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UNITED NATIONS INDUSTRIAL
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Consultant, MISSION REPORT*
(Leon V. Chico)

ANGOLA

Advisory Services to the Director General of the Institute for
Promotion of Small and Medium Enterprises (Instituto Nacional de
Apoio as Pequenas e Medias Empresas) or INAPEM in the initial
operation of the organization

United Nations Industrial Development Organization
(UNIDO) Vienna

Backstop Eff. Ms Benconi, CSRD/PTK

*This document has not been edited.

SELECTED BASIC SOCIO-ECONOMIC INDICATORS

Land area	:	1,246,700 square kilometers
Population (1994)	:	10.5 million
Density of population (1994)	:	8.4 persons per square kilometer
Exchange rate (9/3/95)		
Official	:	576,000 new kwanzas to the US \$
Market (est)	:	1,650,000 new kwanzas to the US \$
Estimated oil reserves (balance 1993)	:	2,801,700,000 barrels

		<u>1991</u>	<u>1992</u>	<u>1993</u>
GDP Growth (est)	:	+2.0%	+1.0%	-22%
Inflation	:	+175%	+500%	+1760%
Exports FOB US\$ million	:	3427	3698	2960
Imports FOB US\$ million	:	<u>1750</u>	<u>2282</u>	<u>1975</u>
Balance of Trade US\$ m	:	1677	1416	985
Exchange rate 31 Dec	:	88.33	568.8	6611

Sources: BNA, World Bank, Financial Times, Wood Mackenzie, etc.

MISSION REPORT

I. INTRODUCTION

Angola is regarded as potentially one of the richest nations in Africa. Only a very small part of its agricultural areas is under cultivation. The southern coast offers vast fishing resources. It has very rich oil reserves and valuable minerals such as diamonds which are currently its major foreign exchange earners. Large livestock and forest resources also exist. However, twenty years of civil war has destroyed much of its infrastructure. Industrial enterprises are constrained by old equipment, lack of spare parts and raw materials. Many of them are producing at about 30 percent of available capacity; several others are not operating at all.

With the signing of the Lusaka Protocol on 20 November 1994, Angola is making a second attempt towards peace. With peace comes the gigantic task of social and economic rehabilitation. A Round Table Conference of bilateral and multilateral donors has been initiated and is expected to be held in June/July 1995.

Meanwhile, the National Institute for the Promotion of Small and Medium Enterprises (Instituto Nacional de Apoio as Pequenas e Medias Empresas or INAPEM) sent a simultaneous request to UNIDO and UNECA to field a joint fact finding/needs assessment mission to provide advisory services to the Director General of INAPEM in the initial operation and future directions of the organization. INAPEM was organized in 1992 following the promulgation of Decree No. 39-I/92 on 28 August 1992. An earlier UNIDO mission on Small and Medium Enterprise Promotion and Development (SI/ANG/90/801) in October 1990 recommended the creation of such an institution to assist small and medium enterprises.

The missions from UNECA and UNIDO overlapped within a 25-day period. The UNECA mission consisting of Ms. Irene Lomayani and Mr. David Kamara was in Angola from 20 February to 8 March 1995, while the UNIDO mission of Dr. Leon V. Chico was in Angola from 3 to 17 March 1995. The outputs of the missions are a report prepared by the UNECA mission, this report prepared by the UNIDO mission which summarizes its main findings and conclusions, including a proposed strategic and action plan for INAPEM. The main elements of the proposed action plan will also be incorporated in a project document for a possible technical assistance in strengthening INAPEM. This will be completed in UNIDO Vienna by the end of March 1995 for the possible consideration of the government and international donors.

II. SUMMARY OF FINDINGS AND CONCLUSIONS

1. The existing policy and regulatory framework for small and medium enterprises makes it very difficult for these enterprises to be promoted and developed. The registration and licensing procedures are difficult and time-consuming processes to accomplish. At least two government ministries are involved: (a) the Ministry of Trade grants the general license or "alvara", which requires that the application be published in the official government gazette (or in lieu thereof, in the newspapers). We understand that this procedure takes at least one year; (b) the Ministry of Justice, as well other agencies involved in the particular sub-sector, is also involved in the process and the requirements are difficult to accomplish, which again takes at least another year.

It is not unusual that many enterprises have reportedly been started and are in operations for as long as five years without having completed the process of registration. This makes it difficult to obtain reliable statistics on the small enterprise sector as well as in ensuring that tax and other laws are complied with. The government actually losses potential tax revenues with a complicated registration process.

In many countries, the registration of small enterprises is a simple "one-stop" procedure and could be done in less than one month and often in a few days. In some countries, there are also laws that allow very small enterprises (of 20 or less workers) to just obtain a local permit from the town mayor in order to operate legally. The same laws usually exempt these enterprises from all other legal requirements for up to five years (i.e., income tax, minimum wage payments, etc.). This encourages small enterprises to operate "above board" or legally.

Furthermore, there are no fiscal and other incentives for small and medium enterprises in Angola. The income tax of 40 percent applies to all sizes of enterprises. It is, therefore, not surprising that many enterprises prefer to operate outside the purview of the law (in the informal sector or "parallel market").

An urgent and thorough review of the policy and regulatory framework is required to make them conducive to the promotion and development of small and enterprises. This should be one of the important tasks of a strengthened INAPEM.

On the positive side, various measures have been adopted to move from a central planned economy to a market economy. By 1992, almost all prices were liberalized. Foreign and domestic trade were opened to private competition. The foreign investments law (Decreto No. 13/86) provides for various incentives which may include exemption or reduction of income taxes and customs duties. In practice, enterprises can now freely purchase foreign

exchange in the open market for their import requirements. The disparity between the official currency rate and the market rate is no longer as wide as it was a few years ago. (As of 10 March 1995, the official rate was 576,000 kwanzas to the United States dollar while the open market rate was about 1,650,000 to the United States dollar).

2. A clear and simple definition of what constitutes a small or medium enterprises does not currently exist. There is an existing formula provided under a 1989 law (Decree No. 33/89) which is complicated and has really not been used. Furthermore, the formula may no longer be relevant under current conditions. The formula uses a matrix of several indicators: (a) importance of the sector to the national economy; (b) project cost of setting up the enterprise; (c) sales volume; (d) complexity of the technology; and (e) number of workers. In practice, various institutions/programmes use their own definitions which vary from one another.

A simple and clear national definition is, however, important in identifying target groups (i.e., large, medium, small, and micro/household) for granting specific incentives and assistance. In the absence of a nationally accepted definition and for purposes of identifying the immediate target group of INAPEM, we propose categorizing enterprises in the formal sector into two main groups:

- (a) Enterprises which only need an enabling business environment, clear/transparent rules and regulations for their operations, and would not normally need any assistance; and
- (b) Enterprises which, in addition to an enabling business environment, also need direct support and assistance (and possibly incentives).

The first group would include large enterprises, foreign or mixed enterprises, and modern small and medium enterprises (which are normally linked to large or foreign enterprises either as subsidiaries or sub-contractors).

The second group should be the main target clientele of INAPEM. This would generally be small and medium enterprises in the formal sector (except those in the first group above), as well as some enterprises in the informal sector which are ready to move into the formal sector and which should be assisted in doing so.

A third group of enterprises also exists, consisting of micro enterprises and those engaged in household income and employment generating activities (often referred to as the informal sector). This group require support and assistance of a different nature. Under present circumstances, the assistance must be "massive and immediate" such as those envisioned in the

emergency rehabilitation programme. The type of assistance required could best be undertaken by community-level organizations, including non-governmental organizations (NGOs). Although very little government tax revenues (or none at all) may be expected from this group, it is an important sector in the social development of Angola which eventually will provide the purchasing power (local markets) for the formal sector to expand.

The inventory made by GARE (Gabinete de Redimensionamento Empresarial) reveals that there are about 1,600 small enterprises and 200 medium enterprises (industrial and commercial), 80% of which are privately owned. Many of these enterprises are reported to be either inactive or operating at volumes far below available capacities. This list of registered manufacturing enterprises available at INAPEM shows a total of 297 enterprises, with about one-third of them listed as either inactive or operating at about 30 percent of available capacities.

A classification of enterprises on a sectoral basis is suggested (in the long-run) when studies and surveys are conducted. This may be based on a simple matrix of number of workers and total assets of the enterprise (excluding land and building). This classification should evolve out of a socio-economic sample survey of enterprises which should be undertaken by INAPEM as one of its first activities. The classification or definition should be updated from time to time by a designated body (i.e., Ministry of Industry or INAPEM Board of Directors) to allow for changes in economic conditions (such as inflation, etc.).

Based on a comparison with other developing countries, the following classification matrix may be used as a guideline:

Classification	No. of Workers	Total Assets*
1. Micro/household enterprises	less than 10	less than \$ 20,000
2. Small enterprise	11 to 100	up to \$ 200,000
3. Medium enterprise	101 to 300	up to \$ 1,000,000
4. Large enterprise	over 300	over \$ 1,000,000

* Total assets exclude land and building, since these costs vary depending on their location and whether owned or leased. In view of the wide fluctuation of the kwanza and for comparability, the United States dollar equivalent is used. We should, however, caution that the above is not a suggested classification of enterprises. It may, however, be used as an initial guideline by INAPEM pending further studies and surveys.

Table 1 on the next page gives a simplified overall view of the target groups in the socio-economic development of Angola and the type of programmes and assistance that may be required:

Table 1: Target Groups in the Socio-Economic Development of Angola and the Types of Programmes/Assistance Needed

TARGET GROUPS	PROGRAMMES/ASSISTANCE NEEDED
<u>Formal Sector</u>	
1. Large enterprises, foreign enterprises, modern small and medium enterprises	Enabling business environment; clear/transparent rules and regulations; good facilities and infrastructure; less government intervention
2. Small and medium medium enterprises, potential entrepreneurs, enterprises "graduating" from the informal sector	Enabling business environment, possibly including fiscal incentives; Support services: training in entrepreneurship & management; advisory & consultancy; in-plant extension in "diagnostics" and productivity upgrading; technical and marketing information, etc; Financing: credit, guarantees, lease-purchase, etc; Site facilities: industrial estates, incubator systems, etc.
<u>Informal Sector</u>	
3. Micro enterprises, including household and self-employment activities; "parallel market"; displaced soldiers; returning refugees	employment and income generation programmes; vocational/skills training; community-level NGO-type assistance and simple credit schemes; fiscal incentives; simple registration procedures; opportunity identification, appropriate technology, etc.

3. INAPEM is the only national institution whose mandate is to provide an integrated support and assistance to small and medium enterprises. However, its current staff capacity is extremely limited which consists of only five persons, including its Director General. Furthermore, the salary levels are way below those of the private sector. (For example, a project analyst/engineering level staff in INAPEM earns the equivalent of about US\$ 25 a month compared to at least US\$ 1,000 a month that a person with the same qualifications would earn in private industry.) Even if we consider the "psychic income" offered by a government post, the disparity of salaries is so large that it would be extremely difficult to attract and retain good people in INAPEM.

The decree creating INAPEM has provisions that may be applied to address the above issues of staff capacity and remuneration:

(a) An initial staffing of 28 management and professional personnel and 17 administration and service personnel is provided for in the decree. To maximize the benefits of a possible technical assistance project to strengthen INAPEM, the recruitment of the above personnel should be a pre-requisite to ensure sustainability and the transfer of knowledge. At least one-half of the professional staff should be in place prior to the commencement of the project.

(b) The decree allows INAPEM to retain and transfer its revenues from one fiscal year to another (subject to approval by the Ministries of Industry and Finance). Revenues specified are sufficiently broad, which include: service fees charged; allotments from the government budget; grants from international and national donors; sale of goods and services and the acquisition of rights to them; profits from investments; reimbursement of loans, interest and commissions; and other profits or income earned for any reason.

The above provision should, therefore, enable INAPEM to become at least partially self-financing after a reasonable period of time (say three to five years). It should also be able to devise an incentive system to supplement the salaries of its staff, based on actual performance (i.e., training hours, enterprises assisted, research undertaken, year-end performance bonus, etc.).

For example, such an incentive system has been implemented in the Institute for Small-Scale Industries (University of the Philippines) which has been successful in attracting and retaining good professional staff. The Philippine Institute also created an "Small Enterprise Development Fund" wherein all its revenues are maintained. The Fund has become the source of funding for its programmes as well as in providing an incentive scheme for its staff. A separate Board of Trustees (which includes major donors and Institute officers) manage the funds. The Director of the Institute is ex-officio Director the Fund.

4. Access to financing is a perennial constraint faced by small and medium enterprises in developing countries. The problem is, however, much more acute in Angola where personal savings is minimal and sources of financing are very limited. The banks are generally reluctant to provide medium and long-term credit to small enterprises in view of the perceived risks involved. This is further compounded by a high inflation rate (1,760 percent in 1993) and the fast diminishing value of the currency (kwanza), thereby resulting in negative interest rates. From the beginning of 1992, the kwanza has been devalued several times from 88.33 to the United States dollar to the current level of about 576,000.

Through banking reforms initiated in 1991, steps are being taken to develop a banking system that will be responsive to the needs of the private business sector. A recent merger of the Banco Popular de Angola (BPA) and the Banco de Comercio e Industria (BCI) resulted in a strengthened Banco de Poupanca e Credito (BPC). In 1992, three Portuguese banks (Banco de Fomento e Exterior, Banco Espirito Santo, and Banco Portugues do Atlantico) were authorized to open affiliates. These banks are, however, still focusing their attention on the larger exporting industries.

Specialized funds have also been instituted by the government. These include:

- (a) Fundo de Apoio ao Empresariado Nacional (FAEN)
Established in 1992, FAEN provides term loans of up to 10 years (with an additional grace period of 2-10 years). The maximum amount of the loan is limited to four billion kwanzas (US\$ 7,000 at official rates) for agriculture and three billion kwanzas (US\$ 5,200) for other enterprises. Interest rates are subsidized at one percent for agriculture and up to 10 percent per annum for other enterprises. Some three trillion kwanzas (US\$ 5,200,000) were disbursed last year. INAPEM has been designated as one of its agents. The Fund is administered by GARE.
- (b) Caixa de Credito Agro-Pecuaria e Pescas (CAP)
Established in 1991, CAP operated mainly operated as a commercial bank during the last three years by accepting deposits and giving short-term loans with its limited capital of 1.5 billion kwanzas (less than US\$ 3,000). It is now awaiting a new statute to be approved and will operate as a development bank to be renamed Caixa Geral de Credito (CGF) with a proposed capital capital of 280 billion kwanzas (the minimum required by law) (US\$ 490,000). It also plans to privatize 49 percent of its capital stock.

- (c) Two other existing funds are: (i) Fundo de Apoio e Desenvolvimento e Pesca Artesanal (FADEFA) for fisheries development, which obtains its funding from fishing licenses amounting to about US\$ 20 million a year. It grants loans up to US\$ 100,000; and (ii) Fundo de Apoio Social (FAS) for community development obtained from a credit line from the World Bank of about US\$ 20 million. These funds have not been fully disbursed.
- (d) The European Commission (EC) is exploring the possibility of creating a fund for the re-industrialization of Angola. This is expected to be implemented through a foreign bank with technical assistance for evaluating projects provided by the EC. The proposed US\$ 15 million revolving fund will be exclusively for existing industries for an emergency programme to purchase raw materials and spare parts. The term of the loan will only be for six months with an interest rate of about 10 percent per annum and repaid at the prevailing rate of the kwanza. The EC is seeking the assurance of the Central Bank (Banco Nacional de Angola or BNA) to be able to convert the re-payments into foreign currency.

The INAPEM has also a pending proposal with the government to set up its own Fund to provide credit to small and medium enterprises. The experience in developing countries wherein the support agency also provides credit has generally not been satisfactory. Assistance agencies are not good bankers. Further, the difficult and time-consuming processes of project evaluation and credit collection will detract INAPEM from its primary purpose of promotion and development.

Instead of INAPEM administering a separate credit fund of its own, we propose that FAEN (and/or CAP) be further strengthened with a larger funding allocation to enable it to increase its credit limit and be able to cover the financing requirements of up to medium enterprises. INAPEM should be effectively linked to FAEN by providing the latter a seat in the Board of Directors. INAPEM should assist entrepreneurs in packaging their loan applications. It should also develop the capability to monitor the projects it assists and provide extension services to enterprises having difficulties in repaying the loans. This will give FAEN greater confidence in approving loan proposals from INAPEM clients.

It may also be pointed out that it is often not necessary to provide small and medium enterprises with highly subsidized interest rates, such as those granted by FAEN. Entrepreneurs are generally willing to pay competitive interest rates as long as the credit is easily accessible. Furthermore, subsidized credit encourages diversion of the loan proceeds for other purposes. It also makes the sustainability of the Fund questionable since the interest charged may not cover losses incurred (not to mention

administration costs).

In the longer term, entrepreneurs may still have difficulty in meeting credit requirements (i.e., in terms of equity and collateral). Other financing schemes which have proven to be successful in other countries should be explored, especially those that will involve commercial banks and the private sector. Other financing options include:

- (a) Creating a Credit Guarantee Fund that can provide guarantees for the unsecured portion of loans to potentially good projects. This scheme has proven successful in encouraging commercial banks to use their own funds to finance small enterprises. The risks are normally covered by a guarantee fee of up to 2 percent.
- (b) Equity or venture-capital type financing, particularly for high-technology projects; and
- (c) Lease-purchase arrangements for the acquisition of machinery and equipment. This scheme has particularly been successful in providing farmers with the necessary equipment in modernizing the agricultural sector as well as small industries in many Asian countries.

Venture capital and lease-purchase financing arrangements are profitable schemes in which the private sector may be encouraged to undertake. Special laws may, however, be necessary for their effective implementation.

4. As stated earlier, the accompanying document titled "A Strategy and Action Plan for the Instituto Nacional de Apoio as Pequenas e Medias Empresas (INAPEM)" is strongly recommended for implementation. The document was prepared in consultation with and the assistance of INAPEM officials. The main activities of the action plan will also be the basis of a proposed draft technical assistance project of strengthening INAPEM, which will be submitted for the consideration of the Government and its international donors.

Meanwhile, several aspects of the plan may already be implemented by INAPEM without the necessity of technical assistance. []