YES, that he/she can meet deadlines, complete appropriate invoices and receipts, deliver a consistent product or service, and be generally dependable and reliable.

Entrepreneurs can access the accounting services for a maximum period of one year divided into two six-month phases, 1st April to 30th September in one calendar year and 1st October of one calendar year to 31st March of the following year.

4.5.5 Mentorship Programme

The aim of the mentorship programme is to provide ongoing support to young entrepreneurs to help them overcome challenges that arise from time to time. Mentors are drawn from a pool of professionals and successful business owners, and entrepreneurs are matched with suitable mentors who can identify and relate to their situations and perspectives. The mentorship programme seeks to:

- Provide mental and emotional support to young entrepreneurs to help them develop positive self-images;
- Provide young entrepreneurs with individual guidance and support when they are confronted with personal and business challenges;
- Direct young entrepreneurs to business contacts from which they can acquire assistance and support services; and
- Provide young entrepreneurs with ongoing monitoring and coaching relating to the process of visioning and goal setting.

The philosophy of YES has been that successful mentoring helps young entrepreneurs considerably by:

- Helping them to discover their abilities;
- Building their self confidence;

- Exposing them to growth experiences;
- Helping them to develop trust;
- Encouraging professional behaviour;
- Heightening their self-awareness; and
- Empowering them to confront negative behaviours and attitudes.

4.5.6 Technical Assistance and Business Counselling Programme

The aim of this programme is to provide access for young entrepreneurs to relevant and appropriate technical expertise when needed. The technical expertise and business counselling is provided by officers of YES and by private consultants drawn from the network of technical partners of YES.

4.5.7 Financial Counselling and Referrals Programme

As part of its overall mandate to foster the development of entrepreneurship in the island, YES facilitates links between young entrepreneurs and financial institutions that understand the needs and constraints of such entrepreneurs..

4.5.8 YES Juniors Programme

YES Juniors is an entrepreneurial-based education programme that targets students in the primary and secondary schools of Barbados. Its long-term objective is the development of the entrepreneurial spirit among the youth. Under the Programme, students are taught the practical skills needed for starting and operating a business. Students are also exposed to the concepts of entrepreneurship and entrepreneurship education. It is felt that by having such early exposure these potential entrepreneurs will:

- Develop self confidence;
- Develop individual creativity;
- Recognize potential business opportunities;
- Realize the potential to own a business; and
- Become aware of self employment as a viable career option.

In an effort to identify the accomplishments of YES to date, the Consultant contacted the Manager of YES and requested information on the achievements of the Scheme. The Consultant was advised to formally write the Permanent Secretary, Ministry of Family, Culture, Sports, and Youth to seek approval for the provision of the information by the Manager of YES. The formal correspondence to the Permanent Secretary, which was also copied to the Manager of YES, was delivered on 9th August 2011. At the date of submission of 15th September 2011 for the Draft Final Report, no response had been received to our letter of 9th August 2011. Subsequently, correspondence dated 17th October 2011 was received from YES, and that correspondence indicated that, 'Permission has been given by the Minister, Ministry, Family, Culture, Sports, and Youth for YES to assist with the provision of all available information as requested for completion of the Study. Please note that it has been requested by the Minister, that all findings and outcomes associated with this Study be shared with the Ministry.' Given the late response of YES and the time line for submitting the Final Report, the Consultant decided not to pursue the request for information on the accomplishments of YES to date.

4.6 Annual Grant to the Barbados Small Business Association

Beginning in fiscal year FY1996-97, the Government of Barbados provided the BSBA with an annual grant to help finance the operational cost of the Association's Secretariat. For fiscal years 1996-97 to 2005-06, the amount of the annual grant was $0.35 million. For fiscal years 2006-07 to 2009-10, the amount of the annual grant was increased to $1.0 million, with the excess over the $0.35 million being allocated for the decentralization of the BSBA's activities. Consequently, the BSBA was able to establish branch offices in the south (St. Philip) and north (St. Peter) of the island. Following the financial constraints experienced by the Government associated with the world-wide recession that began in late 2008, the annual grant was reduced to $0.95 million in FY2010-11 and to $0.55 million in FY2011-12.

Due to the reduction in the annual grant provided by the Government, the BSBA closed its branch office in St Peter.

4.7 Equity Capital for the Small Business Venture Capital Inc.

With the primary purpose of facilitating access to financing for its members, the BSBA incorporated SBVCI in 1997 with equity capital of $2 million provided by the Government of Barbados. Sometime later, additional equity capital of $1.0 million was provided by the Government. SBVCI used the capital given by the Government to provide equity financing to qualifying members of the BSBA.

It would appear that the equity financing initiatives of SBVCI were not as successful as the organisation would have wished, and that lack of desired success has had a dampening effect on SBVCI. SBVCI continues to be operational, but at a low-key level.

4.8 Enterprise Growth Fund Limited

4.8.1 Backgroun d

Sometime in 1996 or 1997 the Government of Barbados made the decision to terminate the operations of the Barbados Development Bank (BDB) because of the significant cumulative losses incurred by the Bank since its establishment. The decision to terminate the operations of BDB was one of the pre-conditions for an Investment Sector Loan provided by the IDB to the Government.

Nevertheless, recognizing that there would still be the need for access to development finance, a study was commissioned to determine the appropriate legislative, regulatory, and fiscal framework under which a new development finance institution could efficiently provide financing on suitable terms and conditions for businesses in the small and medium-sized enterprise sector (SME Sector).

In the report, 'Institutional Framework for the Future Direction of Development Finance in Barbados', one of the major findings of the study was that the establishment of a new development finance institution was necessary to replace BDB, but the role of Government in the activities of that institution should be limited. It is within this context that EGFL was established as a private sector led institution in which the Government would play a catalytic role through the provision of seed capital and tax concessions for investments of equity capital by the private sector in the institution.

On 2nd January 1998, EGFL commenced operations as a limited liability company providing venture capital to the SME Sector. The initial aim of EGFL was to become a minority shareholder in, and partner to, the dynamic enterprises that had significant potential for growth and development.

At the start of its operations, EGFL received initial equity capital injections of $3.8 million, comprising:

- $1.0 million from Sagicor Life Insurance;
- $1.0 million from the Central Bank of Barbados (CBB);
- $1.0 million from the National Insurance Scheme (NIS);
- $0.5 million from RBTT Bank; and
- $0.3 million from Collection, Recoveries, and Liquidation Limited (CRL), an agency established by the Government to recover outstanding funds owed to the BDB.

Soon after the commencement of operations by EGFL, it became apparent that the private sector was not keen on investing equity capital in the institution and that the local entrepreneurial class did not have a strong preference for venture capital financing alone. In response to this, EGFL was repositioned as a Fund Manager offering loans from dedicated, sector-specific funds that the Government quickly established and entrusted to EGFL to manage. A few years later, in 2004, EGFL started offering loans from its own account. These developments have enabled EGFL to cater to a wider cross-section of businesses and have allowed it to fulfil its overall mandate of providing development finance to the critical SME Sector.

Currently, EGFL provides, on its own account, both venture capital and loan financing to both start-up and existing businesses in the SME Sector. The minimum amount for both types of financing is $0.1 million and the maximum amount is $1.5 million.

To qualify for funding, a company must be considered as a small or medium-sized business, satisfying at least two of the following criteria:

- The market value of the company's fixed assets must be greater than $0.025 million but less than $1.0 million;
- The number of employees must be greater than five but must not exceed two hundred; and
- Annual sales of the company must be between the range of $0.1 million and $7.5 million.

For loan funding, security is required, usually in the form of a legal charge over assets acquired with the proceeds of the loan and any other collateral that might be deemed necessary

Other services provided by EGFL on its own account include:

- Technical assistance up to a maximum of $0.07 million per investee company; and
- Business advisory services to help clients turn their profit potential into solid business gains.

As indicated earlier, EGFL also provides financing from several specific, dedicated sector funds established by the Government. These sector funds are:

- The Small Hotels Investment Fund (SHIF);
- The Tourism Loan Fund (TLF);
- The Agricultural Development Fund (ADF);
- The Industrial, Investment, and Employment Fund (IIEF); and
- Export Promotion and Marketing Fund (EPMF).

4.8.2 Small Hotels Investment Fund

The resources of SHIF are used to provide loans to small hotels for financing of projects and programmes relating to marketing, management, procurement of joint services, and refurbishment of properties. SHIF finances projects and programmes that clearly have the potential to enhance the financial viability and operational performance of the small hotel sector. The resources of SHIF are restricted to the Small Hotels of Barbados Inc. (SHBI) and its members whose properties comply with the minimum standards established by the European Travel Trade.

Loans to SHBI are for projects and programmes being implemented by SHBI as a group, and the maximum amount for such loans is $5.25 million. While there is no specified minimum amount for loans to SHBI, the minimum amount for loans to individual members of SHBI is $0.05 million. Loan repayment periods are ten (10) years or less including a five (5) year moratorium on the repayment of interest and principal. Security on loans generally takes the form of a first legal mortgage, but the Fund is prepared to take second mortgages in instances where 80.0% of

the market realisation value of the underlying security is adequate to liquidate all prior charges and the Fund's exposure.

4.8.3 Tourism Loan Fund

The resources of the TLF are used to provide loans for the refurbishing and upgrading of eligible hotels and attractions and/or for the construction of facilities to be used for the purpose of carrying on business in the areas of historical, cultural, and natural heritage attractions. Funding for the accommodation sub-sector is restricted to properties with seventy-five rooms or less, while for the attractions sub-sector the range of the projects can be limitless provided that the projects satisfy the historical, cultural, and natural heritage criteria.

The maximum loan size is the higher of $4.5 million or 15.0% of the total capitalization of the Fund and the minimum loan size is $0.05 million. Security on loans will generally take the form of a first legal mortgage, but the Fund is prepared to take second mortgages in instances where 80.0% of the market realisation value of the underlying security is adequate to liquidate all prior charges and the Fund's exposure.

4.8.4 Agricultural Development Fund

The objective of the ADF is to help entities operating in the farming and fishing sector become more competitive. ADF loans range from a minimum of $0.05 million to $1.0 million. The Fund also provides incentives, technical assistance, and grants.

To qualify for assistance from the ADF an entity must be registered with the Ministry of Agriculture and Rural Development and be issued with a farm or fishing registration identification card. The entity must also be registered with both the VAT Office and the NIS and must show evidence of compliance with the regulations of those two organizations.

Security for loans is required, usually in the form of a legal charge over assets acquired with the proceeds of the loan and any other collateral that might be deemed necessary.

4.8.5 Industrial, Investment, and Employment Fund

The IIEF provides loan financing to manufacturing enterprises that have the potential to add significant value to the Barbadian economy by being a net earner/saver of foreign exchange and/or by generating employment. Eligible entities must be limited liability companies in which at least 51.0% of the share capital is owned by residents of Barbados.

IIEF loans range from a minimum of $0.05 million to $2.0 million. Security is required, usually in the form of a legal charge over assets acquired with the proceeds of the loan and any other collateral that might be deemed necessary.

4.8.6 Export, Promotion, and Marketing Fund

The EPMF was created to provide funding by way of grants to corporate entities, including statutory corporations, involved in the business of exporting or the promotion of exports. The grants are used for the development, promotion, and marketing of products and services.

Projects, programmes, and activities funded by the EPMF include the following:

- Establishment of pioneer/pilot projects aimed at the export market;
- Training courses, symposia, seminars, and workshops on all aspects of export promotion;
- Export market research;
- Advertising and publicity campaigns in foreign markets including press/radio/television, catalogues, brochures, etc.;
- Product design;
- Participation in trade missions, buyer-oriented activities, overseas trade fairs, exhibitions, and promotions;
- Collection trade information;
- Joint ventures for the development of Barbadian goods and services in foreign markets; and
- Any other activity which supports the export of goods and services.

As at 31st December 2010, the total capitalisation of EGFL for the eight funds in its portfolio was $266.6 million. Since its inception, EGFL received 588 applications for financing of which 256 were approved. The total value of financing for the approved applications was $228.4 million. Total disbursements amounted to $236.5 million, of which grants totalled $99.6 million, loans $119.4 million, and equity/bonds $17.5 million. The estimated number of jobs created or sustained as a result of the operations of EGFL was 2,795. Financing for the hotel accommodation sub-sector was estimated to have resulted in the construction or rehabilitation of 1,192 hotel rooms. At the end of 2010, the outstanding commitments of EFGL amounted to $13.4 million.

4.9 FundAccess

4.9.1 Background

Also emerging from the study, 'Institutional Framework for the Future Direction of Development Finance in Barbados', was the recommendation that a separate financial institution should be established to cater to the smallest of enterprises in the SME Sector, i.e. the micro business sector. This recommendation was realized with the commencement of operations of the Barbados Agency for Microenterprise Development, commonly known as FundAccess, on 2nd January 1998.

The initial equity resources for on-lending were provided by CRL Limited, a successor institution to the BDB, CBB, and the NIS. Apart from its provision of equity, CRL also provided funding for the financing the operational expenses of FundAccess for its first three

years.

FundAccess provides loans ranging from as little as $700 to $0.1 million to start-up and existing microenterprises. The projects or activities financed by FundAccess must be commercially viable, and, once implemented, must constitute the primary source of income and employment for the applicants. Business plans may be required for loans in excess of $0.05 million, and applicants must demonstrate the willingness to be trained in enterprise development and to receive technical assistance from FundAccess. Security for the loans is required and typically takes the form of guarantees from two to three individuals.

As intimated, FundAccess also provides business development services to its clients. These services include:

- Microenterprise training;
- Technical assistance;
- Workshops and seminars; and
- Accounting services.

4.9.2 Microenterprise Training

Shortly after approval of their loans, clients of FundAccess are required to complete a compulsory two-day microenterprise training programme. The training programme consists of the following modules:

- Personal development;
- Customer service and marketing;
- Cash management; and
- Records keeping.

The training style is participatory and sensitive to the educational limitations of participants.

4.9.3 Technical Assistance

Through scheduled visits from its Business Development Officers, FundAccess provides ongoing support to clients in an effort to ensure the success of their businesses. The support is provided in areas that may have been addressed in the training programme as well as in financial analysis, strategy, and the development of marketing and advertising proposals. Where necessary, the technical assistance may involve further training delivered by external consultants.

4.9.4 Workshops and Seminars

In an effort to deepen their awareness of the need for good business practices and to foster the development of their businesses, FundAccess also coordinates business development workshops and seminars for its clients. Topics covered in the workshops and seminars include financial management, human resources management, and marketing for microenterprises.

As at 30th September 2011, almost fourteen years after it started operations, FundAccess had approved 1,236 loans totalling $33.1 million to 987 entities. Of the 1,236 loans, 109 were second loans and 140 were refinancing loans. The interest rate on loans as of that date was 6.0% on the reducing balance, and the maximum repayment period was ten (10) years. FundAccess has estimated that its financing activities have resulted in the creation of 1,270 employment opportunities.

4.10 Small Business Centre of BIDC

As part of its overall effort to emphasize the importance of microenterprises and small businesses, the BIDC constructed a special purpose facility for the specific purpose of providing a range of services to microenterprises and small businesses. That special purpose facility, the Small Business Centre, opened in 1998. The BIDC's Small Business and New Enterprise Division, which had been established since 1992, relocated its operations to the Small Business Centre when the latter opened.

During its years of existence, the Small Business and New Enterprise Division provided a variety of services to microenterprises and to small businesses. The services included the provision of assistance to small businesses in the form of grant funding up to a maximum of $50,000 per entity. Both start-up and existing businesses were eligible for the grants, which could be used for a variety of purposes including working capital, productivity enhancement; marketing, and production process enhancement. The grant funding was disbursed on an incremental basis based on activities agreed on by BIDC and the beneficiary entity. Export oriented companies were also eligible for similar types of assistance from the Export Division of BIDC.

With the opening of the Small Business Centre, the BIDC began to emphasize the provision of assistance that could make a greater positive impact on the development of the entrepreneurial spirit. This assistance included the services of the Incubator Centre and of the Small Business Centre itself.

The Incubator Centre is located in the Small Business Centre, and it has facilitated the development of entrepreneurism in the island by providing facilities for start-up microenterprises and for existing microenterprises that have outgrown their previous facilities. In addition, the Small Business Centre provides office space and space for light manufacturing for as many as ten to twelve businesses. Entities pay a small stipend for the space they occupy, and they can occupy the space for as long as three years.

In addition to the above, micro entrepreneurs (actual and potential) and owners (actual and potential) of small businesses have access to a range of other services and facilities provided by the Small Business Centre. These include:

- A resource centre with access to the Internet;
- Secretarial assistance;
- Photocopying and faxing services;
- Rooms for holding meetings;

- Training rooms;
- Focussed training, e.g. training in the areas of Hazard Analysis and Critical Control Points (HAACP) standards, financial management, and operational development;
- Business planning training;
- Training in the preparation of applications for loans;
- Training in writing business proposals; and
- In general, access to the staff of the Small Business Centre.

4.11 Small Business Development Act

The first early outcome of the SEDI was the enactment of the SBDA in 1999 (Chapter 318C of the Laws of Barbados). In 2006 the Act was amended, and the purpose of the SBDA as amended was "to provide for the establishment of a regulatory framework that would facilitate the growth of the small business sector in Barbados and contribute towards the socio-economic development of Barbados". The SBDA, given its definition of a small business, sought to stimulate the development of that sub-sector through the provision of tax incentives for those businesses that qualified under the Act.

Subsections (1) and (2) of section 3 of the principal Act as amended provide that a small business is an enterprise that:

(1) For the purposes of the Act, a small business is an enterprise that:
  (a) Is incorporated under the Companies Act;
  (b) Has satisfied any two of the following criteria:
    (i) Has not more than $1.0 million as stated or paid up capital;
    (ii) Has not more than $2.0 million in annual sales; and
    (iii) Has not more than 25 employees;
  (c) Subject to subsection (2), is not more than 25.0% owned or controlled by a company whose share capital and annual sales exceed the share capital and annual sales mentioned in paragraph (b) or by a subsidiary of that company or by a subsidiary of a large group of companies;
  (d) Is not controlled by a company whose share capital and annual sales exceed the share capital and annual sales mentioned in paragraph (b) respectively; and
  (e) Has no agreement for the payment of fees on a continuing basis for managerial or other services to any person where those services do not form part of the normal business operations of the enterprise.

(2) Paragraph (c) of subsection (1) does not apply to a small business that is financed by venture capital.

With regard to application for the status of an approved small business, subsections (1) to (3) of section 4 of the principal Act as amended provide that:

(1) A small business that is desirous of becoming an approved small business may make an application to the Minister in the manner specified in subsection for that purpose.

(2) An application under subsection (1) shall be duplicate in the Form 1 or 1A set out in the First Schedule and shall be accompanied:
  (a) By a certificate of incorporation;

(b) By a certificate from the Commissioner of Inland Revenue, from the Commissioner of Land Tax, from the Director of the Value Added Tax Division, and from the Director of the National Insurance Department, where appropriate, stating that all liabilities for the payment of taxes and national insurance contributions in respect of the small business have been discharged;

(c) Where the business has gross assets or gross revenue which:

(i) Exceed $1.0 million, by an audited financial statement; or

(ii) Do not exceed $1.0 million, by a review engagement for the financial year immediately preceding that in which the application is made;

(d) Where the business has been in application for less than one year, by a statement of financial projections for a period of three years from an accounting organization or a qualified accountant; and

(e) By such other information as the Minister considers necessary to enable him to make a decision.

(3) An application under subsection (1) shall contain the following information:

(a) The name, residential address, and occupation of each shareholder and director;

(b) The number of shares held or to be held by each shareholder in the company to which the application relates;

(c) The names of all other companies in which the shareholders and directors referred to in paragraph (a) are also shareholders or directors and the extent of any such shareholding;

(d) The names of the directors and shareholders of any company affiliated with the small business and the number of shares held by them;

(e) The type of business and location;

(f) The actual or estimated investment in plant and equipment;

(g) The number of persons employed or to be employed;

(h) The estimated annual income of the business;

(i) Where applicable, particulars to enable a determination of the level of exports, foreign exchange earnings, and foreign exchange savings; and

(j) The date of the commencement of the business or the date on which the business is likely to commence, as the case may be.

With regard to the designation of a small business as an approved small business, subsection (4) of section 4 of the principal Act as amended provides that:

(4) Where an application referred to in subsection (1) has been made and the Minister is satisfied that the business:

(a) Is a small business within the meaning of section 3(1); and

(b) Carries on any activity which is of significant or substantial socio-economic benefit to Barbados;

The Minister may by order declare the business to be an approved small business.

Section 7 of the principal Act as amended details the incentives applicable to approved small businesses. The subsections of that section are as follows:

(1) Subject to the provisions of the Act, the Minister may grant to an approved small business one or more of the incentives specified in subsection (3) where he is satisfied that the business will be of significant or substantial socio-economic benefit to Barbados.

(2) Where any approved small business is one of a group of companies or is associated or affiliated with or controlled by another body corporate, only one such approved small business shall be eligible to receive any of the incentives specified in subsection (3).

(3) Subject to subsection (2) and notwithstanding any enactment to the contrary, an approved small business is entitled to any one or more of the following incentives subject to such conditions as are specified in this section:

(a) The payment of corporation tax at the rate of 20.0% on the profits of the business;

(b) Exemption from import duty on raw materials and on plant and equipment imported for use in the business;

(c) Exemption from withholding tax on dividends and interest earned on investment in an approved small business or in any fund approved for investment in small businesses;

(d) Exemption from the payment of stamp duty under the Stamp Duty Act on all documents related to the business where the registration of those documents is required by law; and

(e) A deduction of corporation tax of an amount equal to 20.0% of the actual expenditure incurred in respect of the use of technology, market research and any other activity that is, in the opinion of the Commissioner of Inland Revenue, directly related to the development of the business.

(4) An approved small business shall not be eligible for the incentive specified in paragraph (b) of subsection (3) where any income earned by that business is derived from the rental of its plant and equipment.

(5) The deduction of tax specified in subsection (3) shall be limited to the tax payable by the approved small business and no deduction shall be allowed to the extent that the amount sought to be deducted is in excess of the tax that is payable by the enterprise.

(6) An approved small business that has been granted incentives under subsection (3), shall permit the Minister to inspect, at all reasonable times, the books, records, and accounts of the business.

(7) All incentives granted to an approved small business under this Act shall terminate if the business ceases to qualify as a small business for three consecutive years.

(8) An approved small business shall not be eligible for any of the incentives specified in subsection (3) where it fails to comply with the provisions of section 5 or 6.[25]

(9) In this section "socio-economic benefit" means:

(a) The generation of new investment or the development of products or processes;

(b) An improvement in employment, production capacity through market research, technical invention or innovation; or

(c) The enhancement of export potential, foreign exchange earnings or savings, or the general welfare of persons in Barbados.

(10) An approved small business shall not be eligible for any incentives under the *Tourism Development Act*, the *Fiscal Incentives Act*, the *Special Development Areas Act*, or the *Shipping Incentives Act*.

(11) An approved small business that has been granted incentives under paragraph (b) of subsection (3) shall:

(a) Keep a record of the articles imported; and

[25] Section 5 deals with the registration of small businesses and section 6 deals with changes in the registration particulars of approved small businesses.

(b) Permit the Comptroller of Customs or a person authorised by him, to inspect, at all reasonable times, such records and to have access to any premises under its control for the purpose of verifying the accuracy of the particulars contained in the record.

Under the principal Act as amended, approved small businesses are also eligible for loan guarantees under the Credit Guarantee Scheme administered by the CBB and for technical assistance whether delivered by a Government department or agency or by an approved private sector organization.

As of 28th February 2011, there were one hundred and sixty-six (166) applications for approved small business status under the SBDA and seventy-five (75) of those applications were approved. The approved status granted to three (3) companies was subsequently revoked, one (1) approved business was acquired by a larger company to which the SBDA was not applicable, and one (1) approved business terminated operations. Thus, there are currently seventy (70) approved small businesses in operation under the Act.

4.12 Establishment of Enterprise Units at the Urban and Rural Development Corporations

The Urban Development Corporation (UDC) and the Rural Development Corporation (RDC) were established in the late 1990's by the Government of Barbados. The mandate of the UDC was to carry out infrastructural work, including the provision of housing solutions for the both the elderly and non-elderly poor, within a well defined urban corridor. For the RDC, the mandate was similar except that the target area was a rural corridor. A few years after they commenced operations, both the UDC and the RDC established Enterprise Units that provided loans up to a maximum of $10,000 to small and micro businesses operating within their respective geographical regions.

Official data on the lending operations of the Enterprise Units at the UDC and RDC was not available.

4.13 Special Technical Assistance Programme of BIDC

In 2001 BIDC introduced a STAP that targeted three types of businesses in the SME Sector; viz:

- Businesses exporting or planning to export;
- Businesses operating in the basic industries sector; and
- Under-performing businesses, presumably whether producing for export and/or operating in the basic industries sector.

The basic industries sector was defined as comprising of companies operating within the furniture, apparel, beverages, condiments, and craft sub-sectors. Under-performing companies

were defined as those whose sustainability was undermined by deficiencies including, inter alia, weak management capabilities.

The objectives of the Programme were to:

- Foster the development of a sustainable and internationally competitive export sector that embraced both products and service providers;
- Assist indigenous enterprises to develop and expand their share of the local market; and
- Assist enterprises to achieve independent financial sustainability.

The maximum level of assistance available under the STAP was $0.4 million, and there were two basic eligibility criteria that applied to all enterprises seeking assistance. Those criteria were as follows:

- The businesses were registered and operating for at least one year; and
- The businesses were located in Barbados and at least 51.0% of the shares were owned by residents of member states of the Caribbean Community (CARICOM).

In addition to the two preceding criteria, there was one other basic requirement from which under-performing entities were exempt; namely;

- The businesses were in good financial standing with the National Insurance Scheme, the Inland Revenue Department, the Value Added Tax Office, and the BIDC.

In the early years of operation of the STAP, funds provided to businesses in the export and/or basic industries sectors were to be used for:

- Human resources development, training, and productivity enhancement;
- Marketing, including research, product design, packaging, and promotion;
- Plant upgrading and operational design, i.e. production process enhancement exclusive of acquisition of plant and equipment;
- International standards certification;
- Compliance and registration of patents and registration with professional bodies; and
- Specific training in areas of innovation and design, international best practices, and cost and quality management.

Upon the recognition that some businesses required capital equipment to improve their efficiency but were unable to raise the necessary finance, acquisition of plant and equipment was added to the list for uses of technical assistance funds.

For under-performing businesses, funds provided under the STAP were to be used for 'Turnaround Management Initiatives'. The Turnaround Management Initiative Sub-Programme provided for the engagement of management consultants to work in-house with the management of under-performing companies to implement turnaround programmes that addressed deficiencies in the areas of:

- Management practices;
- Technologies and plant design;
- Operational and control systems;
- Cost structures;

- Capitalisation and indebtedness;
- Skills and human resources;
- Marketing; and
- Product development and product life-cycles.

BIDC initiated its STAP in 2001, but activities under the Programme were suspended in 2009 due to financial constraints. During the eight years of operation of the Programme, the BIDC disbursed approximately $27.0 million in grant financing to approximately two hundred (200) companies. Some of the major companies in Barbados were beneficiaries under the Programme, e.g. Banks (B'dos) Breweries Ltd., Pine Hill Diary, and Roberts Manufacturing Co. Ltd.

The Barbados Manufacturers Association (BMA) was also a major beneficiary. Under the Programme, the BIDC provided the BMA with substantial funding for its Buy Bajan Campaign.

4.14 Innovation Fund

In 2003 the Government of Barbados established an Innovation Fund with capital of $5.0 million. The Fund is managed by EGFL on behalf of the National Council of Science and Technology (NCST), the parent agency for the Fund. Resources from the Fund are used to provide seed capital financing ranging from $0.025 million to $0.25 million to entrepreneurs who have innovative ideas, but who lack the financial resources to commercialize those ideas. Entrepreneurs can also access technical assistance through the Fund. Under the auspices of the Fund and on behalf of NCST, EGFL also coordinates an annual National Innovation Competition that is designed to stimulate the development of potentially viable innovative business ideas by aspiring entrepreneurs.

Entities seeking financing from the Fund must be incorporated with the majority of shares being owned by residents of Barbados. The commercial activities for which financing is being sought must have the potential to earn or save foreign exchange.

The Innovation Fund was established in 2003, and since its establishment four National Innovation Competitions have been held; 2003/04, 2005/06/ 2007/08, and 2009/10. For the first competition held in 2003/04, prize money was awarded to the entries ranked first and second; $75,000 and $10,000, respectively. For the other three competitions held to date, prize money of $75,000 has been awarded only to those individuals who submitted the winning entries. Since the start of the National Innovation Competitions, EGFL has approved financing for four businesses that have emerged out of the Competitions. To date, two of the businesses have received disbursements of funds; equity investment totalling $411,536.07 and technical assistance financing amounting to $83,431.16. Of the two businesses that have received disbursements, one has commenced operations and the response of the market to that business has been positive. The other business should commence operations shortly.

4.15 Entrepreneurial Development Division of BIDC

In 2007, the BIDC renamed its Small Business and New Enterprise Division as the EDD. The 2007 renaming of the division that dealt with small business could be seen as a re-branding of the BIDC's efforts, with a shift in emphasis to the facilitation of the development of entrepreneurism rather than simply providing technical assistance and other services to existing and start-up small businesses, with small businesses being defined as companies with annual sales not greater than $2.0 million and the number of employees not greater than twenty-five (25).

The EDD, which operates from the Small Business Centre, has an impressive complement of staff that has been providing a comprehensive range of services to microenterprises and to small businesses. The staff complement of the EDD at the time we interviewed the Acting Director of the Division was as follows:

- Director;
- Manager;
- Two Senior Business Development Officers;
- Eight Business Development Officers; and
- One Craft Development Coordinator.

The range of services provided by the EDD to individual microenterprises and small businesses included the following:

- Diagnostic studies;
- Product development;
- Design assistance;
- Training;
- Registration of patents;
- Financing of overseas marketing and promotion efforts; and
- Development of product and service standards.

The development by the EDD of product and service standards for microenterprises and small businesses has been facilitated by a strategic partnership between the EDD and the Barbados National Standards Institution (BNSI).

In addition to the range of services provided to microenterprises and small businesses by the EDD, micro entrepreneurs in particular have access to a Technical Assistance Fund for which annual budget allocations in recent years have been $0.4 million. Under the Fund, a microenterprise can be provided with financial assistance up to a maximum of $10,000.

The EDD has estimated that, since its establishment, it has provided assistance in a variety of forms to approximately 6,000 entrepreneurs including entrepreneurs who benefitted on more than one occasion from the services of the Division.

4.16 National Microenterprise Programme

In 2008 the Government established a National Microenterprise Programme. Under the Programme, a microenterprise was defined as a business with annual sales not greater than $0.1 million and with not more than five (5) employees including the owner of the business. On its establishment, the parent ministry for the National Microenterprise Programme was the then Ministry of Economic Affairs, Empowerment, Innovation, Trade, Industry, and Commerce, and for FY2008-09 the amount of $0.3 million was budgeted for the Programme. In FY2009-10 the amount allocated to the Programme was increased to $1.05 million, but in FY2010-11 the budget allocation was reduced to $0.5 million.

Under the Programme, grants up to a maximum of $10,000 were provided to microenterprises. The typical grant, however, averaged $5,000. Microenterprises seeking funding under the Programme could be sole proprietorships, partnerships, or incorporated entities. As part of the application process, the owners of microenterprises were interviewed so as to determine the legitimacy of their businesses. Financing received under the Programme could be used for the procurement of raw materials, services, or equipment.

The Programme has been managed by the SBDU, with the latter now being a department within the Ministry of Economic Affairs, Empowerment, Innovation, Trade, Industry, and Commerce.[26] Applicants seeking financing under the Programme were required to submit to the SBDU quotations for the raw materials, equipment, or services they wished to procure. Once the applications were approved, the funds were disbursed directly to the selected suppliers.

For FY2008-09 there were 60 beneficiary microenterprises under the National Microenterprise Programme, for FY2009-10 there were 118 beneficiaries, and for FY2010-11 there were 140 beneficiaries out of a total of 169 applicants.

For FY2010-11, average annual sales of the 140 beneficiaries were approximately $25,000. Of the 140 beneficiaries, there were 18 start-up microenterprises and 122 existing ones. The average age of the existing businesses was approximately 8 years. Of the 140 beneficiaries, 67 were owned and operated by males, and the remaining 73 were owned and operated by females. The 140 enterprises operated across nine economic sectors; agriculture, general wholesale and retail, information technology, services, manufacturing, construction, food retailing, entertainment, and art/craft.

The 140 beneficiary microenterprises provided employment for 279 individuals of which 189 were employed on a full-time basis and the remaining 90 on a part-time basis. Sixty-six (66) of the enterprises provided employment for their owners alone, and the remaining 74 provided employment for their owners and for other individuals. Beneficiary microenterprises operating in the services sub-sector generated the most employment; for seventy 70 of the total of 279 individuals employed and of those 70 individuals, 52 were full-time employees and 18 were part-time employees.

[26] On its establishment, the SBDU was located within the Ministry of Commerce, Consumer Affairs, and Small Business Development. In the first half of 2011, the SBDU was relocated in the newly established Ministry of Industry, Small Business, and Rural Development.

5 BARBADOS YOUTH BUSINESS TRUST

In addition to the agencies established by the Government and the BSBA, there is another entity that has sought to promote entrepreneurship in the island. That entity is the BYBT, established in 1996 by a group of Barbadian individuals as registered Charity No. 271 and duly registered as a benevolent organization under the Income Tax Act. The motivation to establish BYBT was based on the work being done at the time by the Prince's Trust, an organization started by Prince Charles to help unemployed youth in the United Kingdom.

The vision of the BYBT is to become a globally recognized best practice organization for youth entrepreneurship development and is mission is, 'To provide under-served young people with dynamic programmes focussing on business mentoring, start-up loans, and entrepreneurial skills.'

In accomplishing its mission, the focus of the BYBT has been on assisting individuals aged eighteen (18) to thirty-five (35) years convert their business ideas into reality. The BYBT has also made a special effort to assist physically individuals convert their business ideas into reality.

The objectives of the BYBT have been to:

- Foster the concept of self-employment and the spirit of enterprise in the Nation's youth;
- Introduce young entrepreneurs to sources of business expertise through and advisory network;
- Complement other youth programmes sponsored by private and/or public sector institutions; and
- Offer direction to those better suited to employment.

The major source of funding for BYBT is provided by donors, including the Government of Barbados. From its start of operations in 1996, BYBT received an annual subvention form the Government, and the most recent amount for that subvention was $0.15 million. From 2002 to currently, BYBT has been receiving annual donations form City Merchant Bank of the USA, and from 2008 until currently it has been receiving annual donations from First Caribbean Bank International (Barbados) Limited.

For the period 2007 to 2011, the IDB provided funds of $1.0 million four-year technical assistance project, 'Development of a Mentoring Programme to Assist Young Entrepreneurs'. The counterpart contribution of the BYBT was 10.0% of the funds provided by the IDB.

The services currently offered by BYBT to young entrepreneurs include:

- Training;
- Business mentoring;
- Networking opportunities;
- Marketing opportunities;
- Loans; and
- Grants.

The training provided by the BYBT is needs based. The needs are identified by the business mentors, and the duration of training sessions ranges from half of a day to a full day. Training participants are required to make a contribution of $25 to the costs of the training. This cost recovery mechanism was introduced around the end of February towards the beginning of March this year. Previously, entrepreneurs were not required to make any contributions to the costs of their training.

The loans provided by BYBT are typically start-up loans up to a maximum of $25,000 and were funded by contributions made by donors. The typical loan provided by BYBT was for the purchase of capital items. If working capital was a component of the loan, the amount disbursed for working capital should not exceed 30.0% of the total loan value. The interest rate on the loans is 12.0% on the reducing balance and the maximum repayment period is five (5) years. BYBT has estimated that it has disbursed just over five hundred (500) loans since it started operations in 1996. Some of the loans would have been for amounts as small as $500.

The typical security for loans was the capital items purchased by the entrepreneurs. For the purchase of capital items, BYBT directly disbursed the funds to the suppliers of the items.

Grants are provided by BYBT to entrepreneurs for a variety of purposes, including:

- Subsidization of attendance fees for entrepreneurs at local expos;
- Financing of the attendance of entrepreneurs at international expos and fairs;
- Financing of feasibility studies;
- Financing of education/training; and
- Financing of Go-and-See trips.

For the last three types of activities, the maximum grant was $1,000.

The BYBT has established a working relationship with YES. BYBT refers entrepreneurs to YES for training, and YES refers entrepreneurs to BYBT for funding and business support (mentoring).

6 THE MICRO BUSINESS SECTOR IN BARBADOS

Section 3 of this Report focussed on the factors that led to the emergence of the microenterprise sector as one with significant potential for the generation of economic opportunities for the poor and disadvantaged segments of the populations in both developed and developing countries. That Section also indicated that, currently, there was no common definition of microenterprises in use, and it therefore provided information on the definitions currently being employed in developing countries, notably in Latin America and the Caribbean combined and in India, and in the developed countries, specifically in the United States and in the European Union.

The definition of microenterprises for the Caribbean that was outlined in Section 3 has been the one employed by the IDB. According to that definition, a microenterprise was a business with ten employees or less and total assets equivalent to less than US$20,000. In Barbados, however, that definition has not been applied.

In Barbados, under the SBDA, a small business has been defined as an incorporated enterprise that satisfies any two of the following major criteria:

- Has not more than $1.0 million as stated or paid up capital;
- Has not more than $2.0 million in annual sales; and
- Has not more than 25 employees;

Thus, under the SBDA, which has been one of the most important policy measures implemented for the MSME sector in the last twenty years, no distinction has been made between incorporated enterprises that could be categorised as microenterprises and enterprises defined as small businesses under the Act.

Under the National Microenterprise Programme, a microenterprise has been defined as a business, presumably incorporated or otherwise, with annual sales not greater than $0.1 million and with not more than five (5) employees including the owner(s) of the business.[27] It is important to note, however, that the definition adopted by the National Microenterprise Programme has no legal status.

Even though no universal definition of a microenterprise has been adopted in Barbados, in practice, the definition of that has been widely used since January 1998 has been that of an enterprise, incorporated or otherwise, with annual sales not greater than $0.1 million and with not more than five employees, including the owner(s) of the business.

In January 1998, EGFL and FundAccess, the two new development finance institutions that were established following the closure of the BDB, began operations. EGFL was indirectly responsible for the origin of the definition of a microenterprise now being used by the National Microenterprise Programme since it defined, for financing purposes, a small or medium-sized business as an enterprise, presumably incorporated, that satisfied at least two of the following criteria:

- The market value of the company's fixed assets must be greater than $0.025 million but

[27] The implicit assumption is that the five employees are full-time.

less than $1.0 million;

- The number of employees must be greater than five (5) but must not exceed two hundred (200); and
- Annual sales of the company must be between the range of $0.1 million and $7.5 million.

FundAccess, the sister financial institution to EGFL that was established specifically to provide loan financing to microenterprises, has not, to the best of our knowledge, adopted a specific definition of a microenterprise. Nevertheless, the bulk of FundAccess' clients has comprised enterprises for which annual sales revenues have been less than $0.1 million. The fact, however, that FundAccess' upper loan limit is $0.1 million has been indicative of the institution's willingness to lend to enterprises that have the potential to generate annual sales in excess of $0.1 million, where the latter is the upper sales limit for qualification as a microenterprise under the National Microenterprise Programme.

The lack of a universal definition of microenterprises in Barbados has been further compounded by the proposal of the BSBA, the umbrella organisation for several enterprises in the MSME sector, that a microenterprise should be defined as an entity for which:[28]

- The number of employees is not more than ten; and
- Annual sales revenue or turnover is not more than $0.5 million.

Apart from the absence of a universal definition for microenterprises in the island, not much is known about the micro business sector in Barbados except that it is large and it is made up, as in other countries, of a heterogeneous mix of enterprises. From a general perspective, most of the enterprises in the various sub-sectors of the overall microenterprise sector can be described as 'replicative firms', enterprises that are engaged in economic activities where there are usually limited economies of scale and that are performed by several other entities.

In terms of statistical data, very little is known about microenterprises in Barbados with the exception that the sector could be considered to be very large based on casual observation. It has been estimated that at the end of 2008, there were 11,275 small companies operating in Barbados.[29] The definition of those small businesses was that contained in the SBDA, and an important element of that definition was that a small business is an enterprise that is incorporated under the Companies Act. It is well-known that most microenterprises in Barbados are not incorporated under the Companies Act, and it was therefore not possible for us to make any inferences regarding the economic contribution of microenterprises based on the figure of 11,275 for small businesses operating in Barbados at the end of 2008.

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[28] See 'Getting to Know Our Members'. 2009/2010. The Barbados Small Business Association.

[29] See 'Small Business Data Collection and Collation Project – Draft Final Report'. January 2009. Sir Arthur Lewis Institute of Social and Economic Studies, University of the West Indies, Cave Hill Campus, Barbados. Prepared for the Ministry of Economic Affairs, Economic Empowerment, Innovation, Trade, Industry, and Commerce.

7 CHALLENGES FACED BY THE MICRO BUSINESS SECTOR

7.1 Role of Micro Businesses

Like any other economic sector, the microenterprise sector has its challenges. However, since the sector is large and heterogeneous, these challenges will vary somewhat according to the economic activities in which the microenterprises are engaged. Our focus is on the major challenges that affect the sector, and our approach to identifying and understanding these challenges is one that is based on the role that microenterprises are expected to perform. There are two perspectives to that role; that of the owners of the enterprises and that of the Government, i.e. the national perspective.

Even though the economic activities of microenterprises in the island vary considerably, the primary objective of the owners of these enterprises is to earn income and to be profitable. When considered from the perspective of the Government of Barbados, the role of microenterprises can be considered to be wide ranging. Microenterprises are important from an official governmental perspective because they have the potential to:

- Reduce poverty through income-generating activities;
- Generate employment;
- Contribute to national income and economic growth;
- Improve income distribution;
- Strengthen civil society;
- Contribute to the further development of the private sector; and
- Promote the entrepreneurial spirit.

It is those far-reaching benefits, when viewed from a national perspective, that have justified the focus on microenterprise development as a critical component of development efforts in the island. In identifying and understanding the challenges faced by microenterprises, the relevant question is therefore, "What are the obstacles that prevent microenterprises from the meeting the primary objectives of their owners and from fulfilling the role assigned to them by the Government?"

In answering that question, the focus must be on the obstacles that the Government, through a refinement of the existing policy framework for the microenterprise sector and/or through major amendments and additions to that framework, can address in a way that successfully unleashes the full potential of the sector.

In so far as is possible, it is important that, whatever measures are taken to address the obstacles, special attention should be paid to the poorer microenterprises operating in the different economic sub-sectors. However, enhancement of the policy framework for microenterprises in the island should be rooted in the recognition that development of the sector is part of a dynamic continuum of business development that overlaps with businesses of larger sizes. Microenterprise development programmes should not segment and isolate microenterprises, but should help them to grow and work more closely with the rest of the economy. Successfully implemented, such programmes would have a multitude of positive effects, not only for the microenterprises themselves, but also for the society as a whole. A central element of any

attempt to promote the development of the sector must include the removal of the various obstacles and impediments facing micro entrepreneurs.

7.2 Challenges Faced by Microenterprises Catering to the Domestic Market

Our approach to identifying and understanding the challenges faced by microenterprises in the island is based on the recognition that these entities can be separated into two groups. The first group comprises microenterprises that cater to the domestic market and the second group comprises those enterprises that cater to the export market.

The vast majority of microenterprises in Barbados cater to the domestic market. Some of these enterprises operate in the non-traded sector and the others operate in the traded sector. The major sub-groups of microenterprises that cater to the domestic market are those engaged in:

- Non-traded services, e.g. construction, cosmetology, information technology, and entertainment services;
- Agricultural activities, including livestock rearing;
- Small-scale fishing activities;
- Wholesaling and retailing of imported and locally produced goods;
- Restaurants, cafeterias, bars;
- Mobile food retailing;
- Manufacturing, e.g. food products, garments, furniture, jewellery, and handicraft; and
- Transportation, e.g. taxis and freight vehicles.

A major feature of the domestic markets, whether formal or informal, in which microenterprises operate is that, with few exceptions, the markets are highly competitive. Coupled with the small size of the microenterprises, the highly competitive nature of the markets make microenterprises especially sensitive to changes in the general business climate. Thus, market forces play a dominant role in determining the success of those microenterprises that cater to the domestic market. In the context of highly competitive markets and given the role that microenterprises have been expected to perform, there have been four basic areas that have continued to present challenges for microenterprises despite significant progress over the last several years. These four areas can be said to constitute the facilitating or enabling environment, and they are:

- The regulatory environment;
- Access to finance;
- Access to business development services; and
- Resources to the sector as a whole.

7.2.1 The Regulatory Environment

Microenterprises engaged in some economic activities are required to comply with the Government's regulatory provisions relating to those activities. Those provisions could include licensing requirements, meeting of appropriate public health criteria, assessment of the road worthiness of vehicles, etc. From time to time, micro entrepreneurs have complained of the bureaucratic difficulties they have encountered and of the costs they have incurred when they

have tried to satisfy the regulatory provisions for their enterprises. Difficulties of this nature can be frustrating, especially for start-up microenterprises. Perhaps, it is for some of those reasons that some micro entrepreneurs have chosen to operate at the informal level. However, we wish to indicate that such difficulties have not been unique or peculiar to microenterprises. They reflect the general inefficiency and sometimes the duplication of requirements that characterise the operations of some agencies of the Government. Greater efficiency and simplification of requirements will not only benefit microenterprises, but the society as a whole.

7.2.2 Access to Finance

Access to finance, particularly at reasonable terms and conditions, has always been the single greatest obstacle that has hindered the development of the microenterprise sector. There is no doubt that the availability of loan financing increased significantly over the last thirteen years as a result of the operations of FundAccess, establishment of enterprise units at the UDC and RDC, and, more recently, establishment of the Government's National Microenterprise Programme. Despite the positive impact of those developments, the supply of financing to the microenterprise sector still falls far short of the demand.

Demand has continued to outstrip supply for various reasons, and perhaps the most important one is that private sector financial intermediaries have continued to view the microenterprise sector as high risk and costly to administer. Weak personal skills on the part of some micro entrepreneurs have been a contributing factor to their inability to access financing. Furthermore, the fact that many micro entrepreneurs operate in the informal sector acts as an impediment to their access to financing. Without access to financing at reasonable terms and conditions, microenterprises will continue to experience difficulty in seizing growth opportunities, and their ability to fulfil the role assigned by the Government will be severely compromised.

7.2.3 Access to Business Development Services

Business development services address a range of constraints that pose serious barriers to growth for microenterprises. These constraints include inadequate management, marketing and technical skills; limited knowledge of improved production techniques and market opportunities; inadequate technology; limited access to markets, market information or advice; and policy and regulatory barriers. The various constraints can be classified into three groups; viz:

- Constraints internal to the business, e.g. low skill level;
- Constraints external to the business, e.g. hostile policy environment; and
- Access constraints, meaning lack of access to markets, information, or technology; which larger firms usually have, but some microenterprises do not.

With access to business development services, traditionally referred to as non-financial services, some micro entrepreneurs can improve the performance of their businesses. In Barbados, YES, FundAccess, and BIDC have been the three major agencies of the Government that provide business development services to the microenterprise sector. However, given the vastness of the sector, those three agencies cannot supply all of the potential business development services

needed by microenterprises. Efforts to expand the supply of services are hindered by the unwillingness of a significant proportion of microenterprises to make financial contributions to the costs of delivery of the services.

In some quarters, there have been concerns about the quality of the business development services. For example, are the training hours sufficient to meet the needs of micro entrepreneurs and are the various programmes adapted to the economic sectors in which microenterprises operate.

Lastly, the fact that many micro entrepreneurs have chosen to operate their businesses in an informal way serves to hinder their access to business development services.

7.2.4 Resource Constraints

Given the enormous size of the microenterprise sector and its economic potential, the resources available to the Government are not sufficient to satisfy the demand for microfinance and other services. In order to expand lending and business development services to the sector, more financial resources must come from the private sector. But investment in microenterprise development by private financial intermediaries will only be possible if those resources can be made available on commercial terms.

7.3 Challenges Faced by Microenterprises Catering to the Export Market

The number of Barbadian microenterprises catering to the export market is few. Since they are producing for external markets, it is more than likely that all, if not most, of these enterprises would have formalised their business operations, thus making it easier for them to access financial and non-financial services. Furthermore, since the number of these enterprises is small and given the importance of earning foreign exchange, in theory, the provision of targeted assistance by the Government to these microenterprises should be a more manageable task.

In general, one would expect that, in the absence of intervention by the relevant agencies of the Government, microenterprises catering to the export market will be faced with the same challenges that confront enterprises catering to the domestic market. However, microenterprises catering to the export market would be faced with an additional challenge; the relatively high costs of production in the island that stem from the high costs of labour and other inputs. The issue then for these microenterprises is what assistance can be provided by the Government to help them overcome that obstacle.

8 COMPARATIVE APPROACHES FOR ADDRESSING THE MICRO BUSINESS SECTOR IN DEVELOPING COUNTRIES

8.1 Background

In the early 1970's, attention was first drawn to the extent and importance of the informal sector in developing countries. After a lapse of a few years, microfinance or microcredit began to attract a significant amount of attention as a potential development tool for unleashing the potential of the informal sector in the developing countries. Thus, beginning in the 1980's and early 1990's, microenterprises and small-scale enterprises in the developing countries started to attract the attention of multilateral and bilateral donor agencies including USAID, agencies of the UN, the IDB, and the World Bank. The challenge that confronted the multilateral and bilateral donor agencies was how to assist the developing countries in establishing sustainable micro-financing institutions for their informal economic sectors while at the same time addressing the other constraints that impeded the development of the sectors in the various countries. As a result of this challenge, various approaches evolved on the part of the multilateral and bilateral donor agencies.

8.2 Alternative Approaches of the Multilateral and Bilateral Donor Agencies

8.2.1 United Nations Support for the Micro Business Sector

The support of the UN for the micro business sector in developing countries has been one aspect of a holistic approach to the general eradication of poverty.[30] Thus, the UN has supported microfinance institutions and approaches that have not only provided credit to micro entrepreneurs, but that have also disseminated additional information and services. The bulk of the efforts of the UN has focussed on the strengthening of microfinance services in Africa.

In its support for the microenterprise sectors in developing countries, the UN has emphasized the value of microfinance from two perspectives; viz:

- As support for initiatives made by the poor themselves to improve their quality of life. That is, the provision of microfinance can create an enabling environment and the right opportunities for people living in poverty to, through their creative potential, to work their way out of poverty with dignity; and
- As a tool for fostering the broader development of human and social capital in developing societies. That is, microfinance programmes have not only provided an enabling environment for the eradication of poverty, but have also contributed to the social and human development process.

Despite the limited financial resources that the UN has been able to devote to the provision of microfinance for microenterprises in developing countries, UN agencies have played an important consultative assistance role in promoting the strengthening of 'fledgling' microfinance

[30] Sub-Sections 7.2.1 to 7.2.5 draw heavily on the article written by Maria Sophia Aguirre and Theresa Prosser, Micro-Credit Strategies and Funding; Lending to Sustainable Development?

institutions and in expanding the scale of successful models, such as the Grameen Bank prototype, that includes social services with the provision of credit.

In recent years, support by the UN agencies for microcredit activities in developing countries has increasingly come under the leadership of UNDP. Even though the provision of actual financial resources by the UN has been limited, in 1997 the UNDP teamed up with UNCDF to create the Special Unit for Microfinance (SUM). SUM began as a joint programme between the two agencies bringing together UNDP's growing work in the field of microfinance with the established credit and microfinance portfolio of UNCDF. The microfinance activities of the UNCDF included an active US$40.0 million portfolio that was administered through largely state-owned financial institutions, credit unions, and NGOs, of which 70% were in Africa, 20% in Asia, and 10% in Latin America. SUM supported both the UNCDF activities and the UNDP MicroStart Programme. The MicroStart Programme was launched at the 1997 Microcredit Summit and was designed to assist "start-up and fledgling initiatives" to become sustainable microfinance institutions.

Although the MicroStart Programme focussed on the eventual goal of institutional self-sustainability for microfinance institutions in developing countries, it has played a key foundational role by shaping the institutional basis and structure of new microcredit initiatives undertaken by the UN. Thus, although actual UN funding for microcredit activities through UNDP has been limited, through the available channel of UNCDF technical and financial resources and, as much or more so, through resources mobilized from private and government sources through the MicroStart Programme, the UN has actually played a significant role in shaping the availability and outlook of microcredit institutions in several developing countries.

In addition to the leading role played by UNDP, other UN agencies have also supported microfinance as a development tool for developing countries. The United Nations Children's Fund (UNICEF), provided support for both BRAC and the Grameen Bank in Bangladesh for several years beginning in the early 1980's.[31] In general, UNICEF has supported approaches that make the provision of credit an integral component of programmes designed to broaden access to social information and services, particularly as affecting children and the 'empowerment' of poor women.

The United Nations Fund for Population Activities (UNFPA) has supported microfinance approaches that combined the provision of microcredit with the provision of reproductive health services for women. Lastly, the United Nations Development Fund for Women (UNIFEM) has supported microcredit in Western Asia, Africa, and Latin America as part of a broader agenda of women's empowerment. In Latin America, UNIFEM has worked in association with ACCION to gain private support for mainstreaming gender-sensitive microcredit institutions. In Africa, UNIFEM helped, along with the Kenya Rural Enterprise Programme (K-REP) and others, to found MICROFIN-AFRIC, a network of forty-five institutions that has been delivering microcredit to women in Sub-Saharan Africa.

[31] Originally, UNICEF was the acronym for the United Nations International Children's Emergency Fund.

8.2.2 World Bank Support for the Micro Business Sector

Beginning in the late 1980's, the World Bank began supporting microenterprise activities in developing countries as sub-components of financing for small and medium-sized enterprises. The early 1990's witnessed a dramatic increase in financing for microenterprises, and since then World Bank poverty-related financing has increasingly been directed to lending for microenterprises as sub-components of social sector loans..

The bulk of World Bank financing for the micro business sector in developing countries has been administered by project management units established by governments in the borrowing countries and channelled through intermediaries, mainly NGOs, to the microenterprises. NGOs have been the preferred choice of intermediaries since they have been considered to be in the best position to reach the poor, mobilize local resources and populations, as well as deliver low cost additional services. On some occasions where able local NGOs have been in short supply, international NGOs have been used to implement the microfinance programmes. Other institutions such as local chambers of commerce, local government agencies, development banks, or rural financial institutions have also been used as well.

In general, the Bank has been able to provide support for the micro business sectors in developing countries through financing for poverty alleviation projects, industrial restructuring programmes, or private sector development. Generally, the microcredit loan sub-components have targeted the rural poor in Africa, Asia, and, most recently, in Central Europe.

8.2.3 IDB Support for the Micro Business Sector

Of the regional development banks that have increasingly become involved in the support of microfinance activities in developing countries, the IDB has played both a pioneering and a leading role since the late 1970's.[32] The IDB's support for microenterprises in the LAC region increased slowly over the period 1978 to 1989, but from 1990 to 1993 the Bank expanded its support through new instruments such as the global microenterprise loans and the packaging together of multiple small project operations. Since 1993, the major instrument used by the Bank to provide support for microenterprises in LAC has been the MIF which was established in 1992. Furthermore, in 1997 the Bank began implementation of its integrated strategy for microenterprise development in LAC with the launching of its MICRO 2001 Programme.

The IDB began its support for microenterprise development in LAC in 1978 through a Small Projects Programme, implementation of which was initiated on a pilot basis. A significant percentage of the small projects approved by the Bank were for microfinance, and for several years, the Small Projects Programme was the flagship instrument for investment by the IDB in microenterprises in LAC. The objective of the Small Projects Programme as defined in the Policy Document OP-706 was "to afford access to credit for such persons or groups of persons

[32] A substantial amount of the information presented in this Sub-Section was based on the document :Inter- American Development Bank. February 1997. Microenterprise Development Strategy. Microenterprise Unit, No. MIC-103, Washington, D. C., USA.

who wish to execute projects that will enable them to improve their living conditions and who most often lack access to commercial credit or development credit on customary terms and conditions."[33]

To be eligible for Small Projects financing, projects must target benefits directly to marginal groups who lacked access to credit. Under the Small Projects Programme, the intermediary organizations through which the financial resources of the projects were channelled to the targeted beneficiaries "must be public development organizations, among the basic purposes whereof must be that of achieving the economic improvement of marginal groups and persons."[34]

From an overall perspective, the Small Projects Programme of the IDB has been a major contributor to the development and strengthening of NGOs serving microenterprises in LAC and to the enhancement of the efforts of the NGOs to improve the livelihoods of low-income people. Although the Programme has represented less than 1.0% of the Bank's lending, it has been highly visible, and for some years it was the bank's main instrument for financing civil society organizations. It was also an important vehicle for promoting innovative pilot programmes, and a key instrument for immediately and simultaneously addressing the Bank's goals of promoting social and economic development.

A major downside of the Small Projects Programme was the high cost of preparing, executing, and supervising small projects, for both field offices and headquarters, relative to the small size of the operations. Also, the lack of concessional resources for financing small projects in some countries made it necessary for the bank to introduce modifications to the Small Projects Operating Policy.

The general lesson learned by the Bank from its Small Projects Programme was that in order to be successful in the implementation of such a Programme, the bank needed to introduce greater flexibility in the projects, tailoring the mix of technical cooperation and credit provided, as well as the financing conditions, to individual NGOs to fit their stage of institutional development and the characteristics of their programmes.

Beginning in the early 1990's, the IDB introduced Global Microenterprise Loans as an additional instrument for promoting microenterprise development in LAC. The Global Loans were designed to enable formal financial intermediaries to serve a new clientele at the lower end of the market, i.e. microenterprises, and were typically channelled through a rediscount facility or a line of credit in a country's Central Bank or a second tier development bank at market rates of interest. The Global Loans provided for technical assistance to the financial intermediaries so as to enable them to develop the capability to serve microenterprises at lower administrative costs. Technical assistance was also provided to supervisory authorities to enable them to devise appropriate regulatory frameworks for micro-lending.

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[33] Inter-American Development Bank. February 1997. Microenterprise Development Strategy. Microenterprise Unit, No. MIC-103, Washington, D. C., USA.

[34] Inter-American Development Bank. February 1997. Microenterprise Development Strategy. Microenterprise Unit, No. MIC-103, Washington, D. C., USA.

One of the general lessons learned by the Bank from its use of Global Loans for the promotion of microenterprise development was that the use of government agencies as intermediaries for the provision of technical assistance was problematic. On the other hand, one of the important positive elements associated with the Global Loans has been the provision of technical assistance to formal financial institutions to assist them in adopting new technologies for reaching microenterprises. In countries where significant financial sector reforms were supported by the Bank prior to the granting of Global Loans, the Globals proved to be a more effective vehicle for expanding financial services to microenterprises because competition was increased and thus the traditional commercial banks were on the lookout for new opportunities. Although some of the Global Loans provided resources to non-formal microenterprise lenders such as NGOs, those programmes were generally not successful in inducing commercial banks to form linkages with NGOs to reach microenterprises.

In general, the Bank's experiences with the Global Loans as an instrument of microenterprise development showed that if the instrument was to be overwhelmingly successful as a tool for expanding access to financial services to the significant masses of microenterprises in LAC, it would require continued adjustment in the future, and that each operation should be tailored to the specific conditions of the country where it will be implemented.

With its introduction in 1993, the MIF became an important new instrument of the IDB in its efforts to support the development of microenterprises in LAC. The fundamental goal of the MIF has been the promotion of the private sector in support of the modernization process in the region, thereby helping to ease the human and social costs of economic adjustment and to improve the competitiveness and productivity of the sector. The MIF can provide financing under a variety of modalities; for policy and regulatory reform (Window 1), for human resources development (Window 2), and for direct support for development of small enterprises and microenterprises (Window 3). With regard to direct support for the development of small enterprises and microenterprises, the comparative advantage of the MIF lies in its ability to use innovative financing mechanisms, such as equity investment, quasi-equity, and guarantees.

Based on its structure, the IDB believes that the prospects of the MIF for increasing private sector investment in the microenterprise sector in LAC are promising. The tools at the MIF's disposal also provide the Bank with greater flexibility for supporting the dynamic continuum of micro to small-scale enterprises.

The MIF has been seen as an important vehicle for promoting policy reform favourable to microenterprises development through Window 1, and for supporting the new training and business service programmes for the more dynamic segment of microenterprises through Windows 2 and 3. Window 3 would also allow the Bank the flexibility needed to make equity and quasi-equity investments in microfinance institutions seeking to formalize their operations or enter new markets, and to develop guarantee mechanisms that would facilitate borrowing from formal financial intermediaries by NGOs that operate microfinance programmes.

By 1997, the IDB had formalised its integrated strategy for microenterprise development in LAC. The overall goal of the Microenterprise Development Programme was to expand economic opportunities through sustainable, dynamic microenterprise development. In order to

achieve this goal, the Bank's strategy focussed on promoting the conditions necessary for the growth and development of the microenterprise sector in LAC.

The specific objectives of the strategy were to promote the development of:

- A favourable policy and regulatory environment;
- Strong, sustainable institutions providing financial and non-financial services to meet the demand of microenterprises;
- Improved access of low-income and disadvantaged micro entrepreneurs (including women and indigenous peoples) to financial and business services; and
- Expanded, continuous and permanent flows of resources for investment in microenterprises.

In the pursuit of its microenterprise development strategy for the LAC, the IDB decided to focus on the areas in which it has a comparative advantage. Thus, the Bank in 1997 launched its integrated programme, MICRO 2001. MICRO 2001 was a five-year programme designed to promote policy and regulatory reform to create an enabling environment for microenterprise development, and to support the creation and strengthening of formal and non-formal institutions that provide business development and financial services to microenterprises on a sustainable basis.

As intimated above, one of the two focuses of the MICRO 2001 programme was the strengthening of institutional capacities in member countries of the Bank to provide services to low-income and disadvantaged microenterprises efficiently and effectively. A key element of that component of the strategy was the use of Bank resources to catalyze the infusion of private investment in microenterprise development by linking NGOs and commercial investors and by promoting the formalization of microenterprises.

For each borrowing member country benefitting under the MICRO 2001 programme, the strategy for microenterprise development was tailored to the needs of the country, based on a comprehensive analysis of obstacles and opportunities that confronted the microenterprise sector in the country, and on the adoption of mutually reinforcing actions to address the identified obstacles and opportunities. The adoption of mutually reinforcing actions was seen as a departure from the more traditional piecemeal approaches of isolated project interventions.

In general, the main strategy components for the various borrowing member countries' programmes were identified as follows:

Policy Reform: In order to foster an environment conducive to microenterprise development, the strategy emphasized the promotion and support of economic, legislative, and regulatory reform tailored to the context of each member country. The Policy Reform included the reform of tax systems and policies, registration and licensing requirements, and legislation affecting specific markets. The Policy Reform also envisaged the promotion of regulations and legal reforms that facilitated the entry of formal lenders into the microfinance arena and the promotion of competition among lenders.

Institutional Development: As a central feature of the MICRO 2001 programme, the IDB supported the strengthening of formal and non-formal institutions and the enhancement of their capabilities to become sustainable providers of services to micro entrepreneurs. The institutional strengthening focussed on helping financial intermediaries and organizations providing business development services adapt their services to meet the demands of micro entrepreneurs and to improve the efficiency and effectiveness of service delivery.

Financial Intermediaries: For its borrowing member countries, the Bank's MICRO 2001 programme supported the expansion and strengthening of existing financial intermediaries through the transfer of improved and innovative technologies to formal financial institutions in order to reduce transactions costs and credit risks. The programme provided for the strengthening of non-formal financial institutions, such as NGOs and credit unions, so as to facilitate their graduation to the formal financial system and their access to capital markets, thus enhancing their ability to mobilize resources in a sustainable manner.

The bank envisaged that in order for microenterprises to grow and build up their capital base, new financial products and instruments such as term loans, leasing, and factoring would be required. The IDB therefore indicated that it would support the development of such innovative services for micro and small enterprises.

With regard to the accumulation of financial resources by micro and small enterprises, the Bank had the view that savings accounts and deposit services were important vehicles for microfinance, and therefore the capturing of local savings was essential to the long-term financial sustainability of microfinance institutions. Thus, the Bank indicated that savings mobilization and the creation of financial products tailored to the demands of micro entrepreneurs for deposit services would be an important element in its microenterprise strategy.

Other Institutions: As part of the MICRO 2001 programme, the IDB indicated that it would support the creation, expansion, and strengthening of organizations specializing in providing market-oriented, sustainable business services to microenterprises. The focus would be on:

- The improvement in the quality of training and of the technical assistance programmes;
- The development of marketing schemes that expand the access of micro entrepreneurs to more profitable segments of the market;
- Assistance to comply with legal and regulatory procedures;
- Promotion of sub-contracting arrangements with larger firms, and
- The transfer of appropriate technologies to improve productivity, especially those that were environmentally sound.

Service providers that assisted microenterprises with the process of formalization would also be supported.

In general, the Bank indicated that the challenge associated with the strengthening of the supporting institutions was the introduction of market principles to upgrade the quality of services now provided, to expand their outreach, and to help create new sustainable services.

The Bank felt that support for institutions providing those services should encourage the institutions to adopt demand-driven principles and cost recovery mechanisms to promote sustainability. In addition, programmes supported by the Bank in borrowing member countries should help create incentives for mainstream institutions to reach microenterprises.

Lastly, the IDB indicated that to be effective, institutional strengthening should be accompanied by the transfer of fresh resources for direct service delivery on a greater scale. The bank therefore indicated that it would increase the flow of resources for microfinance by channelling funds to lenders at market rates of interest, so that they can in turn expand the volume of lending and other financial services. For the Bank, the importance of those resources was that they represented long-term sources of financing that were not currently available. Funds to expand coverage of the microenterprise sector would be provided to non-financial service providers as well.

For the implementation of its microenterprise development strategy, the Bank indicated that the following tools or instruments would be used:

Loans: The Bank's main operational instruments for investing in the development of microenterprises, the Small Projects Programme (which directly financed individual executing agencies, primarily non-profit organizations) and the Global Loans for microenterprises (which created facilities to transfer resources to multiple institutions, primarily commercial banks) would be the principal forms of lending that would be employed.

The Bank indicated its willingness to provide liquidity to wholesalers (through the Global Loans and similar mechanisms), to finance wholesale mechanisms for technical assistance, and to provide financial resources for studies and support for the development of new legislation and improved regulations as well as their application. However, due to administrative and financial constraints, the Bank indicated that, unlike in the past, it could not continue to be the principal direct funder of LAC's NGOs working in the area of microenterprise development. Nevertheless, the Bank indicated that it would continue to finance NGOs programmes for microenterprise development primarily where the programmes presented innovative, pilot experiences with opportunities for learning and replication in other, larger programmes.

Technical Cooperation: The Bank indicated that technical cooperation would be used for:

- Policy reform;
- Institutional development activities;
- Training and technical assistance programmes targeted at micro entrepreneurs; and
- Pre-investment activities to facilitate and enhance project preparation.

For the bank, technical cooperation was particularly important for reducing start-up costs for intermediaries developing new services or entering new markets. The technical cooperation programmes would be financed on a grant or reimbursable basis depending on the nature of the operation and on the availability of funds.

MIF Operations: The Bank indicated that the MIF would not only continue to be an important provider of technical cooperation for policy reform and institutional development, but that it would also be used to support innovative mechanisms such as equity investments in intermediaries providing services to microenterprises. Under such an arrangement, the MIF would typically act as a for-profit investor, holding, for a period of approximately seven years, a share of the intermediary institution's total capital and looking for leverage from other investors. Such investments would include arrangements that guaranteed the MIF's exit and financial returns according to the risk involved. The Bank also envisaged that quasi-equity instruments (bond financing) would be used. For the future, it was envisaged that the MIF would be used to help create a partial guarantee or risk insurance mechanism to promote access to loans from commercial banks for NGOs that provide microfinance.

Through its Window 3, the Bank indicated that the MIF will give priority to the following areas that had the potential to contribute to the achievements of the microenterprise development strategy:

- Strengthening and diversification of microfinance instruments and institutions, including technical assistance for intermediaries, support for graduation of unregulated NGO intermediaries to the formal financial system, and increased outreach of banks and other formal institutions providing commercial finance to new, smaller clients; and
- Improving non-financial services for micro and small firms in areas such as market information, quality control, innovation and technology transfer, and management assistance.

Policy Dialogue: The Bank indicated that it would make use of the existing channels of policy dialogue with the borrowing countries to promote the creation of an enabling environment for the development of microenterprises. This would be accomplished through the Bank's country programming process and through its research and dissemination activities.

For the Bank, past experience had shown that operations to promote the development of microenterprises were most successful when an enabling and regulatory environment existed that allowed institutions providing services to microenterprises do so on a sustainable basis, and that also allowed microenterprises receiving services to grow. Similarly, investments in microenterprise development often failed to accomplish their objectives when undertaken under unfavourable policy conditions. Thus, the Bank indicated that it would pay particular attention to paving the way for successful credit and investment programmes through policy dialogue and policy reform programmes.

Where feasible, policy and regulatory obstacles to microenterprise development would also be studied and addressed as part of broader programmes and operations such as small and medium enterprise strategies and programmes, financial sector reform programmes, and others. This integrated approach was seen as crucial because reforms that promote microenterprise development overlapped significantly with those needed for the growth of small and medium-sized enterprises.

Summary: Thus, based on the preceding details of the IDB's strategy for microenterprise development in LAC, one can conclude that, unlike most of the programmes supported under the umbrella of UN and World Bank that include social welfare programmes linked to microfinance activities, the IDB has approached the development of microenterprises primarily as a means of economic opportunity to promote broader distribution of the benefits of economic growth in a society. Recognizing the hugely significant role microenterprises play in the LAC region, the IDB has viewed the promotion, growth, and development of microfinance as a tool for newly reaching a sector of society and the market, which includes the most marginalized, thus helping to ease the social and human costs of economic adjustment in poorer countries. The Bank has viewed its support for microenterprise development as a significant opportunity to promote the social and economic development of LAC countries in a broader and more equitable fashion.

8.2.4 USAID Support for the Micro Business Sector

In addition to multilateral assistance and private development organizations, bilateral country aid programmes, such as those administered by USAID, have also been a significant source of funding for microenterprises in developing countries as well as for research in the field. For several years, USAID has been very much involved in the support for microfinance programmes as development tools. The Agency has supported microfinance activities in regions around the globe including Latin America, Africa, Eastern Europe, and Asia. One of the world's leading donors, USAID invested over US$1.0 billion between 1988 and 1998 in microenterprise development.

USAID has indicated that its ongoing objective for supporting the development of microenterprises in developing counties has been to assist microfinance organizations to provide financial services to the poor on a wide-reaching and sustainable basis. With regard to programmes that provide the poor with both financial and non-financial services and the granting or not of USAID assistance, USAID has adopted the following policy:

"First, clients should generally be able to choose which services they need, rather than being offered a fixed package of financial and non-financial services on a take-it-or-leave-it basis. An exception may be appropriate where an organization integrates social messages or similarly limited non-financial assistance with the delivery of financial services, to the extent that it does so without compromising the effectiveness of its financial service delivery. Likewise, an exception may be appropriate where the organization can demonstrate that a particular type of training or other service strongly contributes to loan repayment rates by enhancing the productivity of clients' enterprises. Assertions that such services are needed to ensure loan repayment should be viewed with caution, in view of the high repayment rates achieved by many MFIs that provide only financial services."[35]

While USAID has not specifically emphasized or promoted the linkage of social welfare programmes with credit access, there has been a clear 'grey area' of support for programmes that primarily provided financial services, but that also took advantage of poor client contacts to

[35] Aguirre, Maria Sophia, and Prosser, Theresa. 2006 Micro-Credit Strategies and Funding; Lending to Sustainable Development? Washington, D. C., USA.

promote social objectives.[36]

8.2.5 CGAP Support for the Micro Business Sector

CGAP was established as a consortium of donors in 1995. Housed in the World Bank but primarily the product of coordinated efforts from many donor agencies, CGAP was organized to mainstream microfinance as a development tool. Since 1995, it has played a major role in promoting the coordination of international donor efforts in the field of microfinance.

CGAP members have included bilateral aid organizations from many of the developed countries, regional development banks, and other multilateral organizations. The Group has received expertise through an advisory group comprised of experts and leaders from many well-known microfinance organizations, and it has provided technical assistance and limited funds to a variety of microfinance institutions. Although actual funds for providing assistance have been limited, CGAP has played an increasingly important role in its increasing efforts to mainstream and commercialize microfinance on an industry-wide scale.

CGAP has helped to strengthen microfinance institutions and to accelerate their growth and impact as financial service providers. Most recently, it has emphasized an approach to microfinance that fosters a broad variety of financial services beyond primarily just microcredit. Especially active in Latin America and Africa, CGAP has been a leader in promoting an evolution of microcredit activities into 'full-fledged' financial services that serve the poor and are integrated into the wider financial sector. This goal of sustainable mainstream and commercial services for microenterprises has pointed to the need for efficient and sound business practices beyond simply charging high interest rates to cover operating expenses. CGAP's recognition of this need for sustainability and formalization in order to support rapid expansion called for a critical evaluation of linking financial and non-financial services. The Group's 2003-2008 strategy considered that:

"Given the proliferation of hybrid programmes in which financial services for the poor are combined with non-financial services such as education or health, there is an urgent need for guidelines on including microfinance in multi-sector projects. In some cases, such combinations have shown positive results, but in far more cases it is necessary to de-link or better sequence financial and non-financial services."[37]

CGAP has asserted that transparent performance evaluations of the various services could be useful in the effort to make better assessments of the hybrid programmes. Though relatively recent, CGAP's industry-wide coordinating efforts to mainstream microfinance as a development tool have significantly become more influential.

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[36] Aguirre, Maria Sophia, and Prosser, Theresa. 2006 Micro-Credit Strategies and Funding; Lending to Sustainable Development? Washington, D. C., USA.

[37] Aguirre, Maria Sophia, and Prosser, Theresa. 2006 Micro-Credit Strategies and Funding; Lending to Sustainable Development? Washington, D. C., USA.

8.3 Alternative Micro-Financing Approaches

8.3.1 Background

Alternative approaches to providing microfinance for microenterprises have been developed by different types of organizations in a variety of locations across the world.[38] Different institutions, working in different environments with differing poverty conditions and enterprise opportunities, have fostered a number of working approaches for lending to the micro business sector. The various approaches have reflected differences in economic conditions, educational levels, available technologies, and cultural contexts, and they have served to highlight that no single method can or should realistically be advocated as the only answer for all types of borrowing situations. Nevertheless, various approaches and extra services adopted and implemented by individual institutions have impacted individual borrowers and their families differently.

A key component to understanding the international spectrum of support for microfinance institutions and their implications for the development of microenterprises is a brief introduction to the more widely used approaches for making microfinance services available to the poorer and disadvantaged segments of the populations in the various countries. This introduction has focussed on the structure and goals of credit provision, the provision or not of services beyond finance, technical assistance for the use of such finance, and on the types of borrowers targeted.

8.3.2 Solidarity Group Lending

Solidarity group lending involved the formation of small groups among member borrowers for the collective assurance of loan repayment in place of material collateral. Both the Grameen Bank prototype and the Latin American Solidarity group model were different variations of this method of micro-lending.

Grameen Bank Model: The Grameen prototype was based on the lending model developed by the Grameen Bank in Bangladesh. The model was developed by the Bank's founder, Muhammad Yunus, first as an experimental university project in 1976 and later as an established Bank (with government support) in 1983. In this model, borrowers self-organize into small peer groups of five or so (unrelated) members who mutually guaranteed repayment of each other's loans.[39] Repayment of each loan was required in order for all group members to maintain access to future loans. Peer groups were organized to form a village centre where borrowers made loan repayments at mandatory weekly meetings. Usually, some pre-credit orientation was required, though this included only minimal technical assistance. Beyond administering loans, mandatory

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[38] For the alternative approaches outlined in the following paragraphs, see Aguirre, Maria Sophia, and Prosser, Theresa. 2006. Micro-Credit Strategies and Funding: Lending to Sustainable Development? Washington, DC, USA.

[39] It is important to note that there was no form of joint liability, i.e., group members were not obliged to pay on behalf of a defaulting member. However, in practice the group members often contributed the defaulted amount with the intention of collecting the money from the defaulted member at a later time. Such behaviour was facilitated by Grameen Bank's policy of not extending any further credit to a group in which a member defaulted.

weekly meetings were used to promote discipline and to disseminate social services information. Typically, women, especially the poorest, were the targets of these programmes (95.0% of Grameen borrowers were women).

As a result of the Grameen Bank's fine-tuned implementation procedures, size of outreach, replication efforts, and charismatic leadership, this method has become prevalent in Asia and, to a lesser degree, also in Africa. More recently, Grameen-type replicators have also begun to develop in Latin America. A few significant microfinance institutions using this approach included BRAC in Bangladesh, Working Women's Forum in India, Association for Social Advancement (ASA) in Bangladesh, K-REP, (both ASA and K-REP financed local microfinance NGOs and provided their own programmes using a modification of the Grameen methodology), and Pro Mujer in Bolivia (1990), Peru (1996), Nicaragua (2000), and Mexico.

Latin American Model: Developed by ACCION International in Latin America and implemented by both local ACCION affiliates and other microfinance institutions, the Latin American solidarity group lending approach made loans to individual borrowers organized into groups of less than ten. As in the Grameen Bank model, borrowers guaranteed group members' loans in place of traditional collateral. ACCION, originally a student-run volunteer organization in the 1960's and now a leading microfinance organization, began offering microcredit services in the mid-1970's. These services dramatically expanded between 1989 and 1995.

Credit delivery was standardized and loans were normally used as working capital for micro entrepreneurs, including small traders or street vendors. Interest rates were usually higher than those on loans provided under the Grameen model because of organizational funding differences and greater initial emphasis on institutional self-sustainability. Borrowers received minimal technical training and organizational assistance and loans were repaid weekly at programme offices. Services were sometimes, but much less so than in the Grameen model, targeted towards women**.** ACCION affiliates averaged 52.0% women borrowers. Significant examples included BancoSol in Bolivia, Fundación para la Promoción y Desarollo de la Microempresa (PRODEM) in Bolivia, Asociación Grupos Solidarios (AGS) in Colombia, as well as Genesis and PROSEM (Promoción y Servicios Empresariales) in Guatemala (all ACCION affiliates).

8.3.3 Individual Lending

This model provided credit access to individual borrowers who were selected on an individual, discretionary basis and often had at least some small form of fixed assets or income. Beneficiaries or clients of these types of institutions were generally micro entrepreneurs in the informal sector, usually urban micro entrepreneurs or small farmers. Borrowers were often provided with minimal technical assistance. Target groups varied between institutions. Noteworthy institutions offering this type of lending included Bank Rayat in Indonesia (targeted to small farmers, this programme was originally a subsidized rural credit programme dominated by the state-owned banking sector in the 1970's and early 1980's, which, upon widespread loan defaulting, was alternately established as a commercially viable rural banking system in 1984), the Carvajal Foundation in Colombia, Asociación para el Desarollo de la Microempresa

(ADEMI) in the Dominican Republic (an ACCION affiliate), Agence de Credit Pour l'Enterprise Privée (ACEP) in Senegal, and the Self-Employed Women's Association (SEWA) in India, as well as Fondo Financiero Privado (FIE) and Caja los Andes in Bolivia.

8.3.4 Village Banking Model

Village banks were established in relatively stable communities in some countries through the initial assistance of a sponsoring agency. The sponsoring agency provided seed capital to a newly organized bank comprising from ten to fifty self-selected members who collectively guaranteed repayment of the seed capital amount. Members were originally granted small loans from this initial capital, which was gradually increased through mandatory member savings. The size of future loans granted to members was related to the proportion of their accumulated savings, in the hope that borrowers would eventually graduate from the programme once a certain loan level had been reached. Member meetings were held for administrative or training purposes, or as a forum for social purposes. In this way, linked to the structure of savings and credit services, village bank programmes also provided self-help groups and/or social education components.

While village banks possessed a relatively high degree of independence, sponsoring agencies provided extensive support for organizing and promoting the banks, training staff, leaders, and members, as well as for tracking progress. Village banking programmes, mostly established since the late 1980's or early 1990's, generally targeted women (sometimes 100.0% of members), though, in a few institutions, men sometimes formed a substantial proportion of members. Prominent village bank providers included Foundation for International Community Assistance (FINCA) with programmes in Central and South America, the Caribbean and Africa; Freedom from Hunger in Thailand, Burkina Faso, Bolivia, Mali and Ghana; Catholic Relief Services in Thailand and Benin; Save the Children in El Salvador; and CARE in Guatemala.

8.3.5 Credit Union Models

Credit unions, while varied in their institutional approaches, provided savings and loan services to members, usually low-income micro entrepreneurs similar to those served by specialized microcredit programmes. Savings were a prerequisite to loan access and incentives to save rested on a desire for low-cost loans. Credit unions rarely provided technical or training assistance or other additional services, although literacy programs were a service usually offered by African credit unions. They evaluated loan requests on clients' ability to repay the loan. Recognizing that microcredit requests often reflected a combination of family and microenterprise needs by the borrower, loans were not targeted or limited to specific goals or purposes. Thousands of individual credit unions, often affiliated with national or regional credit union leagues, existed in a variety of developing countries. Rotating Savings and Credit Associations (ROSCAs) were common in Africa.

8.4 Comparative Analysis of Alternative Micro-Financing Approaches

Of the five alternative micro-financing approaches described, perhaps the most important observation would be that the Credit Union Model was the only one that was self-financing. For microfinance institutions employing the other approaches, injections of seed capital were typically obtained from external sources.

Credit unions can be considered to be community-based financial institutions organized according to cooperative principles. The first working credit union models sprang up in Germany in the 1850's and 1860's, and by the end of the 19th Century they had taken root in much of Europe. Since then, credit unions have become part of the landscape in all developed countries and in some developing countries.

Essentially, the members of a credit union function as a fiscal collective, coming together to create a non-profit financial institution. Members deposit funds for saving and the credit union also makes loans available to its members. Credit unions tend to be made up of members with some sort of similarity, such as by profession, as with a teachers' credit union.

Perhaps, the most important of the cooperative principles relates to the concept of democratic control by the members of the credit unions. That is, according to the cooperative principle of democratic control, credit unions are considered as democratic organizations controlled by their members, who actively participate in setting the policies of the credit unions and in making decisions. Individuals serving as elected representatives are accountable to the membership of the credit unions.

The second most important cooperative principle applicable to credit unions could be considered to be that of economic participation by members. That is, members are expected to contribute equitably to, and to democratically control, the capital of their credit unions. At least part of that capital is usually the common property of the credit union. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes:

- Developing their credit unions, possibly by setting up reserves, part of which at least would be indivisible;
- Providing benefits to members in proportion to their transactions with the credit unions; and
- Providing support for other activities approved by the membership of the credit unions.

The microfinance services provided by credit unions are geared towards the membership of the organizations, and thus, from a practical perspective, credit unions cannot be seen as vehicles for the wide-scale provision of financing for microenterprises.

Of the other four approaches used for the provision of microfinance services, Solidarity Group Lending based on the Grameen Bank Model has been in existence the third longest after credit unions. If viewed from the perspective of institutions dedicated solely to the provision of microfinance services, then the Grameen Bank would be considered as the institution with the second longest history and as the second pioneer of microfinance services after ACCION

International.

For various reasons, including cultural contexts, social homogeneity, and economic conditions, the provision of microfinance based on the Grameen Bank model can be considered to be the most popular in terms of number of clients served since most of the institutions using this approach can be found in the populous and poorer developing countries of Asia. For the better part, micro-financing institutions using the Grameen Bank model have focussed on rural populations and particularly on female micro entrepreneurs.

Similarly, but to a lesser extent, the wide-scale use Solidarity Group Lending based on the Latin American model developed by ACCION International can be attributed to the cultural contexts, social homogeneity, and economic conditions prevailing in the poorer population segments of the various Latin American countries in which this approach has been employed. ACCION International began as a student-run volunteer effort in 1961 in the shanty towns of Caracas, Venezuela, with US$90,000 raised from private companies, and its initial focus was on addressing poverty in the cities of Latin America. After achieving success in the cities, ACCION International extended its reach to the rural populations of Latin America, and over the years, it established affiliates in Africa, the United States, India, and China. In the developing countries in which affiliates of ACCION International have been operating, the main target group has been female micro entrepreneurs, who in general have been seen as investing more in their families than men do, thus raising the standard of living for their children and, over time, that of their entire communities.

Generally, the Solidarity Group Lending approach, or the peer-based lending as it is also called, did not take root in the developed countries or in the urban populations of some developing countries. Various factors have accounted for this, including lack of cohesion among potential borrowers owing to greater population heterogeneity, the larger sizes of loans required by the potential borrowers, as well as regulatory requirements in some developed countries. In general, the approach preferred by micro entrepreneurs in these cases has been the individual lending approach.

Thus ACCION USA, a branch of ACCION International, has had to tailor its approach to conform to the characteristics of the American market for micro-financing. The affiliates of ACCION USA have been providing a range of microfinance products to American micro entrepreneurs, including term loans, lines of credit, and balloon payment loans. Initial loan amounts for new customers, which were traditionally small ranging from US$1,000 to US$3,000, have been adjusted upwards to as much as US$15,000. Loans to reliable customers have been as high as US$50,000. With regard to the interest rate structure, ACCION USA has also restructured its interest rates to take into account the size of the loans, the perceived risk, and whether the loans were new or repeat ones. Also, ACCION USA has been offering discounted rates to customers who have demonstrated excellent payment records.

The concept underlying village banking was conceived by John Hatch in 1984, while working in a USAID project with farmers in Bolivia. With seed capital obtained from external sources, Hatch established a small loan programme for low-income farmers that put them in charge. The programme allowed the farmers to obtain loans without collateral, their main obstacle to

accessing credit, at interest rates they could afford. Essentially, Hatch's programme brought together groups of neighbouring farmers, and gave them the power to collectively disburse, invest, and collect loan capital as they saw fit. His program became known as "Village Banking."

Thus, village banks are community-based credit and savings associations. They typically consist of twenty-five (25) to fifty (50) low-income individuals who are seeking to improve their lives through self-employment activities. Initial loan capital for the village bank may come from an external source, but the members themselves run the bank; they choose their members, elect their own officers, establish their own by-laws, distribute loans to individuals, collect payments, and savings deposits. Their loans are backed, not by goods or property, but by moral collateral; the promise that the group stands behind each individual loan.

The focus of the village banks established since their birth in 1984 has been on the poorest of the poor micro entrepreneurs. Village banks typically functioned well in rural communities because of the economic conditions, common cultural values, and social homogeneity found in those communities. Also, the small size of the banks made it possible for the full participation of the members in all aspects of the enterprise. In contrast, village banks did not take root in the developed countries or in the urban populations of several developing countries. Greater diversity, less commonality of interests, and lack of social homogeneity would have been the principal factors that would have mitigated against the success of village banks in such settings. Also, the common feature of small size associated with the banks would not have allowed them to serve larger numbers of members and still function in accordance with the fundamental principles embedded in the concept of village banking.

In summary, micro-financing approaches based on Solidarity Group Lending (of both the Grameen Bank prototype developed by Muhammad Yunus and on the Latin American model developed by ACCION International) and on village bank have achieved considerable success in providing microfinance services to poor micro entrepreneurs across the world, particularly in developing countries. On a much smaller scale owing to their institutional structures and regulations, credit unions in both developed and developing countries have also been successful in providing microfinance for their members desirous of establishing their own microenterprises. However, in all developed countries, as well as in the urban and more educated populations of the developing countries, the individual lending approach has been the one employed by most institutions to provide microfinance for micro entrepreneurs.

9 PROPOSED POLICY FRAMEWORK TO INCENTIVIZE THE MICRO BUSINESS SECTOR

9.1 Overview

As documented in Section 4 of this Report, Barbados already has an existing policy framework for its micro business sector as part of its overall approach to the MSME sector. There are, however, elements of the approach to the micro business sector that have not been as clearly defined as they ought to. Some of the institutions and policies that contribute to the overall framework for the MSME sector have produced clearly visible results, others have not, and in those cases the institutions and/or policies could be considered to be failures. There have also been some gaps in the policy framework relating to the transitioning or upward movement of enterprises from one stage of development to the next. A major failure in the MSME policy framework has been the lack of strong, sustained, and appropriate oversight of the functioning of the various policies despite the establishment of a Unit within the Government to undertake such responsibilities. In addition, the proliferation of funds operated by different entities of the Government for microenterprises at different periods over the last twenty years or so did not contribute to the establishment of clear policy guidelines for the provision of microfinance. In many ways, the role played by the BSBA has made a significant contribution to a better understanding of the needs of the micro business sector, and of small and medium-sized enterprises as well.

9.2 Philosophical Underpinnings of the Existing MSME Policy Framework

Without any assistance from any of the multilateral, bilateral, or regional financial institutions or donor agencies, the Barbados Government over the last twenty years or so established a comprehensive policy framework for the MSME sector. The primary philosophical principle underpinning the Government's existing policy framework for the MSME sector, and in particular for the micro business sector, has been an economic one. The economic aspect has taken greater prominence since the Government recognised that, given the features of the Barbadian economy, sole reliance could not be placed on the public sector and on the traditional private sector to generate employment opportunities for all those individuals who were interested in joining the labour force. If the economic principles underlying the policy framework produced the desired results, then, by extension, the relevant social aspects would, under normal circumstances, be also addressed since the financial position of those individuals benefitting from the policies would be significantly improved.

In many respects, the philosophical underpinnings of the Government's approach to the development of the MSME sector, with significant emphasis on the micro business sector, have been similar to the philosophical approaches adopted by the European Commission for the EU 27 and by the IDB for the LAC region. With regard to the subsidization of microfinance institutions, the policy of the Government of Barbados has been similar to that adopted in the EU 27.

In the EU 27, the significant attention paid to microenterprises as part of a composite group of

enterprises known as SMEs has been largely due to the significant role played by microenterprises in that grouping of mostly developed countries. In the EU 27, microenterprises have been seen as the engine of the European economy. They have been an essential source of jobs, have created entrepreneurial spirit and innovation in the EU, and have therefore been crucial for fostering competitiveness and employment. In addition, microenterprise development in the EU 27 has also been seen as having the potential to successfully address issues relating to marginalized segments of the populations in the various member countries. Within the EU 27, it has also been generally accepted that because of the failure of some microfinance institutions to achieve financial sustainability, particularly in Western Europe, that subsidies of some sort would be required for significant periods of time.

With regard to the LAC region, the IDB has approached the development of microenterprises primarily as a means of economic opportunity to promote broader distribution of the benefits of economic growth in a society. Recognizing the hugely significant role microenterprises play in the LAC region, the IDB has viewed the promotion, growth, and development of microfinance as a tool for newly reaching a sector of society and the market, which includes the most marginalized, thus helping to ease the social and human costs of economic adjustment in poorer countries. The Bank has viewed its support for microenterprise development as a significant opportunity to promote the social and economic development of LAC countries in a broader and more equitable fashion. However, the Bank does not favour the subsidization of financial institutions catering to micro entrepreneurs. The Bank's policy in this regard can be stated as, "The economic viability of financial institutions serving micro entrepreneurs is key to their long-term sustainability. Subsidized credit programmes damage the economic performance of financial institutions and the subsidies are usually captured by larger businesses."[40]

9.3 Financing Successes and Failures Under the Existing MSME Policy Framework

Our assessment has been that both FundAccess and EGFL have been financial successes under the existing MSME policy framework implemented by the Government over the last twenty years or so. The STAP initiated by BIDC in 2001 could also be considered to be a financial success due to the considerable financing it provided for a variety of enterprises during the eight years of its operation. Although the National Microenterprise Programme has been operational for a short period, the positive impact of the Programme would make it eligible for being considered as a success. Due to the lack of data, we have not been able to assess the performance of the lending operations that were undertaken by the Enterprise Units of the UDC and the RDC. In our assessment, SBVCI, an institution incorporated by the BSBA in 1997 and which received a total of $3.0 million in seed capital from the Government for the purpose of providing equity financing to qualifying members of the BSBA, has been a failure.

[40] Inter- American Development Bank. February 1997. Microenterprise Development Strategy. Microenterprise Unit, No. MIC-103, Washington, D. C., USA.

9.3.1 FundAccess

FundAccess was established by the Government of Barbados to provide loans and technical assistance to the microenterprise sector. FundAccess began operations on 2nd January 1998, and after operating for approximately five and a half years, it had definitely made a positive contribution to the further development of microenterprise sector. However, a study of the financial performance of FundAccess over the period 1998 to 2001 indicated that the institution was highly capitalized, but its portfolio quality, efficiency, financial viability, and profitability needed to be improved. Of greatest concern at that time was the efficiency and financial viability of the institution.[41]

For the 1998 to 2001 period, FundAccess had not done well in terms of efficiency. Other things being equal, all aspects of the efficiency of a MFI should improve over time, but this was not the case for FundAccess over the 1998 to 2001 period. The operating cost ratio declined from 137.3% in 1998 to 65.8% in 2001, but the latter figure was still substantial when compared to a target ratio of 20.0%. The cost per unit of currency lent increased significantly, moving from $0.60 in 1998 to $3.04 in 2001 as the turnover of the loan portfolio decreased considerably. Lastly, as the turnover of the loan portfolio decreased, the cost per loan increased, moving from $6,304.07 in 1998 to $37,627.25 in 2001.

With the exception of the financial spread, the values of the financial viability indicators for FundAccess were also not good. The spread or yield on the portfolio was very high in 1998 and 1999, 18.2 % and 17.4% respectively. For 2000 and 2001 the yield was lower at 13.3% and 13.4%, respectively, but was nevertheless significant. The decline in the spread for those two years was primarily the result of the significant amount of non-performing loans in the loan portfolio.

Values for the operational self-sufficiency ratio showed that at best FundAccess was able to cover 32.9% of the sum of its operating costs and provision for loan losses in 1999. Similarly, at best the institution was able to cover 23.7% of the sum of its operating costs, provision for loan losses, and cost of capital in the same year. The absence of operational and financial self-sufficiency despite the good financial spreads indicated that operating costs of the institution were considerable in relation to its loan portfolio.

The subsidy dependence index (SDI), the last indicator of financial viability used in the study, measures the ratio of subsidies to revenue from lending. For 1998 the SDI was 8.0, that is, subsidies received were 8.0 times as much as revenue received from lending. Thus, if subsidies were to be completely eliminated, revenue from lending would have to increase by a multiple of eight, i.e. the yield on the portfolio would have to increase by 800.0%. A similar interpretation applied to the SDIs for the other three years. For 1999 the SDI was the lowest at 3.9, and if subsidies were to be completely eliminated for that year the portfolio yield would have had to increase by 390.0%. For 2000 the portfolio yield would have had to increase by 498.0%, and for 2001 by 588.0% if subsidies for those years were to be completely eliminated.

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[41] L. H. Consulting Limited. August 2002. An Assessment of the Performance and Capital Needs of FundAccess. Study prepared for the Barbados Agency for Microenterprise Development, Bridgetown, Barbados.

Furthermore, there was the likelihood that the financial viability of the institution would worsen when the Government decided that, with effect from 1st July 2003, the interest rate charged by FundAccess should be reduced from 11.5% on the add-on basis to 6.0% on the reducing balance basis.

Fortunately for FundAccess, the Government continued to provide annual injections of equity capital into the institution. Now, after approximately thirteen and a half years of operation, FundAccess is on the threshold of achieving complete financial self sustainability. As a result of the rapid growth in its total loan portfolio since 2003 and the continued projected portfolio growth in the coming years, it has been estimated that FundAccess should achieve complete financial self sustainability by the end of 2013.

9.3.2 Enterprise Growth Fund Limited

Just like FundAccess, EGFL was established by the Government of Barbados and it began operations on 2nd January 1998 with a mandate to provide venture capital to the SME Sector in the island. Initial equity resources for venture capital investments by EGFL were provided by Sagicor Life Insurance, CBB, NIS, RBTT Bank, and CRL Limited. Despite the provisions for private companies to gross-up any equity investments in EGFL and to treat those grossed-up investments as deductible expenses in their profit and loss statements, no investments were forthcoming from such companies. In addition, the owners of the small and medium-sized enterprises did not demonstrate a strong preference for venture capital financing alone. Thus, in its first few years of operations, the prospects of success for EGFL were not the brightest.

However, as a result of the response by the Government which placed several sector-specific funds under the management of the institution, the financial performance of EGFL improved significantly. EGFL has now reached the stage where it has been generating net profits on its total operations for the last seven consecutive years up to and including 2010. It has paid annual dividends of approximately $0.15 million for each of the four years 2007 to 2010. The improvements in its financial performance are expected to continue in the coming years, and as a result EGFL should emerge as the preeminent institution providing a range of financial products and services to small and medium-sized enterprises in the island.

Recently, EGFL was named as one of two executing agencies for the Government of Barbados' Smart Fund, and that honour was no doubt due to the excellent reputation and performance of the institution. The Smart Fund was established to provide financial and technical support to renewable energy (RE) and energy efficiency (EE) projects in Barbados. To capitalize the Smart Fund, the Government obtained a loan of $20.0 million from the IDB under an agreement for the Sustainable Energy Investment Programme known as the Smart Fund.

The objective of the Smart Fund is to increase the use of viable RE and EE technologies in Barbados in order to decrease the energy costs of the population; increase the energy's security by reducing its dependency on imported fossil fuels; and increase local and global environmental sustainability by reducing emissions of polluting substances, particulate matter, and carbon dioxide and other greenhouse gases.

The Smart Fund is comprised of six facilities organized under two components, with EGFL being the executing agency for Component One of the components and the Energy and Telecommunications Division (ETD) of the Office of the Prime Minister of Barbados being the executing agency for Component Two.

Component One includes five facilities, four facilities that issue grants and one that issues loans. The grant issuing facilities are the following:

- Technical Assistance Facility, to which $1.0 million has been allocated, provides grants to businesses for funding pre-investment studies of RE and EE projects, for assessing their technical and financial viability, and for supporting their implementation (especially with funding from the EE Retrofit and RE Finance Facility);
- Pilot Consumer Finance Facility, to which $1.0 million has been allocated, provides interest rate rebates or rebates on retail prices (subsidies) to selected retailers that have experience in the 'hire-purchase' consumer finance scheme, and that, thanks to the rebates, can offer better hire-purchase terms to their customers for purchasing RE and EE equipment at their stores;
- Compact Fluorescent Lamps Distribution Facility, to which $1.0 million has been allocated, provides free compact fluorescent lamps to a limited number of residential customers of The Barbados Light and Power Company limited through the issuance of vouchers; and
- Air Conditioning Rebate Trade-In Facility, to which $3.0 million has been allocated, provides a fifty percent instant rebate for households and businesses to purchase energy efficient air conditioners, provided they dispose of the old age conditioners, also through the issuance of vouchers.

The loan issuing facility is the EE Retrofit and the RE Finance Facility, to which $12.0 million has been allocated, provides subsidized loans to businesses for financing the implementation of viable RE and EE projects, including, but not limited to, projects assessed under the Technical Assistance Facility.

The last facility established under the Smart Fund, the Discretionary Grant Facility, to which $2.0 million has been allocated, provides funds for the ETD to use on a discretionary basis for institutional support to execute the Smart Fund. This includes paying for awareness programmes, paying for the issuance of vouchers and air conditioning disposal certificates, paying for the Project Executing Unit (PEU), and monitoring the Smart Fund's performance. At the ETD's discretion, this facility may also provide grants to households or private businesses for purchasing RE systems and EE equipment, replicating the activities of the Sustainable Energy Framework Pilot Programme (which is a separate initiative under the Government's Sustainable Energy Framework for Barbados, funded by the Government and by the IDB through the Global Environment Facility).

Thus, under Component One, EGFL is responsible for managing and disbursing approximately $18.0 million out of the total IDB loan of $20.0 million. Entities eligible to apply for Smart Fund support under the five facilities of Component One are businesses operating in Barbados (regardless of size of annual sales or revenues and regardless of line of business), including hotels.

The Smart Fund gives priority, although not exclusivity, to small and medium-sized businesses operating in Barbados for obtaining support through the facilities under Component One. For the purposes of giving priority, a small or medium-sized business is defined either as one incorporated under the Companies Act and approved as a small business in accordance with the SBDA 1999-23, or one that meets the following criteria:

- Annual gross sales or revenues up to and not exceeding $5.0 million;
- Stated or paid-up capital up to and not exceeding $2.0 million;
- Majority (fifty percent or more of shares) Barbadian-owned;
- Not controlled by another business whose reserves and/or capital or non-Barbadian ownership exceed the preceding criteria;
- Criterion for hotels only – Accommodation capacity must not exceed fifty (50) rooms; and
- Criterion for businesses engaged in agriculture only – Acreage under cultivation must not exceed twenty-five (25) acres.

The Smart Fund may give priority to small or medium-sized businesses in two ways:

- For the Technical Assistance Facility, under normal circumstances only small or medium-sized businesses are eligible for support. EGFL and the PEU have the authority to establish exceptions to this rule on a case-by-case basis. EGFL and the PEU must mutually agree on a good reason for granting an exception; and
- For the EE Retrofit and Finance Facility, the Pilot Consumer Finance Facility, the Compact Fluorescent Lamps Distribution Facility, and the Air Conditioning Rebate Trade-In Facility, when approving support, EGFL may give priority to businesses that meet the definition of small or medium-sized businesses, and that meet all other criteria used by EGFL in credit review activities.

9.3.3 Special Technical Assistance Programme of BIDC

In 2001, BIDC launched its STAP that targeted three types of enterprises in the SME Sector in the island. From 2001 until 2009 when the Programme was suspended due to financial constraints, the STAP disbursed the considerable sum of $27.0 million in grant financing to approximately 200 companies. The funds received by the companies were used for a variety of purposes, all of which had the primary objective of improving the productivity and financial performance of the beneficiaries. Although details relating to the beneficiary companies were not available, we have surmised, given the scope and longevity of the Programme, that it could be considered to have been successful.

9.3.4 National Microenterprise Programme

The National Microenterprise Programme has been operated by the SBDU, which is now a department within the Ministry of Economic Affairs, Empowerment, Innovation, Trade, Industry, and Commerce. The Programme has relied solely on the provision of grant funding to successful beneficiaries, and disbursements of funds have been made directly to the enterprises supplying the beneficiary enterprises with raw materials, equipment, or services. Based on the

number of beneficiaries, the range of economic activities in which the beneficiary enterprises have been engaged, and on the number of employment opportunities created, one can, despite the limited scope of the Programme, make the tentative conclusion that the Programme has been successful.

9.3.5 Enterprise Units of the UDC and RDC

Both the UDC and RDC are still operational as agencies of the Government, and at some time during their existence both institutions established Enterprise Units that provided loans to micro entrepreneurs operating within the geographical defined areas assigned to the two institutions. The Consultant has not been able to gather any data on the operations of the two Enterprise Units, and therefore an assessment of the operations of the two Units cannot be made.

9.3.6 Small Business Venture Capital Inc.

In 1997, the Government injected $2.0 million of equity capital into SBVCI, a wholly owned subsidiary of the BSBA established for the purpose of providing equity financing to qualifying members of the BSBA. Sometime later, the Government injected an additional $1.0 million of equity capital into SBVCI. It is not known by the Consultant if SBVCI was able to source additional funds to match those provided by the Government, where, if we recall correctly, the intention was that SBVCI was expected to raise additional funds on its own to supplement those provided by the Government. It is known, however, that SBVCI used the funds provided by the Government to make equity investments in some of its qualifying members. Details of those investments and the exit strategies that were to be employed by SBVCI to recover its investments plus returns on those investments are not known by the Consultant. What is known is that SBVCI did not achieve the level of success, if any, that it had initially thought was possible. Currently, the organization is still operational, but at a low-key level. Thus, in our general assessment, the operations of SBVCI have been a failure.

9.4 Business Development Services and Technical Assistance

It is generally accepted that the provision of business development services and/or technical assistance to enterprises in the MSME sector has been critical for helping those enterprises to realize their full potential. Under the Government's existing framework for the MSME sector, there are four institutions that provide business development services and/or technical assistance; namely:

- YES;
- EGFL;
- FundAccess; and
- BIDC.

9.4.1 Youth Entrepreneurship Scheme

Since 1995, YES has been providing young entrepreneurs between the ages of eighteen and thirty with a broad range of business development services. From a superficial perspective, one would expect that the services provided by YES would have had some positive impact on the development of an entrepreneurial culture among those who have participated in the YES programmes, and that the knowledge gained from participation in the programmes would have contributed to the better management of enterprises owned and operated by those individuals.

Unfortunately, however, due to a late response by YES to a formal request by the Consultant for information on the accomplishments of YES, the Consultant was unable to gather any information from YES. Thus, we have been unable to make a formal assessment of the performance of YES. In particular, it would have been useful to have some knowledge of the numbers of individuals trained by YES since its inception, the numbers of individuals who have established businesses, the success rates for those businesses, as well as the number of businesses that have graduated from microenterprises to small and medium-sized enterprises.

9.4.2 Enterprise Growth Fund Limited

For companies in which it invests, EGFL, on its own account, has been providing technical assistance up to a maximum of $0.07 million per company desirous of having technical assistance. EGFL has also been providing business advisory services to help clients turn their profit potential into solid business gains. Our general assessment of the technical assistance and business advisory services provided by EGFL has been that the beneficiary investee companies would have used the financial resources provided by EGFL to source the best technical and business advice applicable to their enterprises.

9.4.3 FundAccess

FundAccess, using both its internal staff and external experts, has been providing business development services and technical assistance to its clients. Our general assessment of the services provided by FundAccess has been that, given the limited financial resources available to the institution, the bulk of the services provided to clients has been basic in nature. The quality and level of the basic nature of the services would have been appropriate for some micro entrepreneurs; for others the services would not have addressed all the issues applicable to those micro entrepreneurs.

9.4.4 Barbados Investment and Development Corporation

The BIDC, through the use of the facilities in its Small Business Centre and the staff of the EDD, has been providing a range of services to micro entrepreneurs. The Incubator Centre, which is located in the Small Business Centre, provides facilities for start-up microenterprises and for existing microenterprises that have outgrown their previous facilities. The Small Business

Centre also provides office space and space for light manufacturing for as many as ten to twelve microenterprises. In addition, micro entrepreneurs and owners of small businesses, both actual and potential, have access to a range of other services and facilities provided by the Small Business Centre.[42]

Since its relocation to the Small Business Centre, the EDD has been providing a comprehensive range of business development services as well as technical assistance to microenterprises and small businesses.[43] The EDD has estimated that, since its establishment, it has provided a variety of business development services to approximately 6,000 entrepreneurs, including repeat entrepreneurs.

Our general assessment of the business development services provided by the BIDC for microenterprises and small businesses would suggest that the demand for the services of the EDD has been high. One inference that can be made from the high demand would be that the quality of the services provided by the EDD has been good. This could be expected given the fairly significant number of staff employed by the EDD, and one would expect to find a significant range of skills and expertise among those staff members.

With regard to the financing of technical assistance for microenterprises and small businesses provided for under the Technical Assistance Fund operated by the EDD, we have assumed that the beneficiary microenterprises and small businesses would use the technical assistance grants to obtain appropriate and relevant technical advice. However, in our opinion, the total annual allocation of $0.4 million for the provision of technical assistance has been somewhat on the low side.

9.5 Small Business Development Act

The SBDA is an impressive piece of legislation, but there have been doubts as to whether it has the desired effect. At the end of 2008, there were approximately 11,275 small companies operating in Barbados, where the definition of those companies was that contained in the SBDA.[44] Note that an important element of that definition was that a small business is an enterprise that is incorporated under the Companies Act.

If we make some allowance for the growth in the number of small businesses, as defined by the SBDA, since the end of 2008, then a possible estimate of the number of small businesses in operation at 28th February 2011 would have been 11,500. As at 28th February 2011, of that estimated number of 11,500 small businesses, there were one hundred and sixty-six (166) applications for approved small business status under the SBDA and seventy-five of those applications were approved. Also as at 28th February 2011, the approved status granted to three (30 companies had been revoked, one (1) approved business was acquired by a larger company

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[42] See page 32 of Sub-Section 4.9 for the list of the services and facilities.

[43] See page 39 of Sub-Section 4.14 for the range of services.

[44] See 'Small Business Data Collection and Collation Project – Draft Final Report'. January 2009. Sir Arthur Lewis Institute of Social and Economic Studies, University of the West Indies, Cave Hill Campus, Barbados. Prepared for the Ministry of Economic Affairs, Economic Empowerment, Innovation, Trade, Industry, and Commerce.

and the SBDA was not applicable to the operations of the two combined companies, and one approved business had terminated operations. Thus, as at 28th February 2011, there were seventy (70) approved small business in operation under the SBDA.

There are several factors that could account for the small number of small businesses being granted approved status under the SBDA. Those factors, however, do not fall within the scope of this Study. There are, however, valid reasons that we will propose for modification of the Act.

According to the definition of a small business adopted by the Act, incorporated microenterprises are eligible to apply for small business approved status. It is doubtful whether many incorporated microenterprises are aware that they can seek such approved small business status under the Act. So as to add clarity to the Act, we have proposed the following:

1. The Act should be renamed the 'Microenterprise, Small Business, and Medium-Sized Business Development Act'.
2. The general definition of a microenterprise, small business, or medium-sized business under the amended Act should be 'any entity engaged in an economic activity irrespective of its legal form'. That is, the economic activity would be the determining factor with regard to the general definition of a microenterprise or small business, not the legal form.[45]
3. A microenterprise should be specifically defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is less than or equal to ten (10); and
   ii. Annual turnover or sales revenue exclusive of Value-Added Taxes (VAT) is $0.5 million or less **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is $0.1 million or less.
4. A small business should be defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is greater than ten (10) but less than or equal to fifty (50); and
   ii. Annual turnover or sales revenue exclusive of VAT is greater than $0.5 million but less than or equal to $4.0 million **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is greater than $0.1 million but less than or equal to $2.0 million.
5. A medium-sized business should be defined as an enterprise for which:
   i. The number of full-time employees, including the owner(s) of the business, is greater than fifty (50) but less than or equal to two hundred (200); and
   ii. Annual turnover or sales revenue exclusive of VAT is greater than $4.0 million but less than or equal to $7.5 million **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is greater than $2.0 million but less than or equal to $4.0 million.
6. The amended Act should state explicitly that incorporated microenterprises, or incorporated small businesses, or medium-sized businesses can apply for approved

[45] The general definition we have proposed is that adopted by the European Commission for the EU 27.

microenterprise, small business, or medium-sized status under the amended Act.[46]

7. The turnover limits, and the amounts for market values of fixed assets or stated paid up capital for the three categories of enterprises should be governed by the Regulations to the Amended Act. The relevant Minister of Government should have the authority to adjust those values in accordance with market conditions and inflation.
8. Approved microenterprises should be current in their contributions to the NIS in order to be eligible for benefits under the Amended Act.
9. In an effort to reduce the burden of reporting requirements of enterprises in the MSME sector, the threshold for the submission of VAT returns should be raised to $100,000.[47]

With regard to the proposed amendment of the SBDA, it is imperative that the sponsoring Ministry for the Act should have discussions with the relevant stakeholders in the MSME sector, e.g. the BSBA, EGFL, FundAccess, and the BPSA. Such discussions are absolutely necessary if agreement is to be reached on amendments that have the potential to address the deficiencies of the existing Act and to provide a catalyst for the further development of the MSME sector.

9.6 Small Business Development Unit

On its establishment in 1995, the mandate of the SBDU was that of policy formulation and implementation for the small business sector, inclusive of the micro business sector, based on ongoing and systematic analysis of developments in the sector and on collaboration with the various agencies working in or providing services to the sector. Our general assessment has been that the mandate entrusted to the Unit has not been effectively discharged. Various reasons could be advanced for the inability of the Unit to effectively discharge its mandate, including lack of sufficient staff, quality of staff, inadequate financial resources, and lack of focus on the part of the Unit. Most recently, 2008, the SBDU was given the responsibility for administering a National Microenterprise Programme which involved the provision of grants up to a maximum of $10,000 to individual microenterprises. Although the SBDU has been able to generate some useful information on microenterprises based on its administration of the Programme for the last three years, our view has been that administration of the Programme should not have been entrusted to the Unit. Among other reasons, administration of the Programme by the Unit has served to divert the attention of the Unit from its intended principal focus, the formulation and implementation of policy for the small business sector, inclusive of the micro business sector.

9.7 Other Initiatives

Included in the other initiatives undertaken by the Government for the MSME sector in the last twenty years or so have been the provision of annual grants to the BSBA and the establishment

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[46] Even though we have proposed that for general purposes, the general definition of a microenterprise, small business, or medium-sized business under the proposed Amended Act should be "any entity engaged in an economic activity irrespective of its legal form', participants at the meeting convened to discuss the Draft Final Report unanimously agreed that benefits to be provided under the Amended Act should be restricted to incorporated entities.

[47] The proposals contained in 7, 8, and 9 were made, in writing, by Mr. Timothy Simmons, CEO of EGFL.

of an Innovation Fund. Both of these initiatives were without doubt worthy, and we would therefore urge that the annual grants to the BSBA should be continued, and, if feasible, be increased. Similarly, the National Innovation Competitions organized by the Innovation Fund should continue indefinitely, and, if feasible, additional financial resources should be provided to the Fund.

9.8 Proposed Policy Framework to Incentivize the Micro Business Sector

9.8.1 Overview

Our assessments of the initiatives undertaken by the Government in the last twenty years or so for the MSME sector is meant to serve as a backdrop for our proposed policy framework to incentivize the micro business sector in the island. Based on those assessments, readers of this Report ought to be able to independently determine the approach that should be employed for the formulation of that policy framework. In addition, readers of this Report should also be able to conclude, on their own, which existing institutions are best suited for implementing an integrated set of policies designed to incentivize the micro business sector.

9.8.2 Definition of a Microenterprise or Micro Business

As indicated in our assessment of the SBDA, the general definition of a microenterprise should be 'any entity engaged in small-scale economic activity irrespective of its legal form'. The specific definition of a microenterprise should be an enterprise for which:

- The number of full-time employees, including the owners of the business, is less than or equal to ten (10); and
- Annual turnover or sales revenue exclusive of VAT is $0.5 million or less **OR** the market value of the enterprise's fixed assets or the stated or paid up capital is $0.1 million or less.

Previously, the generally accepted definition of a microenterprise was an enterprise which employed no more than five individuals, including the owners of the business, and for which annual sales did not exceed $0.1 million. For two reasons, our definition has proposed that one of the defining criteria of a microenterprise should be that the number of employees be ten or less. The first reason is for consistency with the definition used by the IDB for the LAC region. Secondly, and most importantly, our definition seeks to take into account those microenterprises that cater almost exclusively to the export market, and for those types of microenterprises the typical number of employees is greater than five. Similarly, the cut-off annual turnover or sales revenue exclusive of VAT has been increased to $0.5 million specifically to cater to microenterprises that focus almost exclusively on the export market. Given the significant efforts that must be expended by microenterprises to penetrate the export market, the provision of extensive assistance in the form of business development services and technical assistance to such enterprises was dubious if the cut-off level for annual sales of those enterprises was limited to $0.1 million.

9.8.3 Implications of the Proposed New Definitions

The implications of the proposed new definition would apply primarily to EGFL and to FundAccess. Under the existing MSME policy framework, to qualify for funding from EGFL a company must satisfy at least two of the following criteria:

- The market value of the company's fixed assets must be greater than $0.025 million but less than $1.0 million;
- The number of employees must be greater than five (5) but must not exceed two hundred (200); and
- Annual sales of the company must be between the range of $0.1 million and $7.5 million.

Given the proposed new definitions for microenterprises, small businesses, and medium-sized businesses under the proposed 'Microenterprise, Small Business, and Medium-Sized Business Development Act', to qualify for funding from EGFL enterprises would now need to satisfy the following criteria:

- The number of full-time employees, including the owner(s) of the business, must be greater than ten (10) but must not exceed two hundred (200); and
- Annual turnover or sales revenue exclusive of VAT must be greater than $0.5 million but less than or equal to $7.5 million **OR** the market value of the enterprise's fixed assets or the stated or paid up capital must be greater than $0.1 but less than or equal to $4.0 million.

With regard to FundAccess, microenterprises seeking financing would now need to satisfy the following criteria:

- The number of employees, including the owner(s) of the business, must be ten (10) or less; and
- Annual turnover or sales revenue exclusive of VAT must be $0.5 million or less **OR** the market value of the enterprise's fixed assets or the stated or paid up capital must be $0.1 million or less.

9.8.4 Additional Capital Injections for FundAccess and EGFL

In Barbados, FundAccess is the only dedicated MFI serving microenterprises. Some micro entrepreneurs have been able to access financing from credit unions and commercial banks, but the terms and conditions attached to loans from those two types of financial institutions have been less favourable than the terms and conditions attached to loans from FundAccess, particularly since July 2003 when the interest rate on loans from FundAccess was reduced from 11.5% on the add-on basis to 6.0% on the reducing balance basis. In addition, to access financing from credit unions, micro entrepreneurs must be members of the credit unions and have savings with the institutions.

As at 30th September 2011, almost fourteen years after it started operations, FundAccess had approved 1,270 loans totalling $33.1 million, and the demand for financing by microenterprises from the institution has continued to increase. In general, the IDB has estimated that, despite its strong growth over the past decades, microfinance was only available to about one in six

potential clients in the LAC region at the end of 2009.[48] The Bank noted that penetration rates varied from country to country. In those with the longest experience, such as Bolivia or El Salvador, as many as one in three potential clients were served by microfinance institutions. In countries where the industry was less developed, such as Argentina or Venezuela, less than one in twenty potential clients were able to access financing.

For Barbados, there have been no studies, to the knowledge of the Consultant, documenting the penetration rates for micro-financing. However, what is known for sure is that, in general, continued access to financing has been one of the major obstacles that has impeded the sustained development of the microenterprise sector. It is therefore critical that, in Barbados, FundAccess is able to raise funds on an ongoing basis for lending to the microenterprise sector.

Although it is a limited liability company, FundAccess is wholly owned by the Government of Barbados. In addition, the rate of interest charged on loans to microenterprises has been less than the typical market rates of interest, particularly since July 2003. Specifically because of those two characteristics of FundAccess, the institution has not been able to access funds from the IDB, the major multilateral financial institution that has been providing funds for on-lending to microenterprises in the LAC region. The general policy of the IDB with regard to the provision of funds for on-lending to the microenterprise sector in LAC has been that beneficiary MFIs must adopt commercially driven, market-oriented lending policies. This policy is at variance with the one adopted by the Government of Barbados for FundAccess. It is therefore critical that the Government continues to provide, on a timely basis, injections of capital into FundAccess to ensure that the institution is able to continue financing microenterprises on the scale that it has done in the past.[49] [50]

Access to financing is critical for the growth and development of the microenterprise sector. However, when viewed from a holistic perspective, the growth and development of the microenterprise sector is an essential building block for the continued growth and development of the entire MSME sector. That is, successful microenterprises have the potential to develop into successful small and medium-sized enterprises. The focus of the financing operations of EGFL is on small and medium-sized enterprises, and as successful microenterprises graduate to small and medium-sized enterprises, one would anticipate that they would seek financing from EGFL. In terms of institutional characteristics and lending policies, there is great similarity between EGFL and FundAccess. Thus, EGFL has not been able to directly access funds from the IDB for general on-lending to or for making equity investments in the small and medium-sized enterprises that the institution serves. Just as for FundAccess, it is therefore critical that the Government continues to provide, on a timely basis, injections of capital into EGFL to ensure that the institution is able to continue financing small and medium-sized enterprises on the scale that it has done in the past.

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[48] Inter-American Development Bank Website. 2011. Microfinance by the Numbers.

[49] For MFIs in LAC circa 2005, the average loan given by FundAccess to microenterprises in Barbados was the largest in the entire LAC region. For 2005, the average loan provided by FundAccess was estimated as US$9,446. See Navajas, Sergio, and Tejerina, Luis. 2006. Microfinance in Latin America and the Caribbean: How large is the Market? Sustainable Development Department, Inter-American Development Bank, Washington, D. C., USA.

[50] For 2009, the average microloan in the LAC region was US$1,200, bearing an interest rate of 29.0%. See Inter- American Development Bank Website. 2011. Microfinance by the Numbers.

Note, however, that recently, EGFL was designated as executing agency for Component One of the Smart Fund, a Fund established to provide financial and technical support to renewable energy (RE) and energy efficiency (EE) projects in Barbados. To capitalize the Smart Fund, the Government obtained a loan of $20.0 million from the IDB under an agreement for the Sustainable Energy Investment Programme known as the Smart Fund. Under Component One, EGFL is responsible for managing and disbursing approximately $18.0 million out of the total IDB loan of $20.0 million.

9.8.5 Special Provisions

For the proposed new definition of a microenterprise, we have suggested that the two criteria to be met should be that the number of employees should be ten or less and that the annual turnover or sales revenue exclusive of VAT should be $0.5 million or less **OR** the market value of the enterprise's fixed assets or the stated or paid up capital should be $0.1 million or less. In increasing both thresholds, our primary reason has been to take into account those microenterprises that cater almost exclusively to the export market. Microenterprises that seek to cater almost exclusively to the export market have to overcome more and higher hurdles than those that cater to the domestic market. Thus, they typically require greater assistance from the relevant agencies of the Government. Given the significant efforts that must be expended by microenterprises to penetrate the export market, we intimated that the provision of extensive assistance in the form of business development services and technical assistance to such enterprises was dubious if the cut-off level for annual sales of those enterprises was limited to $0.1 million.

We have recommended that SBDA Act should be amended to the 'Microenterprises, Small Businesses, and Medium-Sized Businesses Development Act' and that the provisions of that amended or new Act should be applicable to incorporated microenterprises that cater predominantly to both the export and domestic markets. Of course, microenterprises benefitting from the provisions of the amended Act would be required to comply with the provisions of the Act with regard to the preparation of annual financial statements that are audited. Beneficiary export oriented microenterprises should also be required to register annually with the Export Division of BIDC, and that Division should be responsible for providing the relevant business development services and technical assistance to the beneficiary microenterprises.

In those cases where the financing needs of microenterprises benefitting under the Act exceed the maximum amount of $0.1 million lent by FundAccess, the Export Division of BIDC should refer the microenterprises to EGFL for financing. Alternatively, EGFL and FundAccess could consider the possibility of joint financing of the microenterprises.

9.8.6 Business Development Services and Technical Assistance

The provision of adequate business development services and technical assistance to microenterprises constitutes perhaps the major obstacle that must be overcome in the pursuit of further growth and development of the sector. The local microenterprise sector is vast, with just

as many enterprises in the informal sector as in the formal sector, and the types of business development services, and by extension technical assistance, can be quite varied. Furthermore, many micro entrepreneurs have been reluctant to pay, either part or all of the costs, for the business development services they desire.

Under the existing MSME framework, YES has been providing business development services to micro entrepreneurs aged eighteen to thirty years, FundAccess has been providing similar services and some technical assistance to its clients, EGFL has been providing some technical assistance and business advisory services to its clients, the EDD of BIDC has been providing assistance in a variety of forms to entrepreneurs, and the BSBA has been providing business development services to its members. As could be expected, the conditions and/or arrangements under which the services have been provided by the different institutions would not be the same. Similarly, it is unlikely that the quality of the business development services provided by the various institutions would be the same. Hence, from an overall perspective, there is a considerable challenge with regard to the provision of adequate business development services and technical assistance to microenterprises.

Our approach to addressing the challenge is that there should be a Government agency that is responsible for, among other things, coordinating the provision of business development services and technical assistance to microenterprises under terms and conditions to be agreed upon. We believe that the most appropriate agency for undertaking that role is the SBDU.

9.8.7 Small Business Development Unit

On its establishment, the mandate of the SBDU was that of policy formulation and implementation for the small business sector, inclusive of the micro business sector, based on ongoing and systematic analysis of developments in the sector and on collaboration with the various agencies working in or providing services to the sector. As indicated earlier, our general assessment has been that the mandate entrusted to the Unit has not been effectively discharged for various reasons.

Unless the SBDU, or some other substitute agency of Government, functions effectively with regard to the collection and analysis of information relating to the MSME sector, and to the micro business sector in particular, there will always be information gaps or deficiencies that hamper the formulation and implementation of timely and appropriate policies for the micro business sector. It is therefore essential that the SBDU should be strengthened to enable it to effectively discharge the mandate that was originally entrusted to it.

For us, there are two aspects of that mandate that are extremely critical and that have not been addressed adequately. The first relates to the regulatory requirements that small businesses, inclusive of microenterprises, must satisfy. From time to time there have been complaints that some of the regulatory requirements are burdensome. Thus, a major task that should be undertaken by the SBDU should be to work closely with the relevant stakeholders to facilitate the creation of a more enabling regulatory environment for small businesses and microenterprises in particular.

The second critical aspect of the SBDU's mandate we alluded to is the coordination of business development services and technical assistance to microenterprises. As indicated earlier, there are various institutions under the existing MSME framework that provide business development services and technical assistance. There is no doubt, however, that the need exists for other services in addition to those that are already provided. We propose, therefore, that microenterprises not benefitting from business development services and/or technical assistance or those seeking additional services and/or technical assistance should be required to register on an ongoing basis with the SBDU. Through discussion and collaboration with the other institutions serving the microenterprise sector, the SBDU ought to be able to develop the appropriate mechanisms and modalities for providing the business development services and technical assistance that are warranted based on careful and systematic analysis of the requests for such services. At a minimum, partial cost recovery mechanisms should be instituted for the provision of the services.

As a Unit within a Ministry of Government with the significant mandate for policy formulation and implementation for the MSME sector, with a special emphasis on the micro business sector, and for the coordination of business development services and technical assistance to the micro business sector, the SBDU should not be responsible for administering a National Microenterprise Programme that involves the provision of grants to individual microenterprises.

9.8.8 Innovation Fund

To date, the Innovation Fund has made a useful contribution to the development of entrepreneurship in the island. The Fund should therefore be maintained, and, if feasible, additional financial resources should be allocated to the Fund.

9.8.9 Barbados Small Business Association

The BSBA has made an invaluable contribution to the development of the MSME sector in the island. In particular, it has succeeded in highlighting the important role of the microenterprise sector in the island. Thus, we wish to suggest that the Government should do whatever it can to strengthen the BSBA so that the institution can perform a more effective role on a larger scale. We do wish to indicate, however, that as a membership organization that is not a financial intermediary, the BSBA is not a suitable institution for providing financial services to its members. This observation is supported by the experience of SBVCI, the wholly owned subsidiary established by the BSBA to provide equity financing to qualifying members of the BSBA.[51]

9.8.10 New Initiatives

Recently, the Government launched its Trade Receivables Liquidity Facility (TRLF), an entity

[51] The current CEO of the Barbados Small Business Association, Ms. Lynette Holder, supports our proposal that the BSBA is not a suitable institution for providing financial services to its members.

that will be responsible for the factoring of accounts receivables held by microenterprises and small businesses. Factoring, which is also known as invoice factoring, accounts receivable financing, accounts receivable factoring, or debt factoring, is a form of commercial finance whereby a business sells its accounts receivable (in the form of invoices) at a discount to another company known as a factoring company. The factoring company processes the invoices and provides the business with cash advances against the money owed to it. In addition, the factoring company manages the sales ledger of the business. Apart from improving cash flow, invoice factoring is used by businesses to reduce administrative overheads. A variant of invoice factoring is invoice discounting, by which a business can also obtain cash advances against its invoices from a factoring company but the business retains control over the management of its sales ledger. As well as providing finance, which is the main benefit, invoice discounting can provide valuable support services and credit insurance.

Our understanding is that the TRLF is being managed by the CBB in collaboration with the Office of the Accountant-General. As we understand them, the existing arrangements are as follows:

- All business entities seeking to access under the TRLF must register with the SBDU;
- Business entities present their invoices to Government departments or agencies, and if the invoices cannot be honoured within some reasonable time, the entities can choose to have the invoices paid under the TRLF. If such a choice is made, the Government department or agency provides the business with a letter and a copy of the invoice to take to the Office of the Accountant-General;
- On receipt of the letter from the Government department or agency and the copy of the business entity's invoice, the Office of the Accountant-General approves the transaction;
- The business entity submits the copy of the invoice approved by the Office of the Accountant-General to a commercial bank of its choice where the invoice is factored; and
- The commercial banks submit claims for factored invoices to the CBB.

The overall framework we have proposed for incentivizing the micro business sector, and by extension the small business sector, is one where the SBDU, or some other substitute agency of the Government, will be responsible for policy formulation and implementation for the small business sector, inclusive of the micro business sector, based on ongoing and systematic analysis of developments in the sector and on collaboration with the various agencies working in or providing services to the sector. Effective performance of that role will involve the collection and analysis of information relating to the MSME sector, and to the micro and small businesses sector in particular. In the performance of that role, a strengthened SBDU will need to collaborate closely with YES, FundAccess, EGFL, BIDC, and BSBA. For that reason, we believe that the invoice financing for microenterprises and small businesses should be entrusted to FundAccess and EGFL, where the two institutions are provided with advances by the CBB for honouring the factored invoices. The two institutions would be responsible for providing reports accounting for the advances they receive on a suitable time basis to be agreed on, e.g. monthly reporting.

With regard to other new initiatives, perhaps it would be appropriate for FundAccess to consider the feasibility of introducing new microfinance products. Just as ACCION USA, a branch of ACCION International, introduced lines of credit and balloon payment loans to further its

penetration of the American market, we believe that it would be worthwhile for FundAccess to consider what new microfinance products it can introduce so that it can more effectively serve the microenterprise sector in the island.

9.9 Estimated Benefits and Costs of the Proposed Policy Framework to Incentivize the Micro Business Sector

We have proposed an explicit integrated policy framework for incentivizing the micro business sector, and our proposals represent both a refinement and an extension of the existing MSME framework. The benefits of the explicit integrated framework we have proposed are obvious; namely:

- Better information flows on the micro business sector;
- As a result of the better information flows, more coherent, coordinated, and targeted policies for the sector should be realized; and
- The more coherent, coordinated, and targeted policies should create an environment that makes implementation of the policies easier as well as facilitates the use of objectively verifiable indicators for evaluating the results of the policies.

Based on a combination of the preceding three benefits, the Government will be better positioned to help the microenterprise sector realize its full potential.
From the costs side, the major recurrent costs we envisage will be those related to the strengthening of the SBDU or to the creation of a substitute agency of the Government to formulate, implement, and coordinate policies for the small business sector, inclusive of the micro business sector. Additional recurrent costs would also be incurred for the institutional strengthening of the BSBA.

We have viewed the proposed additional injections of capital into FundAccess and EGFL as investments, which if managed well, and they should be given the recent track records of FundAccess and EGFL, should provide acceptable returns.

10 CONCLUSION

The purpose of this Study was to propose a policy framework for incentivizing the micro business sector in Barbados. We approached the task from a combination of perspectives. The first two perspectives we addressed were the provision of information on the micro business sector or microenterprise sector from a global view and the documentation of the existing MSME policy framework in Barbados, including the provision of information on the achievements to date of that policy framework. The next two issues we addressed were a description of the micro business sector in the island and the challenges faced by the sector. So as to provide a comparative perspective to our task, we then went on to provide information on the various approaches that have been employed by the international institutions, multilateral financial institutions, bilateral agencies, donor agencies, and other international agencies to promote the growth and development of the microenterprise sectors in developing countries. Lastly, as a prelude to our proposed policy framework for incentivizing the micro business sector in the island, we provided an assessment of the successes and failures of the existing MSME policy framework.

Based on the approach we have adopted, we have proposed an explicit integrated policy framework for incentivizing the micro business sector, and our proposals represent both a refinement and an extension of the existing MSME framework. The benefits of the explicit integrated framework we have proposed include better information flows on the micro business sector; more coherent, coordinated, and targeted policies for the sector; and the creation of an environment that makes implementation of the policies easier as well as facilitates the use of objectively verifiable indicators for evaluating the results of the policies. Based on a combination of the preceding three benefits, the Government will be better positioned to help the microenterprise sector realize its full potential.

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