<u>“Where There Are No Jobs”</u>

<u>Enterprise Solutions for Employment and ‘Public Goods’ for the Poor</u>

July 2005
Dr. David R. Befus

DEDICATION

This book is dedicated to my father, Clarence P. Befus, a successful U.S. businessman who wanted to help children in Latin America. He had the initiative and courage to combine and integrate his business and social vocations, resulting in a financially sustainable K-12 school in Central America that continues to thrive, more than a decade after his death.

A note on the title of this book: Some readers, familiar with the literature of international development, may think the title is derived from the popular book "Where There Is No Doctor," written by David Werner in 1977. [1] ***Others, especially liberal arts graduates, may remember the 1903 play by William Butler Yeats entitled "Where There Is Nothing." The concepts and cases presented in this book were derived from practical experience in places where there was nothing visible, but the invisible desire of the poor to create, to produce, to innovate…. To work! So many of the world's poor echo the "Prayer of the Employed" written in 1937:***

I do not ask for a house of steel,
Or even one built of stone;
But for the exultation to feel
The tug of muscle and bone.

Not for wealth or men at my command,
Nor peace when I am through –
I only ask work for these hands,
Work for these hands to do.[2]

Preface

"A state is first of all an organization that provides public goods for its members, the citizens."[3] Services provided by the public sector for member citizens have collapsed in many countries of the world today, and yet they are more necessary than ever. As government leaders in developing countries call for approaches that address the terrible "weapon of mass destruction" called poverty, this book presents principles and specific cases where economic enterprise sustains social programs, generates income, and creates jobs for the poor.

My encounter with small-scale economic development began in Latin America in 1974 when I was the coordinator of a small project with indigent college students in Costa Rica. It evolved into a service enterprise: a dormitory residence for 26 students complete with full-time cook and house administrator. The project was run as a business simply because we did not have the funds to sustain it any other way. It worked very well!

Then the students in the dormitory, some from social work disciplines, decided to start a project to help people in a nearby slum community. The students, under the tutelage of a few sociology majors, drafted a list of questions to survey community issues as our starting point of contact with the people. The results of this survey demonstrated that the greatest need was for jobs for the women who, in the majority of cases, were the sole providers for their children. When the concept of helping the women make beanbag furniture was first presented, because it was a productive economic activity they could do at home while watching the children, none of us imagined that this was going to be so successful. Sewing vinyl and blue jean bags at home, then filling them with styrofoam, became an excellent means for dozens of Costa Rican women to generate income for their families. The project changed the life of the community economically and socially, with very little external assistance. The women did the work. The students helped identify sources for raw materials, offered ideas on designs, and found market outlets. Over time, the full responsibility for the project was transferred to leaders in the community.

I was so impressed by this experience that I left Costa Rica to attend the University of Michigan Graduate School of Business and study how business can be used to address the needs of the poor. Many of my MBA classmates were focused on how to become CEOs of Fortune 500 companies, yet several professors were very interested in helping me. One had worked with the International Labor Organization in Geneva, and assigned me several projects related to "the informal sector."[4] Another was a consultant on small business projects for the World Bank: my professor of international marketing had been a missionary in Africa.

When I graduated with the MBA degree, I discovered that there were organizations like the Institute for International Development, a non-profit agency started in Washington D.C. in 1971 to help the poor through economic development. They hired me right out of business school to organize a micro enterprise project in Honduras in 1979, the first of several I would help start through this organization.[5] Even as I developed a model for using revolving loans for helping the poor, I also began small ventures on my own: a health services business and a computer training school. From personal struggles in these small projects, and as an entrepreneur in Latin America, I learned unforgettable and valuable lessons.

I returned to the U.S. in the 1980s to work on a doctoral degree, and to better understand basic issues that I had confronted in promoting economic development through business. To support this educational project, I had the privilege of working in international consulting with a prestigious global company, and thereby was able to see what the world looked like from the vantage point of the World Bank, government agencies, and multinational companies. This experience and the doctoral education, with dissertation study focused on international expatriate investors,[6] was good preparation for subsequent overseas management assignments with World Relief and World Vision, which provided me with opportunities to work in Africa, Asia, and Eastern Europe. These environments were similar in some ways, but also different from the world I knew in Latin America, and it became necessary for me to consider how to contextualize methodologies of using business to help the poor to fit each unique environment. A very important discovery was that it was possible to implement sustainable social projects through business enterprise in all of these environments.

Yes, ***it is possible to utilize productive economic activity to help the poor***. I hope that the concepts and real world cases presented in this book will generate more successful and sustainable economic/social enterprise. The need to find stable foundations for helping the poor becomes more acute, and at the same time the capacity of governments to meet this need has become more limited in most developing countries. There are alternatives that require innovation and creativity. May this book be a source of encouragement and hope for many who are trying to promote a serious response to poverty, perhaps the greatest “weapon of mass destruction” in the world today.

Chapter I

A Grass-Roots Response to the Collapse of "Public Goods" in Developing Countries

"Everyone has the right to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, or old age or other lack of livelihood in circumstances beyond his control."[7]

The United Nations declares that medical care and social services such as education are a "right," and yet these services do not exist for the world's poor majority. The economic segment of the world's population without such "rights" is described by experts as "the bottom of the pyramid, where 4 billion people reside, whose per capita income is less than $1,500 per year."[8] Ironically, one challenge to address the needs of this sector comes from a well-known business professor, famous for strategic planning. When the prestigious University of Michigan inaugurated a new president in March 2003, it was this professor of business strategy taking a prophetic stand: "If Michigan is to realize its potential as a global university, it must aspire to new and larger goals, including serving the poor."[9] Many professionals are troubled by current world economic trends and echo this challenge. "Although major strides were made after 1960 in lowering rates of poverty and improving life expectancy, education and health standards, the tragedy of the 1980s and 1990s was that progress was halted and even reversed for many countries as economic stagnation eroded the gains of the past decades."[10]

Over the past five years a "social enterprise" network has developed in the U.S. business community, with a conscious focus on using business as a tool to help the poor. The book "Compassionate Capitalism" was published in 2004, and "is dedicated to corporate leaders who strive to use the resources of their companies to make the world a better place."[11] Social entrepreneurship is now offered as a career track in MBA schools and promoted in business magazines, generating an entirely new area of business research.[12] Prahalad's 2005 book The Fortune at the Bottom of the Pyramid, and subtitled "enabling dignity and choice through markets,"[13] is reported to be a best seller in the U.S. business community. The book challenges multinational corporations to use business to help the poor.

There are more poor people today than at any time in history, and in many cases they are getting poorer. A noted economist cites the fact that “Africa, south of the Sahara, accounted for only about 1% of total world trade in the 1990s.”[14] It is not even part of the world economy, but is a place where economic development is sorely needed. “The persistence of extreme poverty has fair claim to being the greatest outrage of our time… one section of humanity enjoys $2 lattes and disposable cameras, the other section lives on $2 a day and appears to be disposable.”[15]

Governments and international agencies are expected to respond to this world crisis. Many of the specific cases of economic development projects presented in this book were begun after unsuccessful attempts to get help from government and non-governmental private organizations. Common wisdom dictates that one should seek assistance from existing programs related to economic development with government agencies or non-profit organizations (NGOs) that specialize in this area, rather than start projects on your own. But what is generally discovered is that prospective “clients” or projects do not qualify for assistance, and even less for loans.

It may be that the potential beneficiaries are not in the right geographic area or do not have sufficient experience or collateral. The phenomenon of “mission creep” also seems to have taken place very rapidly in economic development programs, as the initial goal of focusing on the poor seems to quickly disappear. Government and private agencies, under pressure to be financially sustainable themselves, have discovered that it is much safer to work with established businesses, to focus only on urban marketplaces, and to work with the middle class. For whatever reason, outsourcing such projects, or obtaining cooperation from government or the NGO community is often not an alternative. Communities seeking solutions must develop the capacity to implement such programs themselves.

“Mission creep,” the loss of the initial vision and purpose, can impact all forms of economic development activity. The focus on helping the needy gradually moves to a wealthier target group, or the emphasis on community development gets diluted as the economic activity itself takes on central importance. Instead of becoming a means to help others, these projects can become an end in themselves. Nowhere is this more apparent than in the history of micro finance, where the livelihood of the service delivery mechanism, the entity providing the loans and managing the revolving credit program, has often become more important than the livelihood of the clients: "achieving financial sustainability but having little outreach to poor clients."[16] Sometimes even the well-known micro credit programs that are reported in the popular press as solutions to the needs of the poor are seen as exploitative and unnecessary at the local level.[17]

This book presents theory and cases of actual sustainable social programs and related entrepreneurial methodologies that provide the foundation for these programs. It is a practical guide for understanding and implementing social enterprise projects. It begins with a reflection on the need for sustainable projects, and why the political environment appears to be incapable of adequate response. A theoretical foundation is presented for specific economic development methodologies as tools for creating long-term financial sustainability. These economic tools have been used successfully to strengthen and support social projects in many contexts and locations. A classification of economic approaches to project support is proposed, and a variety of actual cases are presented, demonstrating the flexibility of this "tool box" in response to the particular social outreach objectives and context.

The objective of the book is to present sufficient information, theoretical and practical, to allow readers to consider how to start pilot programs and address the needs in communities where social projects are being implemented. For this reason, opportunities to utilize business tools for the support of social services are described in relation to actual cases. Cases are presented using the actual data and location of the project, with sufficient information provided in footnotes that readers who know the areas in which they are located could identify the actual projects and visit them. The purpose is not just to present theory, but also to provide a foundation upon which to build new programs.

The orientation of the book is towards the practitioner, whether from a multinational company, a local firm, a government agency, an international non-governmental organization, a local NGO, a church group, a local community, an even an individual simply desiring to help others. The book presents concrete steps to address the problems of poverty through business enterprise at a variety of levels, and concludes with a presentation of training tools and challenges related to sustainable economic/social programs. These programs can be developed at a grass-roots, community level, and do not require millions of dollars or highly educated professionals to get started. The combined impact of many small economic projects focused on community impact may be far greater than the government or specialized NGO programs.

There are management factors that are common to all projects, and some that are specific to certain situations. The application of the principles presented in this book is not expected to be easy. It is hoped that observations and ideas will be useful in new programs, and can also be applied in existing economic development programs where financial sustainability is required. At the very minimum, leaders of social projects need to recognize that economic tools are valuable for supporting their projects. Financially sustainable economic development projects should be added to their "project toolbox" for addressing the needs of the community, along with government or donor supported health, education, and other services.

The concepts presented in the book are the product of 25 years of experience of the author in promoting this idea, first in the context of Latin America, and then through development projects in Latin America, Africa, Eastern Europe, and Asia. The concepts make sense: ***it is possible to utilize productive economic activity to help the poor***, and to implement financially sustainable economic/social projects.

Chapter II

Four Basic Paradigms or Models for Financially Sustainable Social Programs

"The fundamental thrust of the public goods argument is that the state does something that needs doing. Studying voluntary mechanisms is a means of making sure that what needs doing is really to be done by the state. An even more important reason to study voluntary mechanisms, perhaps, is that not everything *can* be done by the state."[18]

Indeed, many community-based enterprise development programs have been born in areas where the state has been incapable of response. For example, there is a church in a middle-class suburb of Cartagena, Colombia, that always seems to be crowded with people. Many have come to the church through its elementary school programs in the slum surrounding the city, others through the Saturday training sessions in basic business skills, and some through other programs designed to finance worthy entrepreneurs. The fact that the Sunday morning services are filled to overflowing is attributed, to a large extent, to the church programs of social outreach for the ever-growing slum communities of those displaced by the guerrillas, para-military, and government conflict.

That church programs would involve health services and schools is not unusual, but the Cartagena church has added an innovative business foundation for its various projects. People want a job, not a handout. In environments like Northern Colombia, where thousands are displaced by the civil war, and unemployment is over 50%, the church is providing employment to almost 100 people in the three schools it has started in the slums of Cartagena, even as these schools provide, for a nominal fee, education for thousands of children.

Models are needed that combine economic development with a clear focus on helping the poor. They must be integrated with social development of communities. Through the course of this book, four distinct models or paradigms of economic projects are presented for social enterprise.

The most common example, and one that is evident in many community projects in Colombia, is the **service business** that has the capability for generating revenue to cover its costs. These generally start out as subsidized projects begun in response to a specific need for promoting health (clinics, hospitals, etc.), education (schools, literature distribution, etc.) or other social outreach such as camp programs and radio stations. The specific services may be initially offered for free, but a fee for service is often introduced to guarantee that the service is being valued and to help to pay for costs. Over time, as donated support deteriorates, the cost of services is generally increased, and in many cases a two-tier fee structure allows organizations to charge commercial rates to clients who are able to pay, thus allowing the program to subsidize services to poorer target groups.

<u>Service Businesses</u> – the development of self-sustaining enterprises such as clinics, dental offices, schools, and bookstores, where the project charges a fee for services. Some of these projects, like the Clínica Bíblica (hospital) in Costa Rica, have grown to have multi-million dollar budgets. The Colegio Latinoamericano in Cartagena, Colombia, (a K-12 school) has over 800 students. Both of these projects were initiated by expatriate non-profit organizations, developed national leadership, and have been run for several decades by national boards.

Service businesses are conceptually related to privatized social services, but reverse the expected time sequence. Instead of waiting for a service that should be provided by the government or a donor institution, the service enterprise is initiated without dependence on outside funding. Two examples related to the provision of water are illustrative of this approach:

- In the slum village of Sololei in Cartagena, new residents build makeshift huts out of sticks and rice sacks. They can accept the dirt floors and rustic conditions, but they need potable water. The Cartagena church project has helped create small water supply enterprises, funding a push cart and plastic barrels for selected local entrepreneurs who provide the service of water delivery, and at the same time generate income to support themselves and their families.

- In the Central African Republic, an international organization sends out an experienced team of workers to drill wells in poor communities only after a management group has been organized in the community to collect fees and service the well and pump system. The drilling of the well is subsidized, but the long-range sustainability of the water system depends on a business approach and requires pre-project training and an investment from each family.[19]

Another type of economic enterprise that has evolved to provide direct support for social services is the **endowment enterprise**, commercial activity solely for financial support. The concept of "endowment" is quite popular in Western institutions and is a contemporary financial cornerstone of most colleges. Institutions in developing countries also struggle with the need to create a long-range foundation for financial sustainability, but face fewer opportunities for local self-support due to a national population with fewer resources, and also confront international donor fatigue. In this context many social organizations have created innovative businesses organized with the specific purpose of generating funds for the support of their programs. The businesses are managed as completely separate units.

<u>Endowment Enterprises</u> - for long-term support of social programs. For example, the Granja Roblealto, an agricultural farm that raises chickens and pigs in Costa Rica, employs more than 100 people, but was created to support a children's orphanage and day-care centers. It channels over $100,000 in direct financial support to local day-care centers and other children's projects. An entrepreneurial donor started this project.

Another example of the endowment enterprise approach to funding social programs is the Girasoles street-kids project in Lima, Peru. It supports its inner-city program for street children with:

- A fleet of 20 taxis in Lima
- An additional 65 motorcycle taxis in Iquitos
- A riverboat ferry
- A bakery
- A carpentry shop

- A shoe factory
- A silk-screen T-shirt business
- A water purification plant
- Handicraft exports

The combined revenue from these enterprises totals almost $400,000 per year, providing a major portion of the operational costs of the social programs.[20] The employment created often involves the graduates of the street children program, who benefit by learning that work is the basis for support, rather than handouts or begging.

Employment creation is important for projects with street kids, because as children grow to adulthood, they need a job to support themselves. Community organizations in the developing world are increasingly confronted by the poverty that surrounds them, as economic globalization has resulted in declining levels of income for the poor majority. Indeed, if people have disposable income, they can pay for services such as health and education. Responding to this situation, many organizations have also added job creation to traditional programs of health, education or other social services. The **business incubator** approach is being utilized in many social contexts to increase income levels and generate employment for poor people, and as an economic tool that can be targeted at specific populations. The business incubator promotes viable business projects to create employment or generate income.

Business Incubators – the creation of new businesses for target populations needing income or employment, but not having a background or experience in productive economic activity. The business idea is generated by the program, and training, production, sales, and assets are controlled by the program until the participants have learned to make products on their own. For example, street teenagers in a youth center in Mexico were taught how to make puppets and stuffed animals. Through business activity, these young people learned to support themselves and stay off the street. As they are able, the production activity is transferred to their homes, the equipment provided is paid back, and the repayments are used for new enterprises.

The bean bag furniture project for women in an urban slum, described in the introduction, was a business incubator project, as are many of the projects of the church in Cartagena, which, for example, teaches women how to be hair dressers, and then set up beauty shops in their homes. Ex-drug addicts in Mexico are taught how to make simple tortilla presses, using scrap wood. Through business activity, these young men learn to support themselves and stay off the street. As they are able, the production activity is transferred to their homes, the equipment provided is paid back, and the payback is used for new enterprises.

The need to create or improve income levels leads to the increasingly popular approach to helping poor people in developing countries through **micro credit** programs. These require the development of sustainable revolving loan finance mechanisms for people who have business experience and the capacity to manage a loan. The reason that many social organizations are interested in developing these projects, rather than relying on existing specialist agencies that do such work, is that the poor populations they serve are generally not eligible for assistance from any other source. Furthermore, many existing specialist organizations that offer programs in the area of micro credit shun integration with social programs for fear that any direct involvement with other types of social outreach might adversely affect their rates of return. At the same time, the interest rates that these agencies offer are often considered too high, and are often available only for commercial enterprises traditionally funded by local loan sharks.

Models have been created for micro credit on a small scale that also allows for close ties between business and social outreach. The success of these models is seen not only in rates of return and sustainability of the projects, but also in the economic benefits to those in the community. Involvement in helping a person with their business allows for direct contact on an intensive level, and many opportunities for integration of various types of social services.

<u>Micro Credit Programs</u> – revolving loan financing for people who have a business idea, and usually some experience, and who, with additional capital, can generate funds to pay back the loan plus interest. Such a program requires an administrative unit capable of organizing basic paperwork, evaluating loan proposals, disbursing loans, providing training, collecting loans, and financial reporting. The OPDS program in Barranquilla, Colombia, operates a small-loan program averaging $350/family to allow heads of poor households to begin to support their families fully. Many of the clients are displaced people from the civil war in Colombia, and the economic programs are integrated with educational and health programs.

Many communities have attempted to access micro credit programs with government or non-profit organizations that specialize in this area, but have found people in the community do not qualify for loans or assistance. It may be that the prospective beneficiaries fall outside of a specific geographic area or do not have sufficient experience or collateral to qualify. The classic problem of youth applies: "you need experience to get a loan (job), but you cannot get the required experience without obtaining a loan (job)." The phenomenon of "mission creep" has also resulted in a clear loss of focus on the poor in many micro credit organizations; the target beneficiaries sometimes actually appear to be the employees themselves and even the international agencies.[21] Though it is a complex process, the lack of access to existing programs results in the need for communities to develop the capacity to implement such economic programs themselves, for specific target groups.

This is why enterprise methodologies, tools, and cases are described in detail in this book. Like programs in health and education, the economic development tools are significant resources for social outreach, ever more relevant in a world where poverty and unemployment are rampant.[22] The next section of this book explores the first steps for developing the foundations to promote the service, endowment, incubator, or micro credit models.

Chapter III

Institutional Design for Sustainable Projects

As the case is presented for the promotion of economic activity as an integral part of community development, it is necessary to address certain assumptions and principles about the relationship between these types of projects and the community itself. Work is required to provide for man's (and woman's) daily bread, and people in and outside the community need jobs and increased incomes. Services provided by sustainable economic enterprises may be critical to the community. The daily activity of a person in the job environment also provides a social context for their personal growth, and an excellent opportunity for integrated community development. In the workplace one can identify to some degree who the leaders are, and see how they treat others, how they handle family matters, how they handle money, how they react to stress… i.e. how they really live.

Successful economic projects are integrated with community development, but it is also necessary to separate the administration of these projects from political and social aspects of community organizations. Such a separation has three specific benefits for the "clients" of the project:

- The system for service delivery must be allowed to promote ONLY sustainable economic activity, and also become sustainable itself based on some type of revenue generated through its services. For this to function, it requires an administration and operation independent of the internal politics of the community organization, where decisions may be made based on non-economic criteria.
- A critical aspect of the separation from the politics of the community is that only financially viable projects be funded, i.e. only economic activity that makes a profit. The determination of viability in the real world marketplace requires independence in decision-making, and specifically the ability to say "no" to proposals that do not demonstrate economic viability, regardless of who presented them.
- The funds generated by successful projects should be defined in advance only to be recycled and used over and over again, thereby multiplying the benefits for those in need. This will be

implemented only if the funds are separated from other funds, with an accounting that is restricted for economic development projects.

The purpose of sustainable economic programs is to generate services and income and to create employment, within or outside the community, through viable projects that allow for the recycling of resources. Productive activity that is profitable in the real world marketplace can be funded only after a careful investigation, and must show a return that can either pay back the investment or allow funds to be used by others. The idea is to promote a resource that will maintain or increase its value, even while helping others.

Worthwhile economic enterprise is a social development tool based on viable projects, not handouts or donations. The discipline required to enable a business to be profitable in the competitive marketplace is the same faced by any other commercial business. Economic activity that is NOT profitable, in the social development sector, is lamentable, because instead of generating revenue, it consumes public funds or donations that were intended for social programs.

It is a challenging proposition to make the case for profitable businesses as a tool for development, when many have a perception of business laden with images of greed and exploitation. But once the idea is accepted that business offers tools for development, the next great challenge is to explain the complexities of making a profit in the competitive marketplace. It takes a lot of effort to create a profitable business. Traditional community-funded businesses, like sewing projects for groups of women, have a history of subsidized production generating a poor quality product that is not marketable. Such "photo-opportunity" projects are NOT desirable; they also tend to create another experience of failure for those involved.

Some type of separation of the economic projects from the community political environment is also good for the community. Not all of the needy people that want help will be interested or willing to get involved in serious, disciplined economic activity. A separate organizational unit managing the project can make determinations about involvement and participation in the economic activities that will not affect relationships in the ongoing community context. It sometimes also happens that community leaders do not act with integrity, and this is quickly discovered in a business environment. To identify this problem and address it may be of benefit to the life of that person, but to confront it may be difficult or destructive in the community environment.

There are three important principal actors that are key to good management of economic development projects, which can be integrated with, but managed separately from community politics:

1) The operational entity - a single focus organizational entity that often begins as a small committee and then may evolve into a legal association with a board, operational procedures, its own accounting system, personnel, and assets.

The monitoring of service businesses, endowment businesses, invested capital or loans is often made easier by an operational unit or board that is separate from the traditional programs of the community or other social programs. This helps to avoid the perception of a "voluntary organization that collects funds and disburses goods, and therefore does not need me to pay." For example, sometimes loan recipients get confused by a vision of the community as "my community," therefore this is really my (our) money, so why should I pay for anything? The establishment of a separate entity to handle economic or business programs also reduces legal risk that the community might incur.

2) The community – provides the supervision needed during the start-up phase, and then participates through members who are on the board, as the project matures.

The ideas that the business project is operationally separate means that leadership must work hard to integrate the project with the other social programs in the community. This involves a delicate balance, because at the same time the board needs to resist attempts to provide benefits from the business for specific people in the community due to political connections.

The community participates through the placement of leaders on the organizational committee. The task of defining a board comprised of people without self-interest is critical even as the project is conceived. The relationship of the economic programs to the community should also be established by written definition, so that the projects do not become an end in themselves. This might include the condition that board membership, at least a certain number, be reserved for people from the community organization who are involved in other social programs. There also might be informal agreements related to assistance with training programs, project visitation, evaluation, etc. From the start there needs to be a commitment to a permanent relationship between the community and the organization it creates, through a leadership group that will be able and willing to coordinate technical assistance and help with matters like fund raising.

And this leads to a final assumption and definition of "actor" in this process. It is assumed that many of these projects will be started by donated funds, or the investment of loan funds from parties outside the community, whether government or private. So the role of the investors needs also to be considered.

3) The funders – they not only provide the resources for initiating the project, but also may desire to participate in oversight, receiving regular reports, providing technical and administrative assistance, and assuming a role based on their particular background of experience. Sometimes the funders are closely involved, staying in close communication and visiting the projects, and sometimes they are not. Although some of the funds may be sourced locally, in many cases the implementation of economic development requires outside funding. Donors therefore may also play a role in project design. The development of contacts for funding and the presentation of proposals become important elements in the success of the project.

It is important to identify at the outset assumptions related to how economic development projects are funded. An ideal scenario, based in part on indigenous social patterns of pooling funding in many cultures, is that the community itself be the source of the funding. The "ROSCA" (rotating savings and credit association) or "ASCA" (accumulating savings and credit association) literature is vast, and asserts that, prior to the initiation of economic development projects, social structures need to be in place whereby the poor fund projects from their own savings.[23] However, the poor are poor. The social organization process to create ROSCAs or ASCAs is very slow and difficult, and also creates a sense of entitlement for access to funds from the pool. Cultural patterns for utilizing funds donated by community members are often based on a lottery concept, with the possibility of accessing a large sum of money without restrictions as to the use of the funds.

There is also great interest in the concept of funding projects locally. There are cases in which disinterested community members with excess funds have provided the capital for economic development projects; a large church in Bauru, Brazil, created a fund of over $30,000 to provide loan capital for a job creation program in the community. A wealthy patron of a street children's program in Venezuela organized a fund-raising dinner for other wealthy people in which over $50,000 was raised to fund a working farm to support the project. Such local initiatives to raise funds benefit from the relative efficiency of economic projects as "teaching people to fish instead of giving them a fish." The fact that economic enterprise projects, after initial funding, can become self-reliant and continue to provide benefits for the needy without additional requirements for donations is quite attractive, once understood.

However, local philanthropy in developing countries is difficult to tap, as most disinterested giving is channeled through family networks, not through organizations. The major source of funding for community economic development projects continues to be institutional donors: non-governmental organizations, international aid programs, foundations, and government grants. In some countries, such as Mexico, a community organization that has developed a successful track record in the management of economic development programs can access government funding.[24] For many projects, the source of funding may involve a combination of stakeholders.

Chapter IV

First Steps in Organizing the Project

The promotion of productive economic activity, independent of methodology, should begin with a focus on the target group, or the "clients." The objectives should be defined in relation to the needs of the potential beneficiaries, with the recognition that there may be multiple goals that result in a combination of economic project methodologies. For example, in the case of the water delivery business presented earlier, the demand for water (client #1 – newly displaced to Cartagena to escape violence) is coupled with a service business that can be funded either through the business incubator approach, or through a micro loan methodology. (client #2 – the entrepreneur receiving funding/training for the water delivery enterprise.) Economic programs for internally displaced people in Colombia also benefit greatly from the fact that clients often have business experience from previous occupations, and that they are highly motivated to find some means to support their families.

Research regarding the target group should include information and interviews with other organizations offering similar services, to evaluate other points of view about what the critical needs are and how they can be addressed or satisfied. The purpose of this investigation is not just to arrive at a clear definition of the target group, but also to promote positive relationships with other organizations that might also be trying to help, and whose programs might be complementary. In some cases it might be a good idea simply to work with others rather than create a new economic development program. Or there may be training programs or other resources available from partner organizations. However, the focus and orientation of the group desiring to start new social enterprise projects often is very different from that of other organizations, so this kind of cooperation does not always work in practice.

There are also several basic principles to consider before starting a program:

1. <u>The program should be seen as a means for promoting a social impact, and not as an end in itself.</u> The key objective of the community is to help the poor and support programs with a social impact. What is seen in many programs is that this objective can be lost, and the

considerable work of promoting economic activity becomes, in the worst case, another commercial business that benefits a select few. There are many schools and hospitals that started as strategic social outreach for the poor, and today are completely oriented to serving the wealthy. They are sustainable, often profitable, and may even help poor people with some social outreach, but they have lost the principal vision for which they were created.

The same phenomenon has taken place in many micro credit programs, some of which were created quite recently by government and NGOs. In a period of less than a decade some of these have essentially lost all connection with social impact objectives, as the financial sustainability of the service delivery system has taken priority. They may still have promotional information that they use in English fund-raising materials that point to social development foundations or background, but in their field programs they minimize any contact with the poor communities "to promote a better collection performance" or to placate government and institutional donors. It is interesting how quickly this phenomenon of "mission creep" can happen.

Perhaps most surprising are the organizations started to help the poor which today have evolved into big businesses, or into service organizations focused principally on the upper class. A model project in micro finance that was created to replace the market moneylenders becomes, itself, a very high interest moneylender. A school designed to help the poor and disadvantaged becomes the school for the upper class. A clinic that began as a program for the indigent is now focused only on treatment for the wealthy. Such cases exist in many places, and serve to remind us of the danger of losing the vision, and also the need to begin with a focus on the targeted beneficiaries of the program. The well-being of the organization offering the services can easily become a higher priority than the well-being of the people it was created to help. The main focus of management then turns inward. However, the institutionalization of the program is important as a basis for serving others, not for serving the institution and its employees.

2. It is necessary to plan from the very beginning for a sustainable or viable project, which also requires a sustainable service system. The success of economic programs is perhaps more visible than that of other types of projects because they depend on having a viable

project design. When programs offer services that are subsidized, it is often hard to tell whether the projects are really effective. People are generally happy to receive the product or services free, even if the quality is poor or the service not really necessary. When subsidies are depleted, such projects simply disappear.

The operational design of economic projects has to be viable. If local people cannot pay for curative medicine available when doctors work at no cost, it is unlikely that paid local doctors are a viable alternative, and perhaps the medical objectives need to be met through less expensive, more transferable preventive approaches. If local people cannot pay for private schooling available when volunteer teachers work at no cost, it is unlikely that paid local teachers are a viable alternative, and perhaps the school will either have to shift its focus to a mix of lower and middle-class families, or change its educational delivery (two shifts per day, larger classes, etc.) to be viable in the long run. These are the types of questions that need to be considered from the very beginning of a project.

What this means, for projects designed to create employment, is even more serious, because technical review of proposed investments in projects will be necessary to determine whether the projects can succeed. It is frequently easier to make a better margin selling products than to produce them, but many people may know more about production than sales. Through qualified technical staff assigned to the project, it may be necessary to learn first about potential markets before financing projects, with the goal of obtaining a higher margin and better profits for producers. This type of concern has led many organizations that work in economic development to create marketing cooperatives, identify export markets, and recommend to new business entrepreneurs only strategies that allow for sufficient product differentiation to obtain sufficient profit margins.

The world marketplace is becoming increasingly competitive, and this affects small business as well as big business. The small businessperson is at a disadvantage because he or she may not have technology or market knowledge. For this reason it is important that information be provided to help the small company compete with quality products. The assistance of consultants from the established business community, short term or long term, can play an important role in promoting innovation, attractive product design, and alternative markets. Another way to help improve margins is to cut costs, and within the development community there is tremendous potential for businesses to work together in both collective purchasing and assistance with marketing.

It is generally these types of competitive considerations that make the business incubators work: a special market, a proprietary technology, etc. These factors are often more important, in the success of a project, than the financing of the endeavor. The assumption is that programs of economic development will be viable in the real world marketplace, and that is not an easy task. Donors who provide capital for economic projects without questioning the viability of the business model may actually have a negative impact on the outcome of the funded project.

3. <u>The program should not represent a burden for the community.</u> This is another reason to separate these projects organizationally and financially through the creation of a specialized operational entity. For all categories of economic development programs, the goals of financial sustainability must be balanced with other objectives, and this is a tough balancing act. One may desire to charge very little for health care, schooling, or the use of financial resources. However, the fees must cover costs, or the "rental fee" on financial assets (i.e. interest). Revenues must be sufficient to cover the costs of services provided, must offset deflation/devaluation, and must provide a reserve for bad debts or depreciation. Special services like training may need to be funded with specific fees, and any legal or registration costs also must be taken into account.

4. <u>There must be adequate financial systems and internal controls.</u> The task of creating economic enterprises for social benefits has all of the complications of the world of commerce and banking, but is often staffed not by paid professionals, but by volunteers and leaders from the local community. This is a great challenge! For many volunteers, these types of projects are a source of great fulfillment, because they find in them a way to use their professional skills in helping others. It is often the case, however, that the human resources for oversight of these programs are limited, and it may even be necessary to look for help from other communities, professional organizations, chamber of commerce, or even the formal business sector.

Whatever the capacity of the leadership committee, with economic projects it is necessary to define, from the very beginning, the financial system and controls for accounting, to guarantee a proper functioning of the program. These are projects that involve investment of money, and there can be temptations to take advantage of this for personal benefit. Though separate from the community operationally, these projects do impact the reputation of the community, and should therefore be done in an orderly manner.

5. <u>Reporting and evaluations are required of all programs.</u> Monitoring of the project through monthly reports is very important, and should include both financial and social information. All members of the organizing committee should read and evaluate these reports, and the leadership of the program should also share them with the community leadership. In cases where donors are involved, they will also need to receive periodic reports.

For the project to be operational, basic definitions of reports are required. The form of reporting depends on the methodology of the project, but usually includes basic financial performance information, reports on what management and staff did during the period, identification of special problem issues that may require board awareness and participation, and descriptive information about project impact. It is very important that information on social indicators and changed lives be presented in reporting, to help maintain the vision for which the program was created.

It is also a good idea to plan for evaluations that compare the initial plan to the actual outcomes. The presentation of financial reports for evaluation is important to measure some very important goals, but not all of them. For this reason, other information needs to be presented in the evaluation. How does the scale of the project, in terms of numbers of people impacted, compare with expectations? How does the efficiency of the services, for example, the time between a request for a loan and its disbursement, compare to other organizations? What has been the impact of the project on the people it was designed to serve? Perhaps they are the ones most important in evaluating the success of the program.

Reporting is greatly facilitated by computerized systems, which help not only with financial records, but also in keeping a database of information on the clients of the program. Social enterprise projects that are successful quickly develop a capacity to handle reporting with computers. Especially in micro enterprise programs, it is almost impossible to keep track of loans, payments, and client information without a micro computer. As the organization grows, or if there is substantial outside funding, it is also often necessary to contract external auditors to report on an annual basis.

The evolution of an economic development project usually follows a growth pattern along these lines:

a) IDENTIFY AND ORGANIZE THE START-UP COMMITTEE - recruit the initial leadership group from people in the community that can implement the vision over time.

b) INITIAL INVESTIGATION OF THE TARGET GROUP - begin to identify potential clients, analyze their needs, potential, resources, and the environment in which they live. This also includes research of other organizations that may be serving similar groups, and an openness to network and partner with others.

c) RECRUIT VOLUNTEER STAFF – volunteers are needed at the beginning to help with the project organization, and generally are people with potential to become employees, who could promote an efficient administration of the program and who have a vision for the project.

d) FURTHER DEVELOP THE VISION – define the specific nature of the program, goals, objectives, and policies. Begin to develop and circulate a written draft of the plan for the project. Also begin to define basic policies and procedures for operation. Since projects are often born out of other projects in the community, it may be useful to start with the written policy and procedures manual of these other projects, and develop additional statements relevant to the project being organized. It is especially important to define, from the beginning, all necessary controls dealing with how money is handled.

e) SELECT THE DIRECTOR – choose a person who will be responsible for managing the project. This should be done with input from the community, and participation of members of the committee, which will also grow into a first board of directors for the project. The search for responsible managers with integrity and initiative is a critical success factor in promoting economic development.

Economic programs often start within the community with a group of volunteers. As the project takes shape and volunteers can no longer do the work, a full-time employee is often chosen, supervised by the community committee, who can assume the overall responsibility for the program. This person coordinates the work of volunteers, and is responsible for reports and the development of the organization phase of the project. As the project takes on its own identity, the director also becomes involved in the contracting of other personnel, as well as overseeing the drafts of the plan, budget, policies, and related forms.

f) BEGIN WITH GOVERNMENT REGISTRATIONS – in most cases the project will require a special legal status, depending on the laws governing the particular project. Sometimes communities begin economic projects, and even schools and clinics, without getting government approval, and this can result in unfortunate consequences. The principle of "submitting to authority" applies, as the project should also have a positive relation to civil society for good work, and work done well.

g) WRITE A STRATEGIC PLAN OUTLINE – in many cases the initial idea has been developed with creative thinking, input from external donors, and reference to other organizations. All of this must now be placed into the context of the research and findings from steps a-f, and a pilot plan for 3-5 years documented in writing, that includes not only a definition of service delivery methods, but also a financial analysis of project sustainability.

h) DEFINE THE BASIC POLICIES – depending on the local conditions and analysis of the clients, the initial operational policies are drafted, including reporting expectations. This may also require the cooperation of the community leaders, as well as participation of members of the newly formed board. The policy definitions should also include the forms that are proposed for analysis of projects, presentation of business plans, documentation for authorization of investments, oversight of field staff, etc.

i) DEFINE THE SERVICES –the needs of the target group having been evaluated, a program is designed based on the local environment, and taking into account available resources, as well as sustainability targets.

j) DEFINE THE GEOGRAPHICAL FOCUS – it is often important to limit initial services to a specific area, generally where the community is located or where it is involved in other projects, as there are limited resources available.

k) RECRUIT AND CONTRACT PERSONNEL – if some have been working as volunteers on the start-up of the project, they may have already proven themselves for possible full-time employment in the project. Often the first opportunity is given to community leaders, though it is very important to make sure that selection is based on qualifications, not political or family ties.

In some cases, social enterprise requires specialized personnel due to the nature of the project being funded. For example, the start-up of a clinic requires people with medical training, a school requires certified teachers, etc.

For incubator and micro finance projects, initial staffing requires project supervisors who can introduce the program to potential clients, visit existing projects and provide technical assistance, offer business training, and use formal and informal opportunities to build the program. The field supervisor is key to the success of these projects, both in terms of financial goals and social impact.

l) DESIGN THE INFORMATION SYSTEM – the accounting and financial controls are important to define before the project grows very large, and when possible, a micro computer system should be used to reduce costs.

An interesting aspect of the process of institutional development is that the people who are involved in the initial start-up are not able, in many cases, to manage the project as it matures. As the project grows, the capacity of the director and staff should be evaluated periodically, and it should be expected that changes may be needed. Also at the level of the organizing committee and board, there may be the need to recruit new people, even from outside the community's circle of contacts, resulting in lower levels of control in exchange for higher levels of professionalism. The difficulty in "letting the project loose" as it grows is similar, in some ways, to parents who begin to "let their children go" as they mature from adolescents to adults. This is a positive development, but not always easy to accept.

The organizational committee, drawn initially from the community, develops into a full board of directors. The need for a board is often defined when the legal registrations are investigated, and the names that are on the first legal documents may all be of people from the community. As the organization becomes operational, it will become apparent who is really interested and able to function on the board. The board is often important not only for oversight, but as a condition for obtaining funds and support from other organizations. The search for committed board members who serve without expectations of personal benefits is one of the greatest challenges of project organization.

The principal role of the board is to supervise the director. It is not desirable that the board get involved in the daily operations or administration of the programs, but rather that it receive reports, participate and approve the annual plan, and evaluate results. There is a natural tension between a director and the board, because all of the authority of the program resides in the board, whereas the daily responsibility lies with the director. The fact that board members are voluntary adds to this tension, and the occasional involvement of board members can be viewed by full-time staff as lack of commitment when it actually may be simply lack of time. There are at least six areas where the board should invest the time it does have to supervise the program:

1) Maintain the vision for the program. This includes not only the financial goals of the business activity, but also the desire to balance goals related to financial sustainability with addressing the needs of the target group.

2) Supervision of the finances. This includes the review and approval of the annual plan and budget, the monthly review of reports, and an evaluation at year's end. It is also a good idea, in the case of loan or business incubator projects, that one board member be a part of the committee that approves the specific projects.
3) Promote the program with others. In Western societies it is usually expected that every board member be a donor, or bring other donors into the program, but in developing countries the board members principally give time, not money. However, they also represent the organization with other organizations, the local business community, and the local community.
4) Provide specialized technical assistance. An important incentive for many board members is the opportunity to use their own skills and experience in consulting activity targeted either at the program management or at the businesses that it operates or funds.
5) Legal representation of the organization. The legal charter generally designates the board members as the official representatives, from the perspective of the government.
6) Personal oversight of the director. This includes an interest in his/her daily well-being as a person, and not only in relation to the performance and progress of the project.

The director also needs to understand and accept that the promotion of the participation of board members is one of his/her jobs, and a legitimate and necessary use of time. The director should be willing to seek out the advice of board members on specific issues, adjust work plans to adapt to schedules of board members, and organize meetings at an hour and a place that maximizes board member participation. It is very important for the director to remember that participation in the board is voluntary, whereas all of the others involved are getting paid for their time.

In summary, the project begins to function first as a community committee. Then, as it grows, it becomes a separate legal entity, developing as an organization with its own staff, management, and board of directors. At full maturity, the relationship with the community continues, even though all board members and staff may not live or have roots in the particular community that began the project. The initial vision is kept in focus, and the connection with the initiating community also is maintained-it is part of the family, no matter how big it grows.

Chapter V

Common Principles for Success of the Business Enterprise

The success of the productive economic activity that is chosen should first be predicated on an analysis of the environment in which it is found. The question of how our business impacts society should be considered. It appears, for example, that the free market economics and globalization that has been promoted at the start of the 21st century is having little positive impact in developing countries. We need to find models that are consistent with development, and that really can help people. The accepted concept of industrial production, with man as an economic factor with seemingly no intrinsic value, is not necessarily helpful for the poor. So we need to consider an alternative understanding, where, in our concept of the business:

- We recognize that the life of the community also includes the physical environment, flora, fauna, and natural resources.
- We recognize the capacity of people to create and maintain their style of life, their music, their traditions, and their culture.
- We recognize the difference between real needs and created needs, such at those which are the focus of so much of the advertising on television.
- We recognize that quality of life is not what we see presented on television or in teen culture, and cannot be measured based on what we own or what we are able to consume.
- We recognize that we have to open ourselves to find new ways to do our work, listening to those around us, delegating authority, and promoting more flexibility and creativity.

The expectation is that positive values would thrive in the daily administration of the business, and be integrated with the social promotion of the community.

In the 21st century, the poor continue to get poorer, in spite of major technological improvements. The promotion of international trade appears to have lowered employment levels in many places in the world today and the marketplace has become increasingly competitive. Businesses are designed to create wealth, and enterprise development programs promote productive economic activity as a development strategy. The creativity that is needed for the 21st century is a big challenge. How can we harness economic development for the poor, and take a leadership role in promoting productive economic activity as a development strategy? Whereas managers in multinational companies focus on the marketplace of the middle and upper classes, the focus presented in this book is on creating successful business models for the 4 billion poor that are at the bottom of the pyramid, with less than $1500 income per year. Governments often have defined incentives for big companies, but perhaps alternative economic enterprise programs can demonstrate a better understanding of how small-scale operations can develop world scale capabilities. What are the best businesses for the rural villages and shantytowns in the 21st Century? How can a business make profits in markets that appear to be unorganized, local, and limited?

There are seven important variables that impact the success of such economic projects:

1. The source of the business idea: With credit programs, the concept of the economic activity comes from the person requesting the loan. In the other models presented, it comes from leadership in the community, the initial organizing committee, and other sources outside the community. The key question in this economically competitive environment is how to identify what business activity is profitable.

The input of the program director and staff is critically important in defining and evaluating the business concepts for micro enterprise programs. Advice from the board, from local professionals, and even from donors may be significant in defining the business plans for other projects. For example, in the case of Granja Roblealto, the chicken farm that supports a children's program in Costa Rica, the idea of the business came from a principal donor, as it was a highly technical business that he knew in the U.S. environment.

2. The definition of who owns the project: Except for the case of loans, the assumption is that the economic development projects are owned and supervised by non-profit or for-profit boards, with community involvement. This is a fundamental issue, and must be well defined prior to project initiation. Note that, in the case of loans, the ownership of the project by the loan principal is critical in assuring payback. But even in that case, the managers of the loan program will be able to influence the loan principal, especially with regard to promoting a successful project design.

When there are problems, an authority must be defined for the problem issues to be addressed. The nature of the business environment is that unresolved problems will simply cause the projects to self-destruct. On the other hand, when there is success, and the business flourishes, it must also be clear how benefits will be distributed.

3. <u>The identification of management and supervision</u>: The community and the board of the project delegate this role to full-time professionals, because after the initial organization they do not have time to provide adequate oversight. It becomes very important, then, to define who is responsible for the management of the project, and to find the right people for this.

The management of economic projects is the most critical factor in the success of these programs, and especially the entrepreneurial orientation of administrators. It is not easy to find good managers with integrity who are willing to work with the level of staffing, and relative lack of funding that is available for many community-oriented economic enterprises. The key is that they catch a vision for business as a social or development tool, and see their role as more than a paid job. It should perhaps be noted that, in all cases presented in this book, those involved in the oversight of the projects could be making far more money, with much greater professional prestige and "career path" potential, at other jobs in the formal business sector. But they have chosen to work in economic projects that have both a business and social impact.

4. <u>The definition of markets</u>: Even with the loans, it is always necessary to ask about market assumptions, as this is one critical factor in the success of the business. It is of first importance to define and understand the market for products or services. This is an area where innovation is needed, especially in the informal sector.

The motivation to promote business activity as a social development tool liberates managers of these programs from traditional thinking about market size and market share based on commercial rates of return. Service enterprises may accept a simple break-even instead of having to make a defined rate of return, and this frees them to focus on markets of little interest to commercial enterprises. The social development focus of community-based economic promotion also allows the freedom to take risks in crafting new businesses for markets with the poorer populations that may not be of interest in the existing business environment. The social nature of the programs also continually renews a focus on doing good for others, and defines products and services that fill gaps, help, are constructive, and are needed.

5. Appropriate and innovative small-scale technologies that are labor intensive: there are many commercial environments where special market niches can be identified based on special products for defined consumers. The production technologies required to fill these niches can be applied on a small scale, and also involve people more than machinery.

This is an area where small-scale economic projects can excel, especially because there is relatively little competition from other sources. Big companies want large-scale technology that is capital intensive. Many community economic enterprises have been successful at the other extreme, with small-scale technologies that are labor intensive.

6. The definition of product distribution channels: It is generally assumed that the distribution networks have to be confined to those existing in the marketplace. But again, this is a key area for innovation. There is a great need to discover low cost alternative distribution systems for the poor. In many cases the community, in association with other community networks on both a national and international basis, can begin to promote new distribution systems to enable people to increase margins for producers, and lower prices for consumers.

The creation of local networks has been the key factor in the success of many micro credit projects, and is a major factor with the marketing of products from business incubators. A pioneer area is international marketing. For example, a socially-oriented company in Canada has focused on a very needy area of Colombia, and built a profitable export program that enables rural coffee farmers to obtain higher prices for their product.

7. The connection with community programs: The minimum expectation is that projects will demonstrate a direct social impact on the community. This can be seen through increased incomes, new services, financial support for social programs, greater community participation in local governance, etc.

The assumption of this book is that all of the efforts to promote economic activity will incorporate a social development purpose, and that commercial activity is not an end in itself, but a means. At the same time it is important that a business make money, or it cannot survive, much less serve the community. But the purpose is not only to generate profits, but rather to serve.

An advantage of promoting economic activity from a community development perspective is that the values that are central for community development are also critical to business success. In what ways do we expect economic development promoted by poor communities to be different from other purely commercial business activity? At the very least, we would expect to find an emphasis on human values in the workplace:

- If we were helping people who have been exploited to start their own businesses, we would not want them, in turn, to exploit others. We want to promote justice.
- If we believe that we are stewards or managers of creation, we will avoid polluting and degrading the environment, be careful to dispose properly of waste, and respect flora and fauna. We want to promote responsible oversight of the world we live in.
- If we believe in the importance of community, the projects we promote will involve participation with others, not a jealousy for technology and markets. We want to promote mutual assistance and cooperation in the workplace.
- If we believe that there is more to life than "stuff," we will promote that clients avoid materialism and the love of money. We know that money can buy a bed but not sleep, books but not intelligence, food but not an appetite, jewelry but not beauty, luxuries but not happiness.
- Confronted with a market system that often alienates the worker, we affirm work with a rich vision of transforming, designing, crafting, producing and providing for others. Every form of work should promote and recognize basic human dignity.
- Confronted with economic policies that impoverish people and devalue work, especially the work of poor rural peoples, we affirm that all human beings have the right to a job that allows them to live with dignity as persons created in the image of God.

Chapter VI

Service Enterprises - Cost Coverage Through Fees for Services

The most common business activity promoted in communities to provide social, educational and health programs is the service enterprise. Often these projects begin as non-profit projects without any plan to evolve into a business. There are also many cases where community organizations are operating service enterprises without acknowledging that they are, in fact, using a business model for social outreach. Given the present scarcity of subsidies for funding social projects, the service business is also one of the most popular approaches for promoting sustainable social enterprises.

The genesis of the service enterprise is usually a project that begins to cover some of its own costs through service fees, after having started as a subsidized venture. The most common projects of this sort are schools and clinics, which often are born with government support. Water pumping for potable water and agriculture, security networks, daycare or children's camp programs, bookstores, and radio and television stations have also begun as service projects. The need to cover costs often develops over time, when a major donor pulls out, or when costs grow beyond the capability of the local government, non-profit organization, or communities to subsidize them. Sometimes the recognition that a business model will be needed comes in the context of severe budgeting problems. Governments and some international donor institutions sometimes abandon overseas projects that they can no longer sustain, perhaps claiming this as an "indigenization" or "nationalization" process, motivating a speedy reorganization of the project with a business model. Whatever the origin, service enterprises find themselves in an environment where cost coverage, a basic break-even between revenues and expenses, is required for survival.

A first objective in the service enterprise is the need to balance the objective of financial survival with the initial objectives of social outreach. For example, if a medical clinic was started to reach out to the needs of the poor in the community, and can no longer be sustained with donations, how can the objective of serving the poor be combined with the need to collect enough funds to operate? Or if a school was started to provide education for poorer families, but most of these families cannot afford to pay tuition, how will the school be able to continue?

This balancing of objectives requires an evaluation of a combination of approaches that allows for economic survival without sacrificing other objectives. These approaches include:

a) The full costing strategy: a careful evaluation of the total costs that must be passed on to clients through fees, minus any donations, offerings, or subsidies that can be obtained. Where the project depends on donations of plant and equipment, funding, or volunteer service, the market costs of those donations should be taken into account as well, in case additional resources are necessary in the future. Once the total costs are determined, the question of whether the clients can bear that cost needs to be asked. If not, are there parts of the services that can be modified so as to reduce costs?

It should be noted that there is no onus to subsidy in itself, as long as the subsidy is reliable. Indeed, there are many social objectives worthy of subsidy. However, most funding of social projects is for a limited term, with the expectation that the donor can be free from financial responsibility for the project over a period of years. An interesting phenomenon related to completely subsidized programs is that the clients begin to expect them as an entitlement. Attempts to raise prices, as a first step in promoting the continued existence of a social project, are sometimes greeted with demonstrations and threats.[25]

The analysis of full costing of service businesses may require the separation of the installation costs from the operational costs of the enterprise. For example, the community water systems implemented in villages in the Central African Republic assume that the well will be financed by a subsidy, and the sustainable service business organized in the village is designed to service the water distribution network, the cost of maintenance and operation of the pump, and upkeep.

b) The "Robin Hood" strategy: full cost analysis often leads to the conclusion that clients cannot afford to pay the total costs of the project, so a second alternative is to widen the market to include people who can pay higher fees, and thus offset the cost of those paying lower fees. For example, a health clinic might have a special program for more wealthy clients, not because they are part of the target group, but rather because they are charged a good deal more than others. A school might recruit a wide range of pupils from different economic backgrounds, and then highly subsidize poorer families through a scholarship program funded by those paying full fees.

The broader definition of service is not an easy matter, as the transition may involve cultural differences between clientele. The objective of attracting a higher income client also implies substantial changes to the service itself: for example, in a school, the upkeep and appearance of the facilities, the class size, and the professionalism of the staff may require upgrades to attract higher income families.

Another challenge with the "Robin Hood" approach is the mechanism for deciding who is poor and who pays full fare.[26] The management of the service project separate from the community is critical, and also important to address the transition required for attracting new clients as it impacts the areas of staffing and fee collection.

c) The synergy, or related services revenue strategy: many service businesses have facilities and assets that have the potential to generate revenue when not being used for their primary program. A basic place to start the search for additional revenues is with an evaluation of alternative uses of the physical plant. For example, schools often rent out their facilities for evenings, weekends or special events. A retreat center has created a program for housing an overseas studies program during its off-season. Another way to generate additional revenues is to evaluate potential revenue generating businesses within the service enterprise: a clinic adds a small pharmacy, plus sells photocopies, and operates a small soda within the premises. All of these small businesses generate a margin to help cover the costs of the clinic itself.

The struggle with cost recovery may also require substantial reorganization of the project. For example, many bookstores targeted at helping poor people have given up expensive retail space and refocused their "business model" on the placement of popular and educational books in existing retail establishments, and in the marketplace. Literature that promotes adult literacy and popular education is still being made available, but in a different manner.

In cases like this, the project may have been started with a subsidy because the target group was not able to cover the real costs. As the subsidy evaporated from donor fatigue, the project managers had to look for a way to survive. The target group may also have changed. For example, the type of person who buys popular education books at a grocery store is probably quite different from the person who made a special trip to buy such books from a bookstore. As service enterprises change their delivery system, they also need to reflect on how this is impacting their target group, and how it affects their initial goals and objectives.

The separation of projects from a given community is important, in part because of this phenomenon of needing to evolve and adjust. For example, when a school that was started within a community grows to a certain level, it generally must demonstrate both quality in teaching and the ability to cover its costs. Often the community will exert pressure contrary to these goals – promoting the hiring of community members without sufficient regard for their teaching qualifications, and expecting special prices for children from the local community. The desire for benefits for the community members can result in the total destruction of the project. It should perhaps be noted that the tensions in managing these projects create an environment in which some of these projects will not survive: and perhaps some deserve to self-destruct. Trying to prop up a project for the poor when the poor themselves aggressively oppose it, is an unhappy business.[27]

The administration of service projects is made easier by the existence of operating guides and manuals, and also professional associations of all kinds. Many resources are available from academic sources, libraries, and the Internet.[28] Two critical issues not adequately addressed in many other sources, however, are: (1) the importance of setting prices, and (2) the integration of the service enterprise with social impact.

The decision of how to set prices is the most critical to both social outreach and economic survival, and should be reviewed by the management, board, and leadership of service projects. The prices should generally be set at the level of cost coverage. Considering those who struggle just to pay for the service, to generate a "profit" may be considered incorrect. But this is complicated, because costs include not just salaries of employees, but also the ability to spend money on new plant and equipment. Spending on these items may be of benefit to management, so management should not make these decisions alone. Furthermore, revenues are offset by the anticipated scholarships for those who cannot pay full costs, and this also needs careful supervision. The definition of costs is also impacted by the definition of quality of services. For example, if a school packs 40 students into a classroom, it will need less revenue per student than if class size is held to 25, but also will sacrifice quality of instruction.

An additional factor to consider in price setting is the funding required for future project expansion, another area in which the board needs to be involved. Especially if the project was started with grant funds, the need to set aside funds for investment, or even replacement of equipment, can easily be forgotten.

The issue of integration with social outreach is especially important for service businesses, because they generally view the promotion of social impact as a key objective. Given the fact that there may be tension between a maturing project and the community that helped to start it, due to the inability to hire more employees from the community or provide lower prices for community members, the evaluation of integration is made more complex. What often occurs is a move from a geographical focus to a functional one, a natural result of the need to find both qualified employees and sufficient clients for a sustainable operation. Strong leadership with a vision for social impact is especially critical in this context, to embrace the vision of the project even as its outreach expands beyond the initial group that started it.

\- - - - - - - - - -

Case of Life School[29]
U.S. Retirees Respond to the Need for Children's Education in Central America

Background: Attracted by the weather, the relative cost of living, government incentives, and the adventure of living overseas, a couple from Grand Rapids, Michigan decide to retire in a Central American country. They purchase a large plot of land in a semi-rural area, where they build a nice home and enjoy a few years of retired life, though they become somewhat bored with the retired lifestyle.

As they get to know their neighbors and other local people from involvement in a local church community, they are struck by the gap between the theoretical access to education, and the practical lack of skills that young people have to become employed. They see, for example, that the teenagers who supposedly study English in school are not able to speak it at all, and discover that the learning process has been based on a rote methodology of memorization. There are many jobs available in the tourist business for young people who speak English, but they require the actual ability to speak, not a theoretical knowledge. In the same fashion, the young people have been taught about micro-computers, but have never actually used one, and therefore are also not able to apply for basic jobs that require word-processing skills.

Phase I: The idea to help with a training school begins very naturally. A building is constructed on the property, and a "technician" program is designed to teach practical vocational skills, with emphasis on bilingual ability. Several teenagers sign up, and the initial few years are subsidized, with only a small fee charged for specialized classes. The physical plant has been constructed on the retiree's land, and teachers are volunteers or paid informally. At this point, the project is completely managed by expatriates, and is targeted at a dozen young people from the neighborhood.

Phase II: After "graduating" the first class, it becomes apparent that the training, without formal registration with the government educational authorities, is still not sufficient for obtaining a job. Yes, the ability to speak English and actually work with computers is necessary, but so is the formal degree. At the same time, the cost of the subsidized program cannot be maintained over time, but a registered program is necessary to attract paying students. Involvement of national leaders with educational experience is incorporated into the program, and a formal secondary educational program is designed and presented to the government for approval.

The project grows. New facilities are built to accommodate the secondary school. Qualified national staff is contracted, and a fee structure is created to cover operational costs, but still maintain a lower price than other educational alternatives to provide services for poorer families. Enrollment grows from 10 to 50, as a new section is added each year. An operational subsidy is required each year to cover expenses.

Phase III: The maintenance of class size, critical in the financial equation, proves to be difficult with a stand-alone high school, and it is decided that a grade school is necessary as a "feeder" system, and also as a social service. Again, new facilities are constructed, and a substantial investment made in subsidizing staffing, as initial class sizes are not sufficient to cover teacher salaries. At this point a national leadership committee is organized for both government registration, and to provide oversight for the project. Members are drawn principally from families who have had children in the school. The number of students grows to over 200.

Phase IV: The school now has classes from kindergarten through high school, and with almost 400 students can cover all operational costs, plus generate a margin to be reinvested in the project each year. Total revenues for the 2004 school year were $480,154 and expenses $436,494. The national committee has evolved into a formal board of directors of the school association, which meets monthly to provide oversight, and approves the annual plan and budget. More than 40 full-time national staff are employed by the project, yet no subsidies are required. In fact, the margin of revenue over expenses is sufficient to allow investment in a scholarship program for needy families. The physical plant is being provided with a cost to the program sufficient for basic upkeep and maintenance. The school is fully accredited by the government.

\- - - - - -

As this case illustrates, the service enterprise not only requires a business approach, but is also expected to yield a positive social impact on the community. This purpose is difficult to achieve if:

- Teachers are mean and unfair with the students.
- Doctor or nurses treat his/her patients coldly and cares little about their health
- Day-care counselors act in an immature and improper manner.

What is apparent is that this approach requires intensive training of the staff and constant reflection on how the project is meeting the needs of its target group. It is also necessary to evaluate periodically how the project is relating to the community and the local environment, and to promote renewal of a vision for integration of the project with the local community.

Some question the discipline of the business approach, and in some sectors the notion that services, which have been provided as “public goods,” can be made financially sustainable is considered faulty. “The government must provide the enabling environment for serving the poor…” is a definitive statement from a U.S. 2004 conference on healthcare in developing countries.[30] Yet at the same conference it was acknowledged that literally hundreds of health centers had been shut down in developing countries due to lack of funding. Are the poor better served by having no access to health resources? The "Robin Hood" approach to financial sustainability is difficult to manage, and was ridiculed in the same presentation at this conference. But why is it preferable to shut down the health centers?

Perhaps it is simply worth noting that the presentation of methodologies for creating economically sustainable approaches to funding "public goods" services is not the ideal solution.[31] It would be better if governments, international agencies, or church groups funded more basic services for the poor, and especially for health and education. But in the meantime, the concepts presented in this chapter can help fill the gap.

Chapter VII

Separate Businesses for Sustaining Social Services: Endowment

As communities consider how to generate revenues to cover the costs of social services, they quickly discover that there are many programs that require a subsidy because they have no ability to charge fees for services. For example, projects for homeless and abandoned children simply cannot generate revenue by charging the street kids. The data presented by international agencies on the plight of children is astounding: for example, "33,000 under-five-year-olds die from preventable disease every day."[32] A critical requirement to be able to respond to the problems of children in many local communities is first to identify a source of funding.

The concept of generating financial support from sources besides donations and fees has long been accepted in the funding of higher education. Private schools, public and private colleges, and other centers for graduate training often derive a major portion of their annual budget from funds that are invested in the stock market or in other fixed investments, which are listed in their financial statements as endowments. In contexts where financial markets are unstable, the idea of endowment funding cannot be based on passive investments, and therefore requires a rethinking of the term "endowment." If business activity that will help generate a stable cash flow for social outreach can be identified, and there are donors willing to invest in such businesses, this can be a very positive means of support for outreach. From a field perspective, it is necessary to consider the possibility of such support for many types of projects where services cannot generate fees, and where the future of the program is dependent on donated funds. The consideration of the need for stable support foundations for social programs is a sign of leadership maturity, and evidence of willingness to plan for the longer term.

When social projects are initially funded from overseas, the absence of stable self-support foundations is evidence of a lapse in planning by foreign organizations that start overseas projects with donations. Not even in higher education in developing countries has consideration of endowment support been part of "nationalization plans" for most projects. The fact that without such support many colleges and universities in North America would cease to exist seems to be ignored. The irony is that many institutions of higher learning in developing countries struggle to survive with less capacity to charge students, and no endowment support whatsoever.

Interest in endowment funding is often the result of donor fatigue and the realization that long-run programs cannot be supported with short-term donations. Many causes, and even regions of the world, seem to attract funding based on fads that change over time. Donors also age, and the favorite causes of younger people may be quite different from those of the older generation. Yet there are many projects–street children projects, prison training programs, rehabilitation of drug addicts, etc.-that will never be able to generate fees for their support. A subsidy is needed, and if donors do not want to be involved or not for long, where else will the funding come from?

Professionals with backgrounds in business are stepping forward to respond to this question. This goes beyond the "corporate initiatives for community engagement"[33] becoming popular in the U.S. as groups are being formed not just to help non-profits, but to develop businesses for the financial support of a variety of social projects. The objectives of these support groups go beyond fund raising, as this context provides a significant opportunity for utilizing the skills of business professionals, and in so doing, respond to the needs of poor people overseas. For example, a firm in Phoenix is helping a hospital in Honduras generate support through the export of Honduran coffee, which the U.S. company promotes and distributes.[34]

The idea that business projects can be used to support social programs is also good for the programs themselves. For example, in the chicken and hog farm mentioned previously, where an agricultural project helps to provide income for an orphanage and day-care centers for children, one of the benefits is that even the children can see that their support comes from hard work. The farm is located adjacent to housing facilities for 70 children, and many of the spouses of the dorm mothers work at the farm. The children also consume eggs and chickens that cannot be sold on the market; they know where much of their food comes from. Resources generated by productive economic activity generate an ethos different, and perhaps psychologically more positive, than resources from donations.

There is a growing recognition of this alternative, and many new projects are being designed based on this paradigm. The projects tend to be fairly large and complex, requiring technical assistance from people with experience in making business plans and seeking venture capital. Some U.S. donor agencies seek such projects,[35] and several U.S. business network organizations are offering to help with technical assistance.[36]

Much of the technical assistance available from U.S. organizations for starting a business is targeted specifically at business creation. The key for effective economic activities to support social projects is to find the right business that is sufficiently profitable to generate a continual income, and sufficiently flexible to match with the social programs being supported. Creativity and innovation are necessary when designing profitable overseas businesses that can be set up with limited investment funds, that do not require advanced degrees, and that can, at the same time, demonstrate a competitive advantage that results in an acceptable profit margin. Oftentimes a background and experience in business is necessary for a person to be successful with an international business enterprise.

- - - - - - - -

Case
The "Sunflower" Businesses for Support of Children-at-Risk[37]

There are over 100 million children living in the streets today,[38] and at least 40 million living in the streets of Latin America. The mission statement of *Programa Girasoles* is to "work for the rehabilitation of children and young people who have been abandoned." The objective is to rescue street children and promote a rehabilitation process that makes them "agents of change in society."

Who will pay for this? The government has no programs for the abandoned children who live in the street, except for an oppressive police response to the children as a nuisance. At one point in the past, the *Girasoles* project received donations from a church-related agency, but such support is minimal, and not stable over time. The total annual budget for the program is over $500,000.

Business activity to support the program began with an analysis of the assets of the organization, which included a building in downtown Lima and camp centers in Kawai, Kimo, and Puerto Alegría. Facility management of the downtown building was adapted to provide opportunity for parking lot fees and storefront and office rentals. Special retreat accommodations were designed to generate local tourism revenue at the retreat centers.

A second phase in the development of economic support businesses was the evaluation of enterprises that demonstrated potential for future job opportunities for the young people in the program. They had already begun staffing the dining facilities at the retreat centers with program participants, and a bakery business was begun in the Lima facility. A carpentry shop, a shoe shop, and a T-shirt printing business were also started with young people working as apprentices. The program began to buy small taxis in Lima, and motorcycle taxis in Iquitos, and now has 20 car taxis and 65 mototaxis. The taxi business has been the most successful of the enterprise projects in terms of margin, and also has created jobs for program graduates. Two recent new enterprises are a water purification business, and Peruvian handicraft exports for the U.S.

Total net profits from the businesses that exist to generate financial support for the *Girasoles* program in 2004 were in excess of $390,000.

\- - - - - - -

The endowment methodology is perhaps the area where the business plan orientation of for-profit companies is most useful. Basic guides for preparing a business plan are available at no cost from the U.S. Small Business Administration (www.sba.gov) and many other places. Many colleges and even some high schools promote volunteer internships for students in Small Business or Entrepreneurship classes that can be accessed, in some cases, to help on endowment projects to fund social services. The successful implementation of this type of business not only helps people, it provides in many cases opportunity for business professionals to help others.

Chapter VIII

Target Group Analysis and Business Incubator Projects Focused on Helping Specific Populations

The models presented in the two previous chapters for using economic tools for community impact were focused on social outputs first, and then business concepts were applied to make these social outputs sustainable. The next two chapters begin with a different focus: that of helping poor people to increase incomes or obtain employment. The concepts of business incubators and micro credit are introduced, with various means of promoting micro credit described in some detail.

The focus of this book is different from the thousands of articles related to micro finance on the Internet and elsewhere, because it begins with a focus on the target group rather than on service delivery methodology. If the objective is to assist very poor people, the first thing we discover ***when we ask them what they need*** is that not all of them want a loan, nor can they perhaps even handle a loan. So we do not impose on them a credit model, but consider the possibility of other creative economic approaches. The panacea of "MED" models for helping the poor has been questioned since the mid-1970s as "a form of social blotting paper capable of absorbing large numbers and providing urban subsistence levels of income, thus helping to avoid consideration of alternative means of job creation."[39] The alternative of providing equity, the machinery and equipment, rather than a loan or leverage for job creation should be considered, the promotion of an enterprise where the principals or clients are employees, but not involved in management, at least not at the beginning. This is the business incubator paradigm, which can be considered "micro finance," but not "micro credit," because the financed part is equity rather than leverage.

This book is different from many other presentations on economic development in that it is not promoting a model for growing service delivery programs. "The (micro credit) industry has become dominated by a techno-managerial perspective, with a large number of technical manuals and courses on how to manage micro-financial services and financial sustainability, and how to achieve outreach. In the process, the development impetus which first gave rise to micro-finance is often lost."[40] The popular concept called "scaling up" has actually brought very negative consequences for many organizations, as organizational objectives are sacrificed on the altar of institutional growth. Organizations that were started to help the poor change their focus to more wealthy populations, and organizations that were started to help specific communities begin servicing only a certain type of client just to get bigger. This happens especially by refocusing on people selling goods in marketplaces.

But bigger is not necessarily better, and the tendency to leave the poor behind in order to grow micro credit programs has been identified in many studies. "Ironically, it is the success of the 'first wave' finance-for-the-poor schemes, and particularly the Grameen Bank, that is the greatest obstacle to future experimentation. Most designers and sponsors of new initiatives have abandoned innovation, and 'replication' is leading to growing uniformity in financial interventions."[41] Although it is possible to organize financially sustainable micro finance projects on a small scale, and with limited capital, this is not in vogue today.

Many development organizations that work in the area of micro finance were started with an ethos of simplicity and modest lifestyle. This changed with the boom in micro finance in the 1990s. Salaries of managers of organizations that promote themselves based on help for the poor, listed for all to see at www.guidestar.com,[42] graduated to the same salary levels as in the world of big business. For example, in one well-known specialist U.S. micro credit agency, the annual salary of their regional directors rose from $15,000 to $150,000 in a period of less than ten years. The high cost structure of many of these organizations also creates the need for government and international agency contracts for economic survival, to pay U.S. salaries. External funding from governments and other international institutions can move an organization further and further from a focus on either the poor, or long-term commitments to specific communities. There is a sad history of projects begun with a commitment of purpose, in which the desire to help others seems to erode into a focus towards helping oneself.

A curious aspect of this phenomenon, in the promotional marketplace, is that advertising of micro credit programs targeted at major donors and foundations is sometimes misleading.[43] For example, one U.S. organization promises, "for every $1 you provide, $10 will get to the poor." Since the $10 is based on the recycling of loans that have been placed in previous periods, the fact is that the $10 will "get to the poor" regardless of whether the donor sends in the $1 or not. In some cases, the $1 is what the organization needs to cover ongoing U.S. overheads, and no new funds are sent overseas at all.

Promotional claims about efficiency or impact on the poor reinforce previous recommendations that economic projects be started and managed with community involvement, and stay integrated with the community. It is good that the agenda of helping the poor through business is a popular idea with governments and international funding institutions. But the emphasis must be on the target group, and on defining the program based on real needs rather than on an external agenda promoted by others. The temptation to start with an external agenda is natural, as models that have been developed in other contexts are often implemented by copying what was done elsewhere. The problem with this franchise approach to economic development is that it only works when the clients can be adjusted to fit the program, rather than the program adjusted to fit the clients.

For example, many programs compete with each other to help people who sell goods in the marketplace, where micro credit comes in to replace the already existing lending business of local loan sharks. But these models only work for people who have commercial businesses in the market. The replacement of high-priced money-lenders in marketplaces has made many micro credit lenders very successful, and is one of the reasons that so much "micro enterprise promotion" is currently concentrated in markets–that is where many organizations want to find their clients. The fact that clients are selected based on their fit with the definitions of the programs is also why so few micro finance programs are integrated with the needs of communities. Community members often do not qualify for loans because they do not live in the right area, or do not have prior business experience. The predetermined service methodology has excluded them.

How revolutionary it is, then, when the program design begins with definition of the needs of the people being served! If the purpose of the program is to serve the people, it is only logical to start with an evaluation of what the people need, and then apply the best methodology for their situation.

The plan to use a revolving loan or micro credit methodology is a popular alternative because it can generate, through charging fees and/or interest, the basis for the long-term sustainability of the program. Success is dependent, however, on the assumption that people or groups of people have viable existing enterprises or business proposals that can be successful through loan financing. When the people do not have an existing enterprise, or even a proposal for a viable business, other micro finance methods must be created to help them.

The goal, at the community level, is to generate increased income and permanent employment for the poor through productive activity that is viable in the real world marketplace. It is important, also, to consider the secondary goal of making the program itself sustainable, so that funds can be recycled and service delivery continue without a constant dependence on donations. From the start, the available resources, including volunteer assistance of professionals, can be combined with outside resources to promote a focus on transformation, not just of the economic situation, but also of the social environment. Community micro finance is different from other approaches in that it is focused on the needs of a target group that usually includes the very poor, and it is also integrated with other community outreach, such as educational and health programs.

The focus on the poor usually means that this group is not eligible for assistance from other programs. This is because the very poor do not have the financial collateral or job/business experience that is required for entry into most government or international agency micro credit programs. Community programs are generally dealing with a more risky population, but also have some distinct advantages. First, the deep roots in the community in which it works allows program managers more information about the people and their history. Second, volunteer participation of community members in training, visitation, consulting, and helping with small projects is a significant resource for dealing with projects that require a lot of assistance. Thirdly, the methodologies can be applied with a process of graduating from very small projects to larger and larger ventures, based on success over time. This graduation process helps to minimize risk and identify entrepreneurs who are able to increase the size and profitability of their businesses.

<u>Analysis of the target group</u>: The first common discovery that is made in studying the needs of the people to be served is that, in many cases, the potential clients are not ready for the discipline required for a loan program. Again, this is often because community programs are targeted at very poor populations that may have difficulty in conceptualizing a profitable business. Many potential clients would not know what to do with a loan.

The analysis of the target group should consider the people's needs, environment, and also the resources that they have. Evaluation of the needs includes identification of problems with health, safety and security, logistics, and educational background. Sometimes it may be necessary to address problems discovered in these areas before embarking on micro finance activities. For example if crime is rampant in a specific community, the consideration of how to protect machinery or tools for a business has to be discussed as a first priority. If potential clients cannot read and write, specialized training may be needed prior to implementing a business, to prepare them for the need to account for and control money.

The environment of the target group includes issues such as access to raw materials for production, transportation access, marketing channels, local competition, and other factors that play a role in the success of a productive economic activity in that area. The resources of the group include their job experience, their assets, their formal and informal education, their history of access to credit, and their entrepreneurial orientation.

It is often the case that people have had some experience in subsidized economic activities, such as handicrafts, sewing projects for women or communal projects with some connection to business. This background can be helpful if the projects were viable, but also can be a negative factor if the activity was subsidized. Often the expectation is created through these types of "hidden handout" projects that economic development is just another form of welfare, and that there is no need to be concerned about critical issues like quality, oversight and productivity. It is very important to communicate to potential clients that the micro finance approach being proposed is dependent on viable enterprises and hard work.

<u>Selecting a finance methodology</u>: The methodology should be chosen in response to the needs of a specific target group, and these needs may change over time. That is why the presentation of micro finance models in this book is eclectic, a toolbox that can be combined to stimulate a process of graduation through successive levels of growth in the life of a business, meeting the changing demands of the clients. There are cases where poor people, with no previous experience in business and without collateral, have begun with training in a *business incubator*, bought the assets with a

small *community bank* loan, expanded and added employees with a *solidarity loan*, bought new equipment with an *individual loan*, and then gone into the formal banking system to obtain commercial loans. This is the exception rather than the rule, but it can happen.

The first level of business financing is the ***Business Incubator.*** This is a micro finance approach that has evolved internally in many community contexts in response to the desperate need to create employment for people in the community. A business is proposed, usually one in which community members have experience, and seed capital is obtained to fund this business. The community or a community related committee is the owner and operator of the business, and the people who are working in it are treated as employees. As the business proves its viability, the profits are used to pay back the initial capital that was invested. If the people who are employed in the business demonstrate the capacity to run it, they are often encouraged to buy the business, and the funds invested in the business (equity) are converted into a loan (leverage), so that the initial investors or community pool get their funds back, and the pool that exists to help in business start-ups can be used to help other people. For example, a community desiring to help women who were unemployed in a small town in Honduras[44] set up a small bakery, and once it was working, three women who operated it were able to "buy out" the business with a commitment to pay back the invested capital. In this same community, a group of unemployed men who knew how to do upholstery obtained funds to help them get a furniture business started, and as they began to generate a profit, were able to buy the business by paying the funds back to the capital pool.

This methodology is often applied in social outreach with special populations that need employment, such as with street adolescents, people recovering from substance abuse, and ex-prisoners, who all have great difficulty in obtaining employment. If a niche business can be identified that can be operated on an individual basis, this approach creates an alternative for setting people up with a job, even if they know very little about business. Successful examples include teaching street girls in Mexico[45] how to make stuffed animals for export markets, teaching recuperated drug addicts and alcoholics how to make wooden tortilla presses for local markets in Mexico, teaching women ex-convicts how to make artisan products, and teaching male ex-convicts how to organize and run specialized cottage industries of various types.

The important issue in all of these cases was to identify a business plan with sufficient analysis to demonstrate that a viable enterprise was possible. The design of such a business must provide for opportunities that can be supervised initially from the outside, by people not involved full time in the business. And these outsiders who come up with the ideas for the business may also lack important information. Professionals or volunteers from the community may believe that they have a good business idea, but these do not always work out. A coffee shop business incubator for women in Mexico,[46] developed with the assistance of an expatriate with Starbucks experience, was unsuccessful due to location decisions. The coffee was wonderful, but no one from the neighborhood in which the small shop was located would pay for it.

The project design must include the ability to discontinue the participation of certain people, or withdraw the assets from the business, in the case that the proposed clients do not demonstrate the interest or ability to make it work. In most cases, the people who really will show up on time, take responsibility for the assets, and do the work, cannot be identified until the business is operational. This is why the participants in the business are initially considered employees, not owners of the business. That the business is not theirs, for employees to do with as they please, is a most important issue to clarify; it is hard work and entrepreneurial input that will be key in making the business successful, and also in identifying who will be eligible to own the business in the future.

Case

The VIA (Values, Initiative and Assistance) New Business Development for Ex-Convicts
After working for a few years with the *Voz de Libertad* outreach in the prison in San José, Costa Rica, an LAM missionary began to look into ways to help ex-felons begin a new life, once they were outside the prison. The problem for many was that, due to their arrest and conviction, ex-convicts were not able to find employment after getting released from prison. This created an environment conducive to returning to a life of crime, especially related to drug distribution and stealing, to be able to exist outside of prison.

Empowering ex-convicts to start a business began with experimentation, and the provision of tools and equipment for various projects failed due to irresponsibility, lack of management skills, failure to consider the marketplace, and credibility problems related to the expatriate's ability to promote discipline with respect to work and integrity with business management. The provision of assistance was considered to be a gift, and in many cases the "donation" was liquidated to provide for more immediate consumption needs.

After several rounds of failure, a service delivery "committee" for business incubators was organized with ex-convicts themselves. Systems were defined by the *Voz de Libertad* organization to manage program resources as a separate operational unit, called the "VIA (values, initiative and assistance) line of supply." A written business plan was required before initiating any new project that defined markets, finances, operational plans, and "development aspects"[47] of each proposed project.

An example of a successful business funded under this new methodology is a natural juice stand that is operated by an ex-convict at the entrance of a Spanish language institute. The funds required for the mobile cart, the juice-making equipment it contains and working capital for initial stock of fruit were provided by the program. Ideas related to marketing, pricing, and promotion of juice were also offered in a training program. The business has generated a profit since start-up.

Other business activities that have been started by this project include: taxis, pressure washing, leather crafts, painting, sewing, carpentry, and small bakeries. Since beginning this program, managers have become aware that such programs also exist in the U.S., such as the Delancey Street Restaurant in San Francisco that has a staff entirely made up of ex-criminals.[48]

The key requirements for a business incubator project include the definition of the productive economic activity, prices, costs, and a definition of who is responsible for daily operations. A great deal of training is usually part of this model, as the participants do not necessarily have the background to understand production requirements, technology, and markets. In many cases, the training phase is funded by organizations attempting to address the needs of specific targeted populations, and the incubator project can sometimes be built with complimentary services provided by other groups working with ex-convicts, street children, drug addicts, etc.

A variety of businesses have been created using this methodology, and the entrepreneurship of the person or group who initiate the projects is another key factor. For example, funding projects related to rural agriculture in developing countries is avoided by most international micro finance institutions, who consider agriculture too risky for business investment even though most of the poor happen to live in rural areas. A number of incubator business approaches exist for rural agriculture that have been developed through specialized training, emphasis on appropriate technologies, alternative production inputs, and specialized niche marketing. Some involve group enterprises for organic crop production, oriented to export markets. In many cases the simple organization of a rural transport service has proven to be profitable, benefiting not only producers, but consumers, and passengers as well. Organizing group businesses to lower costs by bulk purchasing or raising sales prices by cooperative marketing schemes has also been successfully funded through business incubator approaches.

Capital requirements for the business incubator projects are different than for small loan programs, varying according to the type of businesses under consideration. For a given community, the capital needed may be greater, especially when the business funded is targeted at a group of people. However, the benefits may also be greater when the entire group is taken into account, and the security of the funding is based on the fact that individuals do not hold ownership of the project. Critical management decisions can be made by the organization providing supervision, and changes to the business approach can be implemented in the process of the evolution of the business. It is worth noting that this is a significant advantage over the loan approach, where the loan client is given full control over his business operations, and loan supervisors are limited to giving advice.

The costs of organizing and supervising a business incubator are generally recuperated through a fee arrangement during the equity phase of the project, and the capital costs recovered when the business is bought out by the employees, with the capital, plus interest, converted into a loan payment. If the business is being poorly managed or proves to be dysfunctional, the organization providing oversight can pull the plug at any time. If the business proves to be highly profitable, the buy-out can reflect this, providing a greater return than a standard loan arrangement.

This eventual combination of equity and leverage finance, accompanied by non-financial services targeted at helping with daily business management, controlling costs, and obtaining adequate prices has proven to be an effective methodology, and particularly effective with very poor, homogeneous communities.

Chapter IX

Organization of Three Levels of Micro Credit Programs

Community bank, solidarity and the individual programs described in this chapter are revolving loan methodologies. The basic instrument or development tool used for these programs is a loan. Revolving loan methodologies have in common the following principles:

(1) The loan must be paid back; it is not a hidden handout.
(2) Therefore, the funded project must generate a profit.
(3) This is facilitated by a defined program of evaluation and supervision.
(4) The cost of the program has to be covered by client fees or interest.
(5) Capital that is paid back is recycled to other people.

The implementation of these principles leads to two cycles of sustainability. At the level of individuals and families, the business activity provides them with sustainable resources. As they pay the "rental fee" for the asset they are using, or the interest, this guarantees the financial sustainability of the entity that is providing the loans, paying for staff and services. In the case of community banks and solidarity groups, the loan to the group is seen as one loan, even though it is portioned out to many people, and the fees related to the loan pay for the one project supervisor assigned to the group, plus covering other costs.

The previous chapter referred to the Business Incubator as a first level of micro finance. A second level is Community Banking-community or village banking is a decentralized lending model in which very poor people, without business experience or collateral, can be provided small amounts of capital based on control and supervision by their peers. This method provides a mechanism for funding with minimal risk that will permit poor people to start or expand cottage enterprises, and grow them through successive loans of increasing amounts. The requirement for paying back the loan is accompanied by a defined deposit to a community savings account. The provision of small amounts of capital also helps to identify the entrepreneurs in the group, who with greater assistance might be able to create wealth and employment for others in the community. This approach is well suited for integration with community organization and governance, and has been applied with success in diverse contexts.

There are eight requirements for organizing community banks of between 15 and 50 participants:

1. There must be an organized group, comprised of people who are socially connected in some way. Again, the community projects and governance provide an excellent context for group organization.

2. There must be an autonomous process of selection for the participants of the group, as it is critical that people in the group be considered by each other to be responsible, since all assume the risk of default on each other's loans. The selection process in itself may be the most important issue in the success of the projects, as people will not want to have formal financial commitments with others who have a track record of irresponsibility.

3. Everyone in the group must accept that the activities to be funded will be productive economic businesses that generate income, and not personal consumption. Generally, the activity funded by the small loans provided by community banks are household projects that increase incomes, especially of women. In some cases, members of community banks pool their loans and work on projects together.

4. Any activity funded in the group has to be evaluated by the group and receive prior approval before funding.

5. Loans will be provided in cycles with amounts increasing, but the ability to continue receiving larger loans is conditional on paying previous commitments.

6. A small deposit to a locally controlled savings account will be requested, in addition to each loan payment. Savings will be considered as loan collateral, but a portion also can be available for emergencies, and to replace the need for a loan when a person exits from the

program. Some community banks also open the deposit pool for loans for personal consumption items, often at higher interest rates.

Though having a savings account is often proposed by international agencies and academic experts as a source of funds for micro finance, poor people do not have a lot of money. Even if they did, in most countries the community bank is one of the only contexts in which organized savings pools can legally be encouraged on a formal basis, and then only when managed by the clients themselves.[49] Full-scale programs of administrating savings are difficult to manage, and in most places only the government authorities can authorize a program for holding deposits from the public. The hurdle rate for doing this is generally in excess of millions of dollars, and also requires holding a deposit with the Central Bank, presenting detailed reports, and conforming to other government rules and regulations. This has proven to be very difficult for development organizations, and has also resulted in loss of focus on the poor as micro credit agencies evolve to become commercial banks.

7. The interest rate will be equal to or more than commercial market rates, subject to the decision of the group. These are generally considered to be quite reasonable, compared to the interest rates in the informal sector that the poor can access.

8. Governance of the community bank is democratic, and clearly spelled out in the rules and regulations that all have been provided. This methodology requires a good deal of community organization prior to the financing of projects, but once the group is operating, it involves periodic supervision from the outside. In many cases the full-time staff supervising the programs only show up for monthly group meetings, and may visit some projects, but not necessarily all of them. The assumption is that the members of the group will take on assistance and supervisory roles for each other.

From the perspective of the entity that is organizing programs, the community bank is viewed as only one loan. All of the members are obligated to pay for it. What happens in reality is that, as savings payments accumulate with loan payments, the savings amount of the members replaces the externally injected loan funds in one or two years, so that the lending activity at the community bank level can continue even as the initial amount is completely paid back.

The objectives of the community banks are both financial and social, as are the definitions of the indicators used to measure impact. One important indicator is the level of cooperation of people involved in small business activity, and often the phenomenon of these people helping each other has more impact than the loan itself. Other financial indicators, like payment records for both capital and interest, the amounts of savings that have been deposited, and the level of arrears are often very important. The average loan size for a community bank loan in Latin America is around $50, so this is a program that can operate in very poor environments.

The community bank model is considered to be an efficient form of providing capital to poor people at a low administrative cost per person. The model is of benefit to poor people in allowing them the capacity to start and grow small business activities, and successively become eligible for greater amounts of capital based on a track record that they create for themselves.

A third level of micro finance are Solidarity Groups-another means of organizing revolving loan programs. The loan clients, with little or no business experience or loan collateral in this approach, organize themselves in groups of 5 to 10 people, based on a common business activity or geographic proximity. As members of the group, they all sign a loan contract for each other, taking responsibility for the whole group payment as well as for their own. As in the case of community banking, this will naturally require investigation by group members prior to the formation of a group, and the elimination of prospects unlikely to pay.

The requirement of solidarity with others in the selection process in effect guarantees the loan, as unworthy candidates will be eliminated by their peers. Who wants to take responsibility for payments of others known to be irresponsible? The peer pressure to pay, and to pay on time, is helpful in obtaining a good payment record. A problem with late payments of any group member is a problem for the rest of the group, because others must make up for the one who is late.

Solidarity groups may also focus on helping each other in production, marketing, and organization. The small group meets periodically to share how their businesses are going, and this facilitates supervision from the outside entity, as the project promoter can attend these meetings, and follow them with visits to businesses that might be experiencing difficulties.

As with community banking, there are many manuals and guides available for defining specific procedures for organizing, funding, supervising, and collecting funds from solidarity groups. It is important to define how a group governs itself, who calls meetings, how collections are made, and how both personal and group documentation is written. The requirements for supervision must also be planned in advance, with specific social impact indicators that not only evaluate the financial areas, but how the solidarity group requirements might have generated cooperation and sharing. The average size loan with solidarity groups in Latin America is around $200, and there are also many solidarity schemes that provide growing amounts of capital for subsequent loans.

A fourth micro finance methodology is the Individual Loan: the provision of capital to an individual person is perhaps the methodology most expected, but least evident, in programs that focus on the needs of the poor. This is generally a situation in which some type of guarantee would be required of the person obtaining a loan, and not many people can qualify. Since bigger loans are required, organizations that have limited funds to help the poor also may find this methodology less attractive than other approaches, desiring to give small loans to many people rather than larger loans to few people.

Individual loans require not only guarantees, but also a business plan that demonstrates how funds will be used. That most important factor in evaluating a business plan is looking at the market projections, because it is far easier to make things than to sell them, especially at a good price. In general, a successful individual loan will exhibit some competitive advantage that makes it stand out from other similar businesses.

The truth about success in small business is that it depends to a large extent on the entrepreneurial nature of the person operating the business. Unfortunately, the assessment of “entrepreneurship” is hard to evaluate. That is why the graduation from prior levels of business incubators, community banking or solidarity group lending is such a great foundation for funding individual loans. For example, a rural tailor in Honduras grew his business from one sewing machine to hundreds by focusing on making a special type of blue jeans.[50] He turned out to be a true entrepreneur, though at the time he received the loan this was not evident; he demonstrated a “chispa” or spark that can only be seen through practical experience.

People who have this “spark” make money for themselves in the process of building a business, but they also create a great many benefits for others through increasing production and employment for other poor people. Social benefits are expanded, along with permanent jobs. This does not mean that those whose businesses stay small have failed. Some clients of solidarity groups do not desire to expand their business beyond cottage industries, and are happy not to have more employees and the increased pressures that come from with growth. Many clients of community banks want only to increase household income through their small loans, and have no plans for anything beyond that. They appreciate having a savings account available, but plan to leave it alone for emergencies, not to access it for further expansion.

For many people, however, the different micro finance levels allow for a graduation process for successful projects, with greater amounts of capital available at each level. Many business ideas have been born in community banks, grown into stand-alone ventures through solidarity groups, evolved into well-established businesses through individual loans, and then begun to access loans in the formal banking sector.

Chapter X

Management Requirements for Micro Finance Projects

The management of financial programs to promote economic development requires professional administrative organization. This chapter addresses many of the foundational issues, and these will need to be applied within the context of the particular environment where the project is being implemented.

Limiting the program to specific commercial activity: Economic development programs are created to help the poor to increase income and create permanent employment through investment in productive economic activity. By definition, then, illegal and unethical activity, the financing of consumption, celebration, personal emergencies, and any other expenditure not related to productive activity are excluded. A definition about the expectations for projects is needed not only to protect the organization that is providing the financing and promoting recovery of the funds based on proper investment, but also to prevent the client from becoming trapped in debt, and to help him/her to fend off requests for money from family and friends.

The requirement to invest only in productive activity that is viable in the real world marketplace may exclude certain potential beneficiaries, and it should be noted that micro finance methodologies might exclude certain needy populations. The "poorest of the poor" that are unable to be economically active due to health problems, substance abuse, or even who do not want to work, are not possible to impact through these programs. Some academics and fund raisers who promote micro finance without regard to the limitations of the methodology seem to believe that it is a solution for everyone, and go so far as to propose that programs should not worry about how financing will be used, "because the poor can evaluate how to invest better than outsiders can." The statement sounds noble, but is actually ridiculous and unfortunately can take the blame for many failed programs. It trivializes the difficulty of creating a successful business, and at the same time ignores the reality we all face, which is that there are always things we want to buy, even if we don't really need them. The saying in Spanish is: "Lo que no nos cuesta, hacemos fiesta." *"If it didn't cost me anything, let's have a party."* Again, since the purpose of the program is to promote sustainability, we need to be concerned that viable projects are funded. Economic development is the goal, not just investing in projects, and unsuccessful projects can result in the supposed beneficiaries being worse off after "financial assistance." Conditions must be established to facilitate a process of transformation of a financial asset into a business project that is profitable in a competitive environment.

<u>Management and the Source of capital</u>: Generally the economic development programs begin with donated capital that comes from various sources. Special financing from specific donors often provides the seed funding, and may be matched by local donations. Sometimes funds are also available from local organizations and even the government, as there is considerable interest in the area of micro finance. The organizations providing the capital may have an interest in a specific target group, or a defined geographical area, or in some other characteristic of the target population. Such definitions must also be carefully considered in establishing policies for the program. Once the program has a track record of successful operation, it may also be possible to access additional funds from other such donors. This possibility needs to be taken into account when the program is designed, so that an awareness of project criteria and reporting requirements of future possible donors can be taken into account. Teaching the fund recipients how to organize record keeping and present timely reports lays the groundwork for growth through proposals for additional funding.

Present and potential donors may also affect financing policies. The establishment of financing policy always requires a balancing act: the desire to help the poor and the desire to promote financial sustainability of operations. The requirement to operate the program without a deficit impacts not only how much risk can be taken with client projects, but also other issues such as geographical focus and the ability to require participation in technical training prior to approval of projects.

If the objective of the program is to help the poor and promote social outreach, there is also the possibility that conditions defined by potential funding sources may be unacceptable. It is better for the program to stay small and maintain its objectives than to grow into something different than it was created to be.

Defining Requirements for Projects: The programs are designed to adapt to the needs of the potential clients in the target group. In many cases, training is required for the potential clients, and additional training is a prerequisite for the graduation process anticipated from business incubators to community banks, to solidarity groups, and on to individual projects, with more rigorous requirements and higher levels of complexity at each level.

The programs that begin with a group focus, as opposed to an individual focus, generally require:

- That the people comprising the group have demonstrated experience of working together with others, perhaps on other types of projects.

- That there is a commitment of solidarity in relation to the financial obligations, for the whole group to take responsibility for the payment.

- That the members are from a similar social and economic population.

- That the members have demonstrated responsibility, honoring of commitments, moral character, and interest in their personal development.

- That there is sufficient definition of leadership in the group to manage funds and oversee productive economic activity.

- That there are positive references about the group in their community.

- That members of the group have some technical experience or training in the economic activity to be funded.

- That all persons with the responsibility for paying back the funds are involved in the economic activity as their principal source of income.

- That all persons with the responsibility of paying back the funds are free from personal debts and financial commitments to other financial organizations.

It is also important that potential clients commit to participate in technical training programs; the attendance and participation in such programs is often a requirement for project approval. Technical training will be described in more detail in the next chapter.

Before obtaining financial assistance, potential clients must also commit to the following principles:

1 To use the resources provided for productive activity in cottage industry, services, commerce, or agriculture and not to use them for personal consumption, family emergencies, special events, or any illegal activity.

2 To use funds for the project defined in the application process. If the person decides to use funds for activities other than those specified in the application, it will be grounds for immediate return of the capital. It is not acceptable to change approved business plans and still receive funding.

3 To become eligible for additional capital, the existing capital or loans must first be paid back. Timely compliance with payment commitments will be a critical factor in analyzing any new proposal.

4 For those involved in a disciplined savings program, the commitment that they will also reinvest their savings in their business activity.

5 Willingness to participate in training programs and opportunities to cooperate and share with other business clients.

Evidence should be given of basic financial systems in their businesses, that allow them to evaluate how the business is doing financially, and provide evidence of responsible controls. Systems may be simple, but should exist in some form.

There should be demonstration of an attitude of cooperation with program field personnel when they visit their business, allowing access to the projects and all documentation related to its operation.

The Recruiting Process: The contact with the potential person or group usually begins through the community, and through some type of social outreach that the community is promoting. Many programs have a regular introductory talk for prospective clients that includes a general description of how to get involved, what type of projects are funded, requirements, and definition of the specific steps involved to apply for entry into the program.

A one-page information form is useful at this level, that allows project management to evaluate quickly whether the individuals or groups that want to get involved would qualify, or have a realistic business idea. It is at this level that those desiring to receive assistance can form groups, and learn that they can only do so as part of a group. Program staff and volunteers from the community are often involved at this stage, not only in organizing potential business incubators, community banks, or solidarity groups, but also helping with the definition of the business idea, and providing a sounding board on what kinds of projects might be viable.

Often people who present the initial information form are hunting for money, with little business background or even interest in implementing a project. If they cannot describe the type of project they would like to promote, and how it functions, they probably should not be allowed funding. Perhaps they can be included in technical training, or begin by helping in an incubator project. The approval process must filter all requests for assistance and help the funding organization to focus time only on analyzing projects that have potential.

Projects that demonstrate good potential should be allowed further consideration through a defined application form. This form should include data about the project, location, background, and principals. The amount to be invested and payment plan should be accompanied by a basic business plan that, at the minimum, specifies market assumptions related to price and quantity, and includes a definition of the cost of the goods sold. A major misconception, in the informal sector, is the confusion of cash flow with profit, and the loan application form should be designed to distinguish profit from cash flow, and identify the net operating margin that is important not only for the well-being of the client, but for pay back of the capital.

The evaluation of such information not only allows for analysis of viability, but is also a test of the client's knowledge of the business. Information about the cost of inputs can easily be evaluated. Sales projections may be more difficult to assess, but pricing information can be corroborated. The most important issue generally is the marketing, and assumptions related to quantity sold and prices; retail margins are often highly overstated. A simple analysis is needed to identify this problem.

Except for the case of the community banks, the duty of evaluating applications falls to the project supervisor, frequently with assistance of volunteers in the community. He/she must decide which applications look promising, and pass them on to the credit committee. In the case of community banks, a committee of bank members themselves does the evaluation of applications.

<u>General Program Policies</u>: The overall policies for the program are defined by the board, and need to be evaluated periodically as the program matures. Community leadership also plays a role in defining these policies, and sometimes donors providing the initial capital also are involved. As the board assumes the responsibility for the supervision of the organization, it is also responsible for continual evaluation of program policy.

The amounts of capital or loans provided vary according to methodology, and also depend on the level of development in a given country. There are places where a loan of $50 can be sufficient to start a business, and other places where an investment of ten times that much is not enough to start anything. It is impossible to define the amount of funds needed to start a business without taking into account the context. A rule of thumb in developing countries is that community bank loans start at around $50 per client, solidarity loans at $200 per client, and individual loans at $1000 per client. Investment in incubators depends also on whether they are for individuals or groups. It should be noted that the limitations on the size of a loan or invested capital impacts the costs and capacity of the organization to place funds. For example, a policy prescribing very small loans will mean that project supervisors need to be assigned many projects to visit, whereas larger projects will require fewer projects per supervisor. There are economies of scale in the oversight of these programs.

A related policy issue is whether the same client can obtain multiple loans. On the one hand, helping one business grow, even from an incubator stage, is consistent with the idea of graduation between methodologies, and increases in amounts funded are accompanied by some decrease in risk, as the project is well known. On the other hand, the same amount of funding could be used to help others. Perhaps the answer to this question resides in an analysis of the social impact resulting from increased capital. Within each methodology, and between methodologies, there is flexibility to provide more capital for a project. But the basis for doing so should be to evaluate first what the impact is of subsequent funding in terms of increased income, more jobs, and more production. If this is not done, a dependence on outside funding may be created by subsequent financing, and the business may actually become increasingly less viable through outside assistance, needing a constant pattern of loans to survive.

Policies related to repayment plans also vary according to methodology, and according to the type of activity being funded. The payment plan is usually defined in relation to the cash flow generated through the funded project. In most cases, a monthly payment cycle is possible, and reinforces the habit of paying on time. In fact, when initial grace periods are allowed, this can have the detrimental effect of the client's forgetting about the vital need to make a payment. Agricultural projects present a special case, in which income is often generated at harvest time, but the harvested product also must be stored in some cases to guarantee better prices. Even with agriculture, it is better to create a pattern of regular payments, perhaps with a balloon payback when the harvest is sold, to promote the habit of setting aside some money to pay back capital. It is also a good idea to calculate payment plans requiring a substantial portion of the anticipated net profit, not only to permit a better payment record through a shorter pay-off period, but also to be allowed to recycle capital to other worthy projects.

Policies for payment on business incubators often involve conversion of invested equity into a stream of loan payments. A portion of net revenues is required at the initial phase, as a rental fee on the monies provided and a payment to cover the costs of supervision and oversight. As employees take over administration, they can buy out the business by converting the invested equity into a loan. There is considerable flexibility in defining the payback amount to be able to recuperate not only capital, but also the cost of capital plus fees for services.

Interest rate policy is another area where equilibrium must be found between the good of the client and the sustainability of the organization. The amount charged must be sufficient to cover costs of placement, supervision and collection: the total service delivery costs of the entity providing the capital. It must also provide a reserve for bad debts, and enough to offset inflation and thereby conserve the real value of the fund. At the same time, the costs must be bearable by the client, at a reasonable rate compared to local financial markets. A point of reference in defining what is "reasonable" is the market rate of interest. An interest rate similar to the formal banking system helps to eliminate requests for funding people who actually have access to bank funding, and only would be looking for lower cost funds. Loan prospects in the high-risk informal sector generally have no access to such rates, and they often compare them favorably to the "loan shark" rates available in their environment, finding the interest of rates offered by economic development organizations to be very low.

It is periodically necessary to evaluate interest rate calculations, taking into account both a revised estimate of the costs of services, a revised analysis of uncollectible accounts, and an estimation of inflation or devaluation. Such a review should be made on an annual basis, and recommendations for adjustments presented at board level. For community banks, an additional amount is sometimes charged, with group concurrence, to provide an emergency fund for members.

The policies for collection often include some type of collateral for recuperation of capital, falling into one of four categories:

1 Mortgage guarantee–land, buildings and houses with legal documentation that can be registered.

2 Equipment collateral–tangible assets that are described in loan documentation, and which are transferred if payment commitments are not made.
3 Leasing contracts–when bought by loan proceeds or with organization funds, the equipment is held in the name of the organization until payment is made.
4 Cosigners–other people with defined income who sign as responsible parties to the loan, and who have to pay it back if the principal does not.

The actual practice of collection through loan collateral is very difficult, and the collateral is most useful in creating a serious image for the economic development program, and the necesity to pay back capital. The specific requirements for collateral depend on the local context. In some countries it is illegal to use production equipment as collateral, for example, because it would take away the person's form of earning a livelihood. So it would not be possible to take a sewing machine, but one could instead assign a television set as the guarantee.

The client is always provided a payment plan, and also a tentative plan for monitoring and supervision of the project. In some cases the project supervisor goes with the client at the moment of fund disbursement to buy equipment and raw materials, and help to assure that the investment plan is being followed. Whatever the means used to disburse funds, it is recognized that decisions made in the first few weeks after disbursement are very critical. The investment in the project is important, but the success of that investment depends, to a great extent, on prior investment in training, orientation, and preparation of the client.

\- - - - - - -

Case

The Organization to Promote Social Development (OPDS)

As the "micro finance community" embraces the concept of formally registered banking programs that require millions of dollars and appear to generate a movement away from the poor, the OPDS case illustrates that financially sustainable small-scale programs are possible, but not easy to create.

The program began with a request from a church denomination with over 700 affiliated member churches, located principally on the Northern Coast of Colombia. The unemployment problems of the country are coupled with the phenomenon of internal displacement of families due to the civil war, with perhaps as many as one million of the displaced relocating to the relatively more peaceful north. The OPDS institution was created by the denomination, but with a separate board, and had office facilities and a small staff primarily oriented to the management of health projects.

The initial request for assistance from the LAM venture capital fund was for a $50,000 loan fund, but after discussion and negotiation, a $5,000 pilot project was initiated out of the Barranquilla office, with a subsidy for one staff person and expenses. During this pilot phase, documentation for loan application, processing, collection, reporting, and all of the administrative structures were defined with technical support and assistance. However, it was quickly discovered that the person hired to run the program, a relative of one of the board members, did not have the required abilities or background. Additional funding was then made conditional on a change of staffing.

The project was essentially started again by a new staff person, hired this time based on education and experience. Over a period of three years,-over $30,000 has been invested in the revolving fund, which has 57 active clients,[51] for an average loan size of $350/client. Floating peg devaluation in Colombia is approximately 17% and OPDS charges 3% per month interest. The program is currently covering all direct costs, and capitalizing a small margin to maintain the value of the loan fund.

Challenges to get OPDS to this level include:

- The geographic limitation of the service area due to costs. OPDS cannot serve the entire Northern Coast, but must limit services to the general area around Barranquilla.
- The hiring and evaluation of staff based on abilities, not relationships.
- The requirement for reports, not only for the LAM but for local board members in Colombia.
- The differentiation between investments in the revolving loan fund, and subsidies for the initial installation of the program.

- Remuneration issues, as the present administrator of the program would like a higher salary, now that the program is functioning well.

The expectation also was that OPDS would be eligible for funding from other sources once it could demonstrate a track record. There are programs that supposedly would provide loan funds to OPDS at low interest, but the board and management of the organization has not shown initiative or interest in accessing these funds.

- - - - - - - - -

This case illustrates that the creation of small-scale micro credit institutions is possible, but also very difficult. The human resource issues are actually more significant, in many cases, than the financial resource issues. Where can you find good people? How do you keep them, once the project is successful, since that is when they expect greater rewards, and the equation for funding the program through the interest margin does not allow for fulfilling these expectations?

Chapter XI

Training to Promote the Sustainable Economic Activity

The presentation of economic development methodologies often focuses on the technical requirements of the service delivery program, not on the needs of the client. The sustainability of the program is important, but not as important as the sustainability of the underlying economic activity that is funded. For example, if a specific program has all of the systems and controls to promote punctual loan collection, but clients have to sell their assets or obtain funding from higher cost loan sharks to pay their loans, this is not success. And if service, endowment, or incubator businesses cannot demonstrate a sustainable operation after receiving capital, but rather must continue to obtain injections of funds to keep the business afloat, the benefits of the program are minimal or even negative. The success of economic development programs to help the poor should include financial success of the supported businesses, demonstrated by a positive margin of revenues over costs.

The most important issue in facilitating successful projects in generating this margin is the skill of the entrepreneurs, the small business administrators. Frequently the assumption of the small business operator in the informal sector is that they can succeed with minimal standards that result in a poor quality product with very small margins, sold in a market already flooded with such products. The most common example was mentioned before: the community sewing "business" organized for women, where all inputs of production are subsidized and products are made that cannot be sold at a profit in the real world marketplace due to poor quality, and where there is little discipline in relating costs to prices. The problem is not just that these businesses fail, but that many people experience another personal failure, as expectations of employment or income are shattered. ***Training in basic business concepts is very important to prepare people adequately for economic activity that can generate genuine profits.***

<u>Requirements before financing is provided</u>: The business plan or application form, in the case of a loan, is a test of whether potential managers have the capacity to organize and administer a small business. The organizers or applicants must be able to describe in detail the basic ingredients of the economic activity, costs, production process, and market prices. If they are not able to do so, they will need help.

Others can help them provide information: family members, neighbors, people in the community or local religious organizations. If external consultants offer assistance, they should do so with a conscious effort to use this opportunity to identify the areas in which the potential client or client group needs technical training, and make pre-project training a requirement for approval and funding of the project.

The topic of pre-project training is a much-debated issue in organizations that promote economic development. One point of view is that small business entrepreneurs do not need training, because they know much better than outsiders how to use their money, so financing should be provided without asking many questions. This view is popular not only for its egalitarian focus, but also because it implies that organizations do not have to invest in training programs, and thus can be easier to sustain financially, without having that burden.

At the other extreme is the view that training inputs, both formal and informal, are actually as important, or more important than the financing itself, which basically provides the incentive for people to accept constructive recommendations regarding how their business should be managed. For example, to teach entrepreneurs the difference between profit and cash flow helps them with their entire business, not just with payback of a loan. From this perspective, the need for training programs is seen as the most valuable tool for helping the poor be successful in the complex world of business. This may be difficult to prove through empirical studies, as the attitude of potential clients toward required classes is often similar to children's attitudes towards school: they go if they are required to, but would rather not. But through required training, project principals learn much that is important, even if they may not recognize this at the time the training takes place.

Every new program for helping the poor through economic programs needs to consider both perspectives. The evaluation and valuation of what people already know is important, and given the costs related to training, it may be necessary to limit the investment in educational programs, and target them only at critical areas of need. But these critical areas cannot be ignored, and therefore some basic training programs should be incorporated with most economic development programs, and therefore must also be considered part of the investment or costs to be covered by program revenue. Furthermore, if subsidies can be obtained from other sources for training, or partnerships crafted with other organizations that provide educational programs, these should also be sought. It should also be noted that formal training programs provide good opportunities to integrate social values and a community vision into the program.

There are three basic areas of training that have proven to be critical to the success of small business programs, and fundamental themes can be easily organized into three training modules:

General administration of business for entrepreneurs, with an introduction of the program, organization and expectations.

Principles of marketing and sales.

Cost control and basic accounting or record keeping.

These modules can be organized in three separate sessions, and provided at a time that does not take project managers or potential clients away from their jobs. For example, evening or Saturday afternoon sessions of 2 to 3 hours can be scheduled at a place that is easily accessible, often the community center or a local school. In some contexts it may be necessary to encourage people to bring their school age children in case the adults need assistance with reading or mathematics: many potential participants may not be able to read or write. Formal training sessions can be taught by program staff or community volunteers, and it is extremely important that trainers be well prepared. Written materials and handouts are critical not only for helping in presentations, but also to standardize the content of the courses, and assure a minimal quality of presentation. It is recommended that every training module conclude with an evaluation by the students, to make sure that the training is meeting its objectives. A very common problem identified in evaluations is that the trainers, sometimes with university education, have not been able to simplify concepts enough for the potential clients, who may have little formal education. Constant effort is necessary to ensure that teaching is understandable. It is also important to achieve an appropriate balance between trying to provide a high quality educational program while keeping the costs within budget.

The introductory module on general administrative principles can be used to present, in detail, all of the requirements for obtaining funding, and the specific expectations for potential participants or clients. After the objectives of the program have been discussed, the social basis of promoting productive economic activity can be presented, with examples of how small business projects can impact the local environment. Commercial organization can be presented from a human and ethical perspective, with the goals being those of: providing for family, living in a responsible and honorable fashion, and working hard to ensure success. The first session can be offered as an introduction for all who are considering involvement in the program.

Recommended Topics of Workshop #1: General Administration for Entrepreneurs

1. Why are we here? Start with a reflection on the purpose of the program in relation to our daily lives in the community, with a focus on the concept of work, and the ability to work to provide one's daily bread. If the project is a "public good" service or endowment business, present a clear vision of the social purposes and expectations.

2. Economic development as a strategy to help people: expectations of social and community outputs such as increased income, employment creation, production, and other benefits.

3. Expectations at the project level: successful businesses, competent administration, ethical practices, the need to generate a margin after covering costs, or for payment of capital and related fees.

4. Explanation of the specific requirements for individuals or groups who wish to participate, including a detailed presentation of the business plan, or in the case of incubator or loan programs, an application process and definition of next steps.

5. What is an entrepreneur? How the success of the business depends on the innovation and commitment of the participants.

6. What are critical administrative areas in a business? The importance of understanding markets, and implementing basic controls, concluding with promotion of attendance at the next two modules for those who are ready to commit.

The second module is about marketing. What does the potential business manager or client need to know about the market? The most common problem is that few people seem to distinguish between production and sales in their analysis of business activity. It is easy to determine how many shoes, shirts, or bags of beans can be produced with outside funding, but distribution systems for all of these are more complex, and prices differ considerably in relation to where and when these products are sold. It is often the case that the distribution decisions are more critical in the success of enterprises in the informal sector, than are product definitions.

Recommend Topics of Workshop #2: Understanding sales and markets

1. The importance of markets, and the need to understand better our own markets for products or services. Introduce the four critical elements of marketing: product, price, place (distribution), and promotion.

2. Identify the conditions required for adequate sales levels. What are the starting assumptions?

3. How can we change the marketing mix to increase sales, improve margins, stabilize sales over time, take advantage of seasonal or special opportunities, and cooperate with others?

4. The presentation of ideas and potential strategies to help, depending on the context. The instructor will need to get information on the project proposals under consideration to prepare this segment.

5. The complications generated when businesses provide credit to sell a product or service, and an analysis of how to avoid doing so, or make sure the business gets paid.

6. Promotion of innovation in marketing, often involving the utilization of contacts with new friends from the workshop itself to sell products and service, discover alternatives for export, product modification, sources of information, etc

Through the training in basic marketing, the potential participants and clients should be encouraged to think about costs and sales prices, and consider alternatives for distribution of their product that would allow them an increased percentage of the total retail margin. They should also consider changes of their product or service that would make it more marketable, and ways to cooperate with others who could help them in improving quality. The analysis of markets is a significant part of the review process for potential businesses, and this training should also help to complete written analysis forms that may be required for obtaining assistance.

Aside from marketing, the biggest problem of the small business is lack of adequate financial controls. As was mentioned before, a chronic problem is the confusion between cash flow and profits: the perception that because money is coming into the business, money is being made. But often the amount coming into the business is less than the cost of what is being sold, and this is especially true with the injection of outside capital. So the purpose of the training module on control and basic accounting is to help potential projects and clients develop systems that they can manage to evaluate the performance of their business, to ascertain if the products they make or the services they sell are profitable, and to allow them to measure how they are doing on a daily basis.

Such measurement assumes a system for recording revenues and expenditures. At the beginning of a project, some of the expenditures are related to investment in equipment, but some also may be part of the "cost of goods sold" of products. This concept must be introduced to allow clients to determine profit margins. The module should be presented with cases and examples, and simple systems proposed for analysis. It also needs to be developed with a sensitivity to the types of business activity represented in the group, as control systems depend to a great extent on the type of business being considered.

Recommendations for record keeping need to be as basic as possible. For example, for people who do not read or write, a system of pockets can be proposed, with one daily transfer from revenue pocket to the expense pocket, with amounts to be noted at that time, perhaps with the help of a child or a friend that has had some schooling.

Recommended Topics for Workshop #3: Cash control and basic accounting

1. The need for careful analysis and planning for a successful project is first explained, with examples of where these were lacking.

2. Administrative control – the definition of mechanisms for planning and control. What are we really interested in measuring?

3. The design of basic registry systems that can define revenue and expense on a daily basis. The instructor will have to plan this in relation to the real needs of the participants. It is especially important not to impose on them a double entry bookkeeping system or other complex accounting programs that an instructor may have learned at the university.

4. Cost analysis to determine where net margins are being generated, on the basis of a product, product mix, service, etc. In some cases, a simple break-even analysis may be used.

5. Definition of key concepts: working capital, cost of goods sold, and owner/business equity. It is also important to define the salary expectations of the entrepreneur or participants as part of the costs of operations, as this is often left out of the equation when determining profitability.

6. The requirement to put aside the amounts necessary to cover replacement cost for capital equipment (depreciation), pay back capital and the fee for using the capital, i.e. interest.

7. The additional long-term goal of reinvesting a certain amount of the margin from operations in the business so that it can grow.

==============================

For training programs to be successful, there also must be a training program for the trainers. The best teachers will be those who know the context the pupils come from, and who also have the time to visit them personally. It is important to note, in the contexts of developing countries, that people with recognized degrees are often the least qualified to do client training, as they may have learned everything through a rote learning method that is very difficult to apply in the informal sector. For example, a session that begins with the definition of “credit and debit” copied on the blackboard for the class to memorize is typical, and essentially worthless.

It is also important that trainers communicate an enthusiasm for the topic. Training programs are sometimes begun with a shared vision, but in time the pace of the operational workload has its effect. The need to focus on projects that are having problems, or place more funds in new projects, or increase the number of clients to be supervised, in loan or business incubator programs, squeezes out all time for training. Participant evaluations of the training, referred to at the beginning of this section, help identify when the teacher has lost interest in the class, or when the training program has just become an empty bureaucratic hurdle for getting financial assistance.

<u>Additional Resources for Training</u>: The offer to provide training through the three standard modules described above is generally possible within the financial limitations of sustainable programs, and also provides a great opportunity for the involvement of volunteer professionals with a community interest. Other training resources are also available, often through organizations that have this as their specific objective. The Small Enterprise Education and Promotion (SEEP) Network provides an entire range of materials, some under the category of “business development services” as a complementary program for micro credit programs.[52] Many governments provide technical training for small business. Some non-profit organizations may have subsidies to provide training, especially to help the poor. They also may have written training materials and guides that would be very helpful. The problem is, in many cases, that people do not know how to access these programs. Another aspect of preparing for the three prescribed training modules is to identify and promote additional training that may be available through networking with other organizations.

Chapter XII

Operational Requirements for Financial Sustainability

Profitable Businesses: The viability of economic projects as businesses that generate a profit margin is the key to any sustainable program. It is therefore important to underscore the role that entrepreneurial innovation plays in making a profit margin possible in economic contexts that are competitive or difficult. Even with training, business plan analysis, peer group evaluation of prospective clients, and market experience, it is difficult to predict in advance which businesses will be successful. Entrepreneurship becomes evident in practice. Examples from my experience include:

- In Karonga, Malawi, three women produce and sell small doughnuts in the marketplace and make almost 100% margin on their costs. They have a reputation for having the freshest doughnuts because they make them in small batches off-site, and use only quality ingredients. Also, because they work together in production and sales, they sell many more doughnuts than their competitors.
- In Cluj, Romania, a vegetable farmer obtains a higher price in the market because he washes his carrots. This was an idea suggested by the loan supervisor, and has allowed him to have a competitive advantage over other truck farmers. Curiously, the practice has not been copied.
- In Barranquilla, Colombia, small electric washing machines are rented out in middle class neighborhoods on a daily basis, and transported to and from rental sites on a trailer pulled by a motorcycle.
- In the rural mountain town of Puriscal, Costa Rica, a cooperative exports miniature vegetables to Homestead, Florida, filling forty foot containers with produce that is contracted one year in advance for special "windows" of opportunity.
- In Puerto Prince, Haiti, handmade floor carpets are produced in a small factory of only three people, using an air compressor and a labor-intensive knitting "gun" obtained from Dalton, Georgia.

- In La Entrada, Honduras, a group of workers produces mud-based clay tiles, "tejas," for export to Miami, where the kiln-dried clay roof tiles that cost only pennies to produce fetch over $3/unit due to their hand-made look.
- In Cuzco, Peru, an artist developed a style of painting colonial-type portraits with the slightly exaggerated eye sizes, and now commands high prices for his unique style, evident in some of the higher priced hotels in that tourist city.

A high value must be placed on the creativity, innovation, and hard work that allow enterprises to be successful. The identification of entrepreneurs is a critical part of economic development.

To design financially sustainable programs and service delivery mechanisms to promote enterprise, it is also important to recognize that there are substantial differences between environments in different countries, environments in different areas within a country, and between different sectors of the economy. For example, as we consider the requirements for collecting revolving loan funds, even the laws related to loan collections differ from one country to another. It is not possible to design a "cookie cutter" approach that is applicable to all situations. Even the style and format of loan application forms may vary greatly from one place to another.

There are principles, however, that do not vary. Basic questions that determine the viability of a business will be necessary in all cases. Some form of record keeping for clients is needed, and all the programs need to define administrative procedures and reporting systems. The capacity of the organization to present reports for the board of directors, and for other publics, is a key requirement for accessing additional funds from other sources, as well as for operational viability. A well-run organization is needed to provide project oversight.

Program leadership and staffing: Economic project viability evolves over time, and cannot be initiated without full-time staff, who are often drawn from the community and bear full responsibility for the project. The performance of the project supervisor is critical to the success of the organization, because he/she is the one who really manages the operation. In the cases of business incubator and loan projects, even though technical analysis is applied, it is often the personal contact with potential project principals that is required before funding can be approved. The personal interaction is essential for determining the credibility of the information presented.

For revolving credit programs, the number of clients and projects that each supervisor can handle on a monthly basis is also the most important single cost factor that impacts overall program financial sustainability.

The project supervisor not only helps to get the project started, but is also the key person providing follow-up after the implementation of a project. He/she may also promote the concepts provided in the training, and generate the reporting information on how the project is going. In the case of community banks, the project supervisor is the staff person who attends the meetings and who knows all of the members.

The tasks of the project supervisor should be well defined. For service and endowment businesses, these will depend on the type of business. For business incubator and micro credit, the tasks can be defined in relation to the number of clients, field projects, or amount of capital they are supervising, and this "load per staff person" used to analyze the targets necessary for organizational financial self-sufficiency. Again, this will vary greatly from one place to another, not only due to different salary ranges, but also the conditions for providing oversight for projects. For example, if a person can be assigned to a relatively small geographical area, they can visit many more projects than if there are great distances between projects. As the program grows, if there is a graduation process from small to bigger loans, supervisory needs may decline even as amounts loaned become larger, because the clients are already known. Programs that allow repeat loans also may not require an investment in training for the repeat clients. Volunteer assistance with consulting on small projects can reduce costs, and the decentralized mutual assistance expected of community banks and solidarity groups allow these to be considered, from a supervisory perspective, as one "client," because generally only one visit is required to meet with the entire group.

It would be great to find project supervisors that can evaluate projects, provide meaningful consulting assistance, and also help with training. However, it is not always possible to find such people, especially at the salary levels that are proposed to get the program started. The most important characteristic of potential staff is interest in getting out to visit the projects, rather than a desire to be behind a desk. Perhaps the best assistance new entrepreneurs can receive comes from staff who have either had businesses, or have plans to start one.

As the hands and feet of the organization, it is also important that staff have a social development orientation. Also, besides doing a certain amount of office work, staff often handle cash for projects, or from the collection of loan capital, interest, or fees; so they must be people with integrity.

As the economic development program grows, additional staff may be needed for office and accounting tasks. The person who initially sets up the project may not qualify for supervising others in these roles. This is where leadership from the board may be required in helping define job descriptions and confronting growing administrative complexities. This has proved traumatic in some cases, even for well-organized communities, when professionals that were not part of the founding of the project, nor part of the community, were brought in to supervise those who were founders and part of the community. The administrative requirements of the program have to take precedence over career path expectations of staff. At the same time, consideration must be given to salary scales and incentives that motivate good staff people to stay in the organization.

Field staff must understand that the success of the entire program depends on the viability of the productive economic activity they are supervising, especially because there are no resources to access funds except those generated from their successful businesses. So the process of evaluating their capacity to set up a viable enterprise is critical. Then, proper investment of funds and timely assistance through field visits, in the cases of business incubators or loans, complete the list of essential capabilities field staff must demonstrate. Obviously, the work of the project supervisor is critical to the success of the program.

The performance of staff should be periodically evaluated through the quantitative data on the businesses or client loans under their supervision. For business incubators and loans, the payment records and training attendance records should be included in the evaluation. Since the results of any particular assigned client "case-load" cannot be attributed solely to the supervisor, the evaluation should so include other assessment tools. A short form used for all supervisory visits could be filled out with a description of what was addressed, and signed by the client. This also documents that projects were visited, and communicates that the visit is more than a formality, and requires the identification and addressing of problems in the business, and an inquiry into the personal development of the client and his/her family.

The project visitation form can then be filed with the project information, which will allow a better understanding of what happened, in case the business develops problems in the future. The brief report on visits can be reviewed by program management, and used as a learning and planning tool.

For business incubators and loan clients, the project supervisors are responsible for a defined portfolio, but give special attention to cases in which clients are having difficulty, or where payments are not being made on a timely basis. The monthly payment records combined with the narrative on project visits provide a basis for planning future activity. A visit to a client where everything is going very well may take only 15 minutes, whereas a visit to a problem project may require several hours. The form used for describing project visits allows management to understand how the project supervisor is organizing his/her time for the portfolio of projects under his/her control.

Reporting on the Profit Margin, Payments of Capital and Interest: It is critical that timely information on revenues and cash flows be available for project supervisors and management. The ability to generate this information is a critical indicator of whether the organization that has begun an economic development program has the capacity to succeed. Many donors to economic programs will provide a small amount of seed capital, and request a copy of the monthly reports before they disburse additional funding. Without a record of revenues, costs or client payments, it is not possible to evaluate whether a project is on-track to a sustainable recycling of the financial resources.

The funds for establishing a business incubator, for initial loan capital of a community bank, or for solidarity or individual loans, should be disbursed only after establishing a written payment plan that clients have agreed to. For business incubators, the plan often is based on a percentage of monthly revenue, for community banks it is a payment on the externally funded group loan, and for solidarity and individual loans it is an amount per person. In some cases a local bank account is used as a collection mechanism, to minimize the need to handle cash. Reporting on payments is done either by presenting a copy of the bank deposit, or from information that the bank presents to the organization. Whatever mechanism is used, a monthly report must be derived from the process that allows project supervisors to know that all clients are keeping their payment commitments.

The preparation of these financial reports may become complex due to the multitude of small payments, and the need to calculate for the payment of capital and a service fee, usually collected through an interest percentage. If clients do not pay on time, the interest fee may be different from the one initially contemplated in their payment plan. Funds received must be divided between capital, interest, service fees, and any penalty for late payment. There are many accounting programs that can help to keep all of this in order. The need for such software becomes acute when an organization has more than 50 clients since it is difficult to manage detailed payment schedules and revised collection information by hand. Furthermore, the pattern of client payments affects the amount of funds available to pay organizational expenses, and the provision of capital to new projects. Efficient accounting and clear accurate reports are essential to the well-being of the program, just as they are to the business the program serves.

The importance of documenting revenue data and collecting capital and fees: The concept of promoting economic development through specialized organizations is based on the hypothesis that it is possible to generate sufficient funds to break even and recycle capital to new projects. This means that there must be a net margin, and for loan projects the ability to collect enough interest or fees to sustain operations. If capital is not paid back, there will be no funds to recycle. If there is no net margin on operations, or interest, or other fees are not paid, subsidies will be required to keep the project going. Unless collections are made, the funds will be lost, and the organization will quickly disappear.

Even if subsidies become available to support the project when profits are not possible or payments are not made, the need for such subsidy will have a negative impact on the image of the organization. First of all, it is ironic that projects that promote businesses that supposedly generate profits would have to be supported by donations. Secondly, when customers or clients with a defined payment plan are not held responsible for those payments, news of this often circulates in the community, and the organization suffers a psychological vulnerability. The perception is created that it is not really necessary to pay, and to keep commitments. In many developing countries the lack of integrity in financing of projects with the poor is considered a major liability, as governments and international institutions, by not enforcing payment commitments, have taught people that they do not really have to keep commitments. Teaching people that they *do* need to have integrity is one of the positive social aspects of economic development programs.

In fact, the disbursement of capital without sufficient attention to the requirements for paying back the funds is irresponsible and damaging. The public sector "loan programs" in Latin America in the 1980s generated a popular saying, " he is a greater fool who pays a loan than the one who gives it." Through a variety of undisciplined financing schemes, the poor have been taught, in some places, that there are no consequences if they do not keep commitments. In some cases the perception of "economic development" is nothing more than the expectation of a donation, with the image created that these are resources that people are entitled to, without any reference to paying for them. The sad thing about this phenomenon is the difficulty it creates for organizations whose very existence depends on collecting payments, and the fact that a bad track record of programs for the poor eliminates incentives to provide any additional services.

The importance and cumulative impact of viable client enterprises is thus highlighted again. If the person or group that is obtaining an injection of capital for a defined business project views the funds as a donation they deserve, the program is in trouble. And if the project that is funded has to be liquidated to pay back the capital, or must take new capital from high interest loan sharks to survive, even timely payment of capital cannot be considered a sign of success. It is well documented that many business projects in the informal sector, funded by organizations that provide capital to help the poor, leave their clients worse off than before, with a business failure and a large debt to pay.[53] The end result is desperation, rather than hope for a better future.

An organization set up to promote economic development must be capable of collecting revenue. It is understandable and expected that there will be some cases where clients pay late, or are not able to pay, but in every case a serious commitment to promote payments needs to be made. That is the only way the impact of the provision of financial resources will complement other social programs, and not become another condescending subsidy. It must be understood from the beginning that the expectation that customers and clients will pay back the investment in their project is serious.

Key elements in the promotion of revenue and capital repayments: The critical issue for revenues and on-time payments is the viability of the economic activity that was funded. If the business is not profitable, revenue and payments must be generated by other sources, and poor people have few other resources. Again, the initial evaluation of the business proposal is important, as is the training and technical assistance provided in the initial phases of business installation.

Even if the business is profitable, poor administration or an increase in consumption patterns can consume all of the net profits before funds are set aside for payments. The evaluation of the administration of the business is critical. Financial review includes an analysis of how profits are being handled, identifying any personal use of funds, reinvestment in the business, and what is being set aside for the future. Though one goal is to increase the income of the people involved in the projects, salaries should be defined in advance so that limits are set. Primary attention should be given to the generation of profits, before redistributing profits.

When the program is first presented to potential participants during the first training session, the importance of a net margin on operations should be emphasized, and an explanation made about why it is important. The training sessions show clients how to project anticipated revenue streams and payments and define the assumptions for how the projections are generated.

For incubator and loan projects, the expectation of monthly payments is presented, and also the penalties assessed for late payment. When funds are disbursed, the accompanying documentation clearly presents a listing of the payments, and specifies what happens when payments are not made. Clients are provided a receipt for each payment, which reminds them of the date of the next payment. The payment can be checked off a listing of payments that the client has. The monthly reporting for project supervisors also contains the client payment histories, and clients are reminded of payment requirements during the supervisory visit. The steps the organization will take to confront late payments are well defined in advance, and are put into operation when clients fall in arrears. The definition of procedures for late payments is preceded by a discussion of reasons why people may want to pay on time. In general, late payments are assessed some type of additional penalty, but this may not be sufficient to impact client behavior. For business incubators, a significant part of the evaluation of whether the employees can handle the business as owners is their capacity to make payments. For community banks, in the case that payment of the external loan is not provided in a timely manner, access to the group savings pool is often revoked. For solidarity and personal loans, an incentive for punctual payback is the potential approval of subsequent and larger loans. Many clients have a vision for expanding their businesses through successive stages of growth, expecting additional outside capital to do so. If they understand that such assistance is dependent on their demonstration of keeping payment commitments, this provides them with a strong motivation to keep their payment schedule, or even in some cases to pay in advance.

Clients who pay late also receive the special attention of the project supervisors, and may be motivated by these staff people to get their payments in order. The pressure brought on them by project supervisors is due, in part, to the fact that these program employees are evaluated on the basis of how well their projects succeed. Chronic late payments result not only in a focus on the particular business, but in what might have been at fault in the initial program analysis, the client selection process, or past supervisory visits by program staff.

Policies for confronting businesses losing money, or accounts in arrears: The accounting system should provide a monthly reporting of business progress. In incubator and loan cases, each project supervisor should receive a listing of the payment record for the portfolio under their supervision, and as field visits are planned, the clients with late payments should receive priority. The written visit reports should include a response to the question of why the particular project is not paying on time.

If losses are being generated or payments are late due to issues over which management has little control, such as the weather, natural disasters, political events, sickness, etc., the business can generally be granted a reprieve from any type of penalty, and allowed to get back on schedule in the months that follow. There are often cases where it is not possible, however, to determine if external factors really are the cause, and in these situations the exemption from penalties should be only for a short period of time, and be closely monitored by management or the board.

If the payment is late due to natural business cycles, difficulty in collections of outstanding accounts, special problems with production, etc., then help should be offered to address the specific need. There may be very special cases in which natural or personal disasters or other destructive events outside of the control of the principals make it impossible for the business to continue. However, such a declaration should not only require management approval, but also the approval of the board of directors.

If the business is losing money or the payment is late due to irresponsibility of the client, or if the evaluation of the late payment demonstrates that the business has no possibility of being viable, efforts should be made to collect the capital by an immediate liquidation of the project assets. This may be required during the first months of operation, when the initial capital has been used and the "honeymoon" is over. It is common for businesses to keep some of the initial loan capital and use it for cash flow for the first months. If so, the true cash flow generated by productive activity is obscured, and cannot be determined until the initial investment is used up. If operating cash flow is insufficient to sustain the business, it is best to address the issue as quickly as possible, both for the good of the organization and for those involved in the project.

The temptation simply to refinance projects by changing the paperwork that defines profit or payment expectations should be avoided. Though this appears to help by defining away accounts in arrears, the underlying problems of the businesses that are not generating a margin still exist. Managers of economic development programs must be willing to face reality, as such programs do not have access to donated funds that can hide losses generated by non-performing projects. Social development projects often "have-no-memory" of losses, as they are funded by grants and may not be required to demonstrate viability. Economic development projects do have a memory, and projects that lose money cannot be hidden simply by redefining accounts receivables on paper.

For incubator and loan projects, payment plans generally separate out the amount of capital being paid from fees and interest amounts. This distinction is relevant to the clients, because it enables them to see how much the service charges are. It is important in the case of business incubators, because the potential owners can evaluate how the rental fee they are paying as employees might be converted to paying for the business, were it their own. In the case of late or partial payment, fees and interest are always paid before any of the amount is applied to capital. The separation of the payment in this fashion is even more important to the lending organization, because the fees and interest are the basis of its financial sustainability. The payment of these amounts is generally recorded on a cash basis, rather than on an accrual basis, recognizing both the risk in obtaining this portion of the accounts receivables, and the importance of collection for the organization's budget. Posting of interest receivables as income, before the amounts are paid, can result in theoretical income that cannot be used to pay real expenses. The costs of the organization, and specifically the salaries of the staff, depend on the actual collection of interest and fees.

Payments should therefore be considered in arrears the first day after payment is due, but since client reports are usually provided monthly, by the time the project supervisor finds out about the late payments the client may already be many weeks behind. The process of visiting to determine the background for late payments is therefore very important, and the goal should be to visit all of those clients who appear on the arrears list first. If commitments made during this visit are not kept, and the account continues in arrears, the program director should send a formal letter to the client or group requesting that accounts be put in order within three business days, or the organization will take measures to collect capital. This letter should remind the client of their initial commitment and any revisions defined through supervisory visits. It should also define the measures to be taken: for business incubators, the assets will be taken, for community banks, the savings pool will be charged, for solidarity loans the other members of the group will be asked to make payment, and for individual loans the cosigners will be notified of collateral taken. Variations in these measures may exist depending on the particular context of the program, but an official letter, on organization stationery, with reminders of specific actions to be taken, has proven to be a very good mechanism for promoting collections.

The absence of any response to this letter probably means that more than 60 days have already transpired since the payment was due. The clients should be encouraged to pay any amount they can, and at least to cover interest and fees. However, if there is no response, the case should be presented to management, and perhaps to the board credit committee, for legal collection. By this time the case will be evident in the organization's financial statements, and a brief report from the project supervisor should be circulated to recommend specific actions. The handling of the case should be determined after consultation, and organization management or board members may be willing to try their hand at getting a response, especially if the clients are related to the community in some way. If management or the board decides to contract a lawyer, the legal collection process also begins with a letter that notifies the client of the need to pay the entire loan. In some cases this letter alone is sufficient to get the client back on track. However, if this does not happen, the legal collection process should be implemented.

The recommendation that legal process be applied is not because used equipment is valuable, nor is it anticipated that cosigners or other collateral can be easily converted into payments. The fees that lawyers charge also consume a major portion of any amount that is collected through the legal process. What motivates a professional effort to promote collection after 120 days or more of arrears is the fact that the entire image of the program is under observation. If defined procedures for collecting funds are not implemented, the organization will earn an image that it is not serious about needing funds to be paid back, and many other clients, and potential clients, may also plan not to pay their loans, finding other more important uses for their funds. Irresponsible clients who do not pay will destroy the entire credibility of the program, as the news that one client was able to get away with this without problems will quickly be spread to the entire community.

The need to take a strong position on collections is one of the reasons presented for separating the program from the community political structure, as sometimes the people who believe they do not need to pay have acquired this belief, somehow, through their community association. The sad irony is that economic development programs have played a special prophetic role in identifying that some established community leaders, and even political and religious authorities, do not practice integrity in the business environment. If this person has a loan and does not want to pay, the economic development program has the special "ethical role" of demonstrating that leaders also need to be held accountable.

The very serious nature of a legal collection process also calls for management evaluation of how the situation was allowed to happen. Can evidence of the problem be identified in the initial project design? Was there sufficient evaluation of the project? Was the training adequate? Were there any warning signs in the field visit reports? It is often the case that one or two people “test” a newly initiated economic development organization by simply deciding not to pay, and it may be that the problem situations encountered are part of the learning curve. It is important to make sure that all that can be learned from the experience is understood and applied.

Recycling of sustainable financial assistance for the poor: one reason that the concept of sustainable financing is proposed is that subsidies for projects are harder and harder to obtain, and programs that depend on donations can only help a few people and then they are depleted. The advantage of a project that is able to cover its own costs or recycle funds over and over for new clients is not only that it is easier to market to donors, but also that it creates a sustainable foundation for helping many people over a long period of time, independent of subsidies. Even if the local community discontinues direct involvement in the economic project, it should be able to continue on its own without external support.

The fact that these programs can be economically self-reliant does not mean that subsidies are bad in themselves, just that they are frequently difficult to obtain. The methodology of recycling capital in a sustainable manner is attractive in many situations where there are relatively few resources, and if subsidies do become available to support specific aspects of the program, such as the technical training components, they can be well utilized for short periods of time without impacting the financial foundations of the entire program.

There are three levels in understanding the cost components of economic development programs in relation to financial sustainability:

1. The most basic level, and easiest to understand, is the level of total direct costs. The revenues from sales of products or services must be sufficient to cover the costs of goods sold, personnel expenses, and all other expenses. For incubator and loan projects, the costs of placement of capital, training, supervision, collection, and general administration must be

covered by the fees and interest generated by the program, or they will begin to consume the capital that the program has available for funding businesses.

2. The second level of costs would also include a reserve amount for replacement of assets, i.e. a sinking fund that anticipates the need for future investment in the business. For incubator and loan programs this involves the generation of a bad debt reserve fund. The amount that should be put into a reserve depends on performance, but given the fact that starting businesses with the poor is inherently risky, at least 5% of the total amount of outstanding capital should be covered by such a reserve. When specific projects go into the legal collection process, the total balance of these projects can be written off against this reserve amount. It is important to note that funds written off can still be collected, but should be registered off of the official bookkeeping, and reported as special revenue if repaid.

3. The third component of costs, and a major issue in developing countries, is an amount to offset inflation and devaluation. In many cases there is a continuing decline in the value of the dollar in relation to local currency, and unless this is covered through profits, interest or fees, it will result in a loss of value of the business equity. The margin to cover this amount must not only be generated, but also continually capitalized, i.e. added to the balance sheet.

The goals of the economic development organization should include a financial sustainability target that strives to cover these three levels of costs. This will not happen immediately, as a subsidy is often necessary to get the enterprise operating. Revenues should increase over time, as the funds are invested and the project grows; it often takes three years from the time of organizational start-up to program financial sustainability. Monthly financial reports should clearly demonstrate the progress in relation to this goal, and an analysis of direct revenues and costs and inflation/devaluation reviewed periodically in setting prices. Though organizations are not expected to become financially sustainable immediately, progress towards that goal may be a major factor in obtaining additional capital from donors.

<u>Anticipated evolution towards financial sustainability</u>: When the community starts the program, it often begins operating out of borrowed facilities, with volunteer staff. The first tasks are the definition and design of the program. The first expenses are usually related to an initial staff person

and his/her costs, plus all of the legal and paperwork costs of getting the organization off the ground. Monies coming into the program from outside donors will probably be almost entirely for the project operations, with very little used for the program installation.

As the project grows, new personnel may be hired, sometimes a director who may oversee the work of the initial staff person, and be assigned further development of the project. At this stage a separate office is often rented, which helps in promoting a separate identity from the community. The program begins to accumulate its own furniture and equipment. It starts to have an identity of its own, and funds obtained from donors may not only be used for the business project, but also to build a basic infrastructure for support of the program–furniture, computers, vehicles, and other equipment. At this point the project may be subsidized to some extent, with careful attention to patterns of spending in relation to revenue.

Once the project reaches a mature level, it can demonstrate that it is able to cover all of its costs from revenues, even after assigning an amount for a reserve for future replacement of assets or to handle bad debts, and after capitalizing an amount of funds equal to the devaluation/inflation rate. It should be noted that devaluation is generally used as a proxy for the inflation rate due to the political factors involved in defining inflation, and the fact that funds are often sourced in dollars, so the goal of maintaining their value in dollars creates an understandable benchmark.

The mature economic development organization promotes sustainable economic activity, and is at the same time sustainable from revenues that it generates from its own products or services. It has an administration that is independent from the community, although connected through board members who are from the community; and it has objectives, including social impact, which are being implemented by employees who share that vision.

Chapter XIII

The Future of New Income, Jobs, and "Public Goods"

One of the surprising issues in social development is how short a memory there is. Projects are started and then they seem to disappear. A new organization comes along, with staff that knows nothing about what happened before, and starts the same project again. In large organizations and small, an institutional amnesia seems to create a fog. Especially surprising is how governments and large non-profit agencies watch projects fail; and then do the same thing all over again. This may be because they have the money to spend, but it is very sad.

To avoid a repetition of past failures, the basic requirements for a successful creation of projects to generate income, jobs, or "public goods" include: (1) the financial sustainability of the program over time, and (2) the ability to maintain the vision of the project over time. Some failed projects did not meet the first requirement, and disappeared. There are many examples of well-meaning projects that were disbanded once the funding ran out; abandoned buildings often serve as testimonials. Day-care centers and orphanages continually appear and disappear, for example, as well-intentioned groups attempt to respond to the needs of street children, and then discover how expensive it is to run this type of program.

Even more cases exist in which there was a loss of vision in projects that began with a focus on the poor and a connection to the community. The activity goes on, but without any social impact. Large and reputable organizations were started for the poor, but no one can remember what happened to that objective. There are scores of schools and hospitals that were started to help the needy, but have since become oriented only to the upper class. Job creation programs were organized, and the international organization that started them left hundreds of thousands of dollars in a revolving loan fund with hopes that these projects would be a means to help create employment for the poor, but only a few years later, the funds are targeted at the middle class, and managed without any regard for social objectives. The focus shifted to the well-being of those who manage the funds, since more wealthy clients mean higher interest rates, more financial security, and better salaries.

People involved in overseas projects need to think about these issues. Yes, it is true that "the major impact of a project is on the local people, and even though the project failed, a lot of lives have been affected." But wouldn't it be better if the project could survive financially, and at the same time keep its vision?

There are ten benchmarks that can help set projects on a path to sustainable success:

The first step is to define an exit plan before you start. If the project is started with expatriate support, a projection should be made of when that support will end, and a transition anticipated. If the project is started with subsidies from overseas, these need to be phased out gradually, local resources identified, or some type of endowment financing secured. It is not possible to anticipate the future entirely, but the exercise of trying to anticipate what will happen next year, and in the next five years, is helpful.

The second step is to define the core purpose, and then promote this vision from the very start. The question to ask is: what are the key outcomes and results we are expecting? This question helps to define the project in terms of its primary goal. There are often many ways to obtain the same output, and what you want to avoid at all costs is that the means becomes an end in itself. For example, if the purpose is to help the poor, using the means of a revolving loan program, this must be kept in focus, as the revolving loan program in itself can become the purpose, and the poor forgotten. Many a project has encountered "mission creep" and wavered from its original goals, sometimes because they were never well defined, and sometimes because they were not kept in focus by continued articulation.

The third step is to involve other partners and link the project with those who can help it to keep its focus. The international and local partners generally look at a project in the same way as a parent might view a child's progress from birth, adolescence, young adulthood and maturity. This is not a paternalistic pattern, but rather shared ownership of the goals of the project. Team relations with other organizations and stakeholders help keep the vision.

The fourth step is to invest in local leadership, which usually means a board of directors who have no connection with financial remuneration, but have a deep enough interest in the project to give of their time and resources to help. It is very important that this leadership not be centered in just one person, and that the group take a genuine interest in the project. A formal board must first of all keep the vision of the program, and also supervise the finances, promote the project, provide special advice, represent the organization in a legal sense, and supervise the management.

The fifth step is to require sound management. Some may see this as an imposition from the West, but that is simply not true. Whatever the customs in the two-thirds world, when things are run badly, there are problems. No one celebrates if the government cannot keep the electricity going, and no one is rewarded for incompetence.

The sixth step is to emphasize continual training that includes a presentation of the goals and objectives for which the project was created. There will always be board turnover, and if the new board members do not have the vision, it will gradually perish. There will always be management and staff turnover, and if they do not have the vision, it will become lost in the program. Written materials that describe the project start-up and recite the history are extremely helpful.

The seventh step is to evaluate carefully the legal status of the organization, and make sure it is appropriate for the long term. A common error is not to obtain legal status separate from other organizations, and when these have problems (especially community political structures) the project is affected. A classic error for expatriate staff is to retain project ownership, and then suffer the consequences when they wish to extricate themselves. Any project that owns property needs to consult legal authorities to create the most advantageous structure for perpetuity.

The eighth step is to allow adequate time for the project to be successful. Often the initial subsidies required for installation are cut too soon. Another common mistake is to “turn the project over” before it is even working. Organizations appear sometimes to transfer ownership of projects because they have failed, not because the international agency has become interested in partnership. These abandoned projects not only tarnish international reputations, but also put the local partner in the sad position of having to struggle and then turn out the light. It takes much more time to get things to work in the two-thirds world, and expatriates should perhaps estimate "adequate time" based on their home culture expectations, multiplied two or three times.

The ninth step is to promote local participation and ownership. These two are related, as it is hard to motivate participation without ownership. At the same time, ownership has to be decentralized so that one person or family does not control the project. In many countries, and based on a legal framework of an association, a general assembly of stakeholders in the program meets once a year to hear reports on the project, and elect a board. There are other successful cases where those who work in the program are themselves the stakeholders.

The tenth step is to make sure that the project has a viable operational design. If local people cannot pay for curative medicine available when expatriate doctors work at no cost, it is unlikely that paid local doctors are a viable alternative, and perhaps the medical objectives need to be met through less expensive, more transferable preventive approaches. Or perhaps the clinic will have to shift its focus also to include more wealthy families, to be viable in the long run. These are the types of questions that need to be considered from the very beginning of starting a project.

The Challenge That Lies Ahead

Promoting productive economic activity can be an effective tool for responding to the needs of the poor, but it is not easy. It is important to acknowledge this fact, and identify the significant problem issues. The saying "if they give us lemons, we need to learn to make lemonade" is appropriate for thinking about challenges for any successful economic development program. We encounter various "lemons" as we design enterprise "lemonade."

<u>The "Evil Structures" Lemon</u>: The struggle with a world dominated by greed, exploitation and inequality is quite notable in the world of economics. "The world's richest 20 percent now receive 86 percent of the world's domestic product, the poorest 20 percent have only 1 percent, and the middle 60 percent just 13 percent. The world's richest two hundred people saw their incomes double between 1994 and 1998 to over a trillion dollars. The world's richest three people have assets greater than the combined output of the forty-eight poorest countries."[54]

Governments craft policies to help their citizens, and in the process impoverish people of other countries. Free market capitalism is proposed as a strategy to promote economic development, but not practiced by those who prescribe it. “Protectionism of industrialized countries is concentrated in sectors of big export interest to developing countries, and the system has been increasingly loaded with rules that are more an impediment than an incentive to developing countries’ engagement in international trade.”[55] Big companies attempt to ruin smaller companies in a competitive market environment with few rules and no protection. The ground for competing in the business environment is not level, and unethical practices are common, just as they always have been.

Some economists write about the world economy, injustice, and unfair practices, and present grandiose and ideal solutions.[56] Unfortunately, we do not live in an ideal world, but rather in one where a complex environment is resistant to change, and where we still get lemons. “Not all the participants in the creation of economic growth have the right incentives.”[57] Facing this reality, we need concrete plans for how to live and “make lemonade” in the communities where we live, especially to empower the poor to work and support our families. Whatever one believes about economic systems, the fact is that most of the world’s poor continue to confront the lemons of increasing poverty, social injustice and surprising economic inequality. We need to exert all the political capital we have to address these problems, but at the same time to promote constructive projects to survive in the actual environment in which we find ourselves.

It is this type of perspective that motivated the substance abuse recuperation program in Mexico to teach recovered drug addicts and alcoholics to make wooden tortilla presses. Managers of this project are aware of the problem of unemployment in Mexico, the problem of the hiring/firing and personnel policies of the maquila (assembly) industries in the border cities, and the problem of the access to drugs and alcohol; entire books are written about all of these phenomena. But what can be done to help? They discovered a product that was easy to sell, that could be made from inexpensive scrap lumber, and produced with simple technologies. This productive economic activity provides stable incomes for families, and a respectable and meaningful means of “working with their own hands.”[58]

The problems of the region where these people live are enormous, and due to the proximity to the U.S., many "do-gooders" from the north respond by bringing down food and clothing to distribute directly to those they find in the street. But what people really want is not to live off of those hand-outs, but rather to have the capacity to earn their daily bread. A job is valued more highly than anything else, because it is the key to the capacity to provide for oneself. This is where a response to the poor should include not only service, but listening to those we serve. If we listen, we may find that there are ways we can help people to increase income and become employed, even in the very difficult circumstances in which they find themselves.

The "Lemon" of the Community Context: Listening to the poor can be discouraging when there is an expectation to respond to the needs of the community. Even in a small village, people may not want to work together, and the foundation of "public goods," such as health and educational services, is increasingly weak and under-supported. Governments in developing countries, required to balance the budget for social services with tax revenues, simply are not capable of providing basic services.[59] "The crisis of the welfare state has meant primarily that the structures of public assistance are being privatized and expropriated for private gain."[60]

Rather than waiting for the government to provide elementary education in the slum communities surrounding Cartagena, the Blas de Lezo church organized three schools in the slums, with two shifts per day to maximize services. Rural villages in the Central African Republic know that the government has no programs to help them, so they organized a community enterprise to fund the upkeep of wells for potable water, requiring a financial investment from community members.

And this is not easy. Working with volunteers is not easy, and the community context has always been to some extent dysfunctional. We need to have realistic expectations. Will someone use his or her community or family affiliation to try to benefit from the program? That happens a lot. Will someone who appears to have integrity turn out to be irresponsible? Count on it. Another irony of many programs started for the community is that they develop to a point where they exclude community members.

The special problem for non-profit agencies is that they may have a tradition of providing donations, and the initial communication that an economic program is different, requiring discipline or a pay-back of capital, may be traumatic. Usually someone will test the boundaries, and it will be necessary to take action. It is disappointing to realize that people who are considered leaders in the context of community politics are unethical and irresponsible in the context of a business. As a test of social commitment this process may be a good thing, but it is also demoralizing when people fail the test.

On the other hand, it is exciting to see cases where the community has benefited greatly, and expanded its social outreach, through economic programs. In a small neighborhood in one of the poorest slums of Santo Domingo, the leaders decided to use the community bank concept as a tool to help others. They had noticed that most people in the community did not want to participate in community meetings, having no motivation to get to know their neighbors. To promote interaction with the people in the neighborhood, an invitation was made, through distributing flyers, for a new program to be started in the local church to promote income. It was called the neighborhood village bank, and the methodology was described to all of those attending a first meeting, scheduled during late morning in the church building.

From this small project a solid community bank program was begun, with the involvement of both those inside and outside of the church. The community group has its own board, incorporation papers, accounts, and even one part-time employee. The image of the community has been completely changed, and it is known for its interest in promoting development for all.

<u>The Lemon of Limited Access to Resources</u>: Once the importance of productive economic activity has been accepted, the question arises of how to fund it. Some people are accustomed to the idea of donating money for social programs, or even more used to giving donations for food, medicine, and other basic needs. Appeals for funds for these types of programs are common, but how are economic programs to be funded? The saying that "if you give a man a fish, he eats for a day, but if you teach him to fish, he eats for a lifetime" does not take into account that it is much easier to raise money to donate a fish than to raise loan capital or money for the educational programs and tools to empower the person to fish on his own. How strange!

Donors need help to understand this problem, and the comparative opportunities generated by economic development projects. The pictures of the starving child may be great for promotion, because they generate an emotional response. But simply providing food does not address the real problem: that the parent has no employment. In the long run, helping the parent to get a job is less expensive than subsidizing the food, clothing and educational costs of the children. Productive economic activity is more complicated, and perhaps less picturesque, but a better and even more cost effective solution!

Perhaps there is no better example of success in making such a transition to this approach than World Vision, an organization known principally for its child sponsorship program. In a period of less than 10 years the overseas programs of World Vision, with many struggles along the way,[61] have grown sustainable revolving loan programs for the poor from zero to over $60 million.[62] These are resources that are continually recycled for productive investment in small businesses that generate income and create employment.

Governments, community groups, and the private sector in developing countries are catching this vision, and pooling resources to promote economic development. "It takes creative individuals with fixed determination and indomitable will to propel the innovation that society needs to tackle its toughest problems…important social change frequently begins with a single entrepreneur."[63] Many of the projects described in this book were begun after a dialogue with donors promoting education of the benefits of economic development, using pilot projects for start-up, and accessing local funds based on the initial track record of the enterprise over time. In many cases the challenge is to find donors who will accept the risks related to starting new projects, because once the enterprise begins to function, it can often attract resources on its own.

Resources for economic development are not dependent on international donations; case studies of the economic power of the informal sector in Peru demonstrated that it was "expected to generate 61.3 percent of the GDP recorded in national accounts."[64] The problem is how to harness these resources, especially when they are tied, in many cases, to property values insufficiently protected by law. A subsequent analysis by the same author states, "nearly every developing and former communist nation has a formal property system. The problem is that most citizens cannot gain access to it."[65]

At a meeting where the concept of economic development was being presented in Brazil, three entrepreneurs from a medium-sized church described how they had raised a revolving fund of $30,000 from church members themselves to help increase incomes and create jobs in the neighborhood where the church meets. They never even considered presenting a proposal to external donors, but were able to start a project with resources from their own community.

What would happen if this vision were captured by other groups and multiplied by hundreds, or even thousands? Not a vision for multi-million dollar complex programs, but for small projects using the principles in this book to start targeted economic development programs. Small, clearly defined economic projects can initiate financially sustainable schools, medical centers, business incubators, revolving loan programs, or profit-making enterprises to support social projects in communities. "So much development work is focused on macro-economics and increasing GDP per capita. These large-scale government aid projects are doomed to failure because of corruption, bureaucratic sloth and ultimately, the dependency they breed among recipients. Until the development community realizes that the solution to poverty lies in increasing the wealth of the small-plot farmer, it will continue to fail."[66] The combined output of many small projects can be far greater than the few large ones that are funded by governments and international agencies. Small enterprise projects grow with strong roots in communities, and in the long run are more sustainable in finances and vision for meeting the needs of the community.

[1] Werner, David, (1977) "Where There Is No Doctor," Palo Alto, California: Hesperian Foundation
[2] Kresenky, Raymond, (1937) "Prayer of the Unemployed," *1000 Quotable Poems*, New York, Willet, Clark and Company, p. 191
[3] Olson, Mancur, (1965) The Logic of Collective Action, Harvard University Press, p 15
[4] C.K. Prahalad was in his first years at the University of Michigan, and neither famous nor known at that point for an interest in the "bottom of the pyramid."
[5] Institute for International Development (IIDI) changed its name to Opportunity International when it moved its U.S. offices to the Chicago area in the mid-1980s
[6] Befus, David, (1986) *Foreign Direct Investment of Expatriate Entrepreneurs: the Case of Honduras*, University Microfilms International, Ann Arbor, MI
[7] Article 25 of the United Nations Universal Declaration of Human Rights
[8] Prahalad, C.K., (2005) *The Fortune at the Bottom of the Pyramid*, New Jersey: Wharton School Publishing, p. 4
[9] *Dividend*, "C.K. Prahalad Challenges Michigan to Expand World View," Ann Arbor, Fall, 2003, p. 38
[10] Grindle, Merille, (2000) "Ready or Not: The Developing World and Globalization," *Governance in a Globalizing World*, Washington D.C, Brookings Institution Press, p. 186
[11] Benioff, Marc, and Southwick, Karen, (2004) *Compassionate Capitalism: How Corporations Can Make Doing Good an Integral Part of Doing Well*, New Jersey, Career Press, p. 4
[12] Dees, J. Gregory, Emerson, Jed, and Economy, Peter (2001) *Enterprising Nonprofits: A Toolkit for Social Entrepreneurs*, John Wiley and Sons, New York
[13] Prahalad, C.K., (2005) *The Fortune At The Bottom Of The Pyramid*, Wharton School Publishing
[14] Gilpin, Robert, (2001) *Global Political Economy*, New Jersey, Princeton University Press, p. 6
[15] Mallaby, Sebastian, (2004) *The World's Banker*, Penguin Press, New York, p.1
[16] Fisher, Thomans and Sriram, (2002) M.S., *Beyond Micro-Credit: Putting Development Back Into Micro-Finance*, Oxford, U.K. p. 20
[17] "instead of replacing the loan shark, you have become the formalized loan shark," is a refrain perhaps first addressed to a popular Bolivian micro credit program at a conference called by the President of Bolivia in 1997, then successively to many others. Many micro credit organizations have gravitated toward lending money only in the local marketplaces, successfully replacing the high interest market money lenders. However, this form of lending creates little employment and is targeted only on commercial enterprises.
[18]Schmidtz, David, (1991) *The Limits of Government: An Essay on the Public Goods Argument*, Westview Press, p.11
[19] Hocking, Jim, (2004) *ICD International – Well Drilling*, Presentation at Micro-Enterprise Development Summit, GBIM, Winona Lake, IN
[20] Lavado, Pablo, "Insuring the Life of a Ministry," *Latin America Evangelist*, (July/October 2004) Miami, Latin America Mission, p. 17
[21] For U.S. agencies "working for the poor" in micro credit, their annual Form 990s documenting salaries in excess of $100,000, not only for executives but for field staff, are available publicly at www.guidestar.com
[22] Many other resources exist, and directories of resources. The best primer on "enterprise development" may be Edgcomb, Elaine, and Cawley, James (editors, 1993), *An Institutional Guide for Enterprise Development Organizations*, SEEP, Washington, D.C. For the internet, start with the SEEP website (www.seepnetwork.org)
[23] Rutherford, Stuart, (1996) *A Critical Typology of Financial Services for the Poor*, Working Paper 1, ActionAid, UK
[24] FIPS, (2004) Foundation for Productive Integration of Mexico, "Jonah Project" with Chichimeca indigenous population in San Luis de la Paz region
[25] When World Vision closed its program for feeding supplements for children in San José, Costa Rica in 1994, there were demonstrations against the organization in the communities. When the Colegio Latinoamericano in Cartagena began charging a fee for all registered students in 2004, after decades of providing free private education, the physical safety of the staff was threatened.
[26] Providing 40% of its profit for poor clients, the Clínica Bíblica in San José, Costa Rica, has a special social department that collects information from clients applying for a subsidy, and verifies it. See Cabezas Badilla, Franklin, "Una Reseña Histórica – Nuestra Clínica," San José, 1996
[27] The famous quote about the U.S. welfare system comes to mind: "hated by those who administer it, mistrusted by those who pay for it, and held in contempt by those who receive it…" (Goldmark, Peter, (1978) New York State Budget Director)
[28] www.rpcv.org, the National Peace Corps Association website, provides excellent information on more than 60 countries and indexes materials available from multiple sources. One goal of this organization is to link U.S. schools to a network of communities in the developing world.
[29] financial data from reports presented at the annual meetings of the general assembly for the PdV school in San Antonio de Belén, Costa Rica. The author is a member of the general assembly.
[30] Poenaru, Dan, (2004) "Sustainability of Healthcare Missions in the 21st Century," Global Health Mission Conference, Louisville, KY

[31] Due to the gap, specialized resources are available. For water systems, check www.living-water.org or www.lifewater.org. For health, check www.gomets.org or www.mtppi.org.
[32] UNICEF, (1998) *The State of the World's Children*: Focus on Nutrition
[33] Batstone, David, (2003) *Saving the Corporate Soul*, a presentation of The Timberland Company community service program in chapter 3, Jossey-Bass, California
[34] Café Por Favor, 3400 E. McDowell Rd., Phoenix, AZ. (www.porfavor.com)
[35] Geneva Global, from Pennsylvania, U.S., has funded a network of internet access communication booths to help support a university student project in Peru.
[36] Business Professionals Network (BPN), helps to form U.S. groups to support start-up businesses overseas, Portland, Oregon.
[37] Programa Girasoles Base Conceptual, (2004) strategy paper with appendix "Proyectos Generadores de Ingresos,"
[38] Linthicum, Robert, (1994) *Exploiting Children in Our Cities*, Together Magazine, World Vision, #42
[39] Allen, Hugh, (1977) "The Informal Urban Industrial Sector and Growth: Some Thoughts on a Modern Mythology," Institute for Development Studies, University of Nairobi, Kenya
[40] Fisher, Thomas and Sriram, M.S., (2002) "Beyond Micro-Credit: Putting Development Back Into Micro Finance," Oxfam, Oxford, UK, p. 20.
[41] Hulme, David and Mosley, Paul, (1996) *Finance Against Poverty*, Routledge, London, UK, p. 135
[42] IRS Form 990 for U.S. foundations and non-profit organizations includes financial reports and salary information, and is available at no charge on the Guidestar website, www.guidestar.com.
[43] Readers may appreciate the fact that critical thinking at this level is not well received, but the specific statements about impact and efficiency that are cited here can be found on websites and in promotional materials of various U.S. agencies.
[44] Funded from the LAM economic development pool (2002) in the town of La Florida, Honduras, close to the Copan ruins. A business student from John Brown University prepared the business plans for these projects.
[45] Funded from the LAM economic development pool (2000) in Tijuana, Mexico. The girls began by making a "Frijole Baby" doll, and then graduated to making puppets. The men use scrap wood, but sell the presses for $10.
[46] Funded from the LAM economic development pool (2001) in the capital city. The store was organized on the street of the local bus lines, but people who take local buses will not pay a dollar for coffee. The funds invested were recuperated through the sale of the coffee machine equipment.
[47] Warn, Steve, (2004) *Supporting Ex-Felons as God Supplys*, LAM/VIA, Costa Rica
[48] Cohen, Adam, "A Community of Ex-Cons Shows How to Bring Prisoners Back Into Society," *New York Times*, January 2, 2004
[49] Chalmers Center for Economic Development, (2003) total savings after 25 weeks reported for the entire group reported at only $97, *Chalmers/FHI Pilots in the Philippines*, Covenant College. See also Bussau, David, and Mask, Russel, (2003) *Christian Microenterprise Development: A Handbook*, CMED Network, pp. 21-26.
[50] Jonathan jeans, funded in Siguatepeque in 1980 by IDH, grew to "maquila" or assembly factory status by 1984.
[51] OPDS, "Informe de Alcance, Impacto, y Razones Financieras," (Marzo, 2005).
[52] McVay, Mary, (2003) *BDS Market Development Program Design Tool*, The SEEP Network, Washington, D.C. www.seepnetwork.org
[53] Fisher, Thomans and Sriram, (2002) M.S., *Beyond Micro-Credit: Putting Development Back Into Micro-Finance*, Oxford, U.K
[54] Tabb, William K., (2001) *The Amoral Elephant: Globalization and the Struggle for Social Justice in the Twenty-First Century*, Monthly Review Press, New York, p.206
[55] Zedillo, Ernesto, (2003) "To Be or Not to be at Cancun," *Forbes*, September 1, 2003, p. 36.
[56] Sachs, Jeff, (2005) *The End of Poverty: Economic Possibilities for Our Time*, Penguin Press, N.Y.
[57] Easterly, William, (2001) *The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics*, MIT Press, Massachusetts, p.23
[58] this is from an injunction in the Bible, "make it your ambition to work with your own hands so that you will not be dependent on anybody," I Thessalonians 4:12, a text seldom used by priests or preachers in developing countries, because it is so hard to find work. Even the famous *Lord's Prayer* mentions "give us this day our daily bread." Prescribed at a time before welfare or aid programs existed, was it also perhaps referring to gainful employment?
[59] Stiglitz, Joseph, E. (2003), *Globalization and Its Discontents*, W.W. Norton Company, New York, p.208, "the IMF never wanted to harm the poor…." A discussion of budget requirements and the resulting need to cut social programs.
[60] Hardt, Michael and Negri, Antonio, (2000) *Empire*, Harvard University Press, Massachusetts, p.301. For a more complete review of the debate on globalization, see Bhagwati, Jagdish, (2004) *In Defense of Globalization*, Oxford University Press, and Goldsmith, Edward and Mander, Jerry, (1996) *The Case Against the Global Economy*, Sierra Club Book, San Francisco.
[61] Befus, David, (1995) "From Assistance to Enterprise: the Re-Engineering of World Vision Community Development," in *The Role of NGOs in Economic Development: "State of the Art,"* Institute for Development Strategies, Indiana University,

pp. 93-108
[62] World Vision economic development report, 2005
[63] Bornstien, David, (2004) *How to Change the World: Social Entrepreneurs and the Power of New Ideas*, Oxford University Press, p. 3
[64] de Soto, Hernando (1989) *The Other Path: The Invisible Revolution in the Third World*, Harper and Row, New York, p. 12
[65] de Soto, Hernando (2000) *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Basic Books, New York, p. 153
[66] Polak, Paul, (2005) "Trickle-Up Economics," *Forbes*, June 20, 2005, p. 42