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FINANCING PROBLEMS OF SMALL-SCALE INDUSTRIES (SSI) IN AFRICA*

by

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* The views expressed in this paper are those of the author and do not necessarily reflect the views of the Secretariat of UNIDO. This document is an unofficial translation reproduced with formal editing.

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FOREWORD

This report presents a summary outlook of the financing problems of the SSI sector in Africa.

After an introduction of general considerations, the following specific problems will be reviewed:

- Equity Financing
- Lending Problems to SSI by Various Types of Lenders
- Borrowing Problems as Seen from SSI's Point of View
- Promotional and Financing Policies
- Recommendations on these Inter-related Problems and Improvement of Financing Policies

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GENERAL CONSIDERATIONS

1. Political authorities and analysts have been more conscious since of the beginning of the 1970's of the fact that SSI make up a major sector of African economies compared to public sector and foreign-dominated companies. This reality has been even better appreciated in more recent years, which explains why the attention of governments and international cooperation is concentrating on the subject.

2. Without entering into terminology issues, one generally admits that SSIs are enterprises whose full range of responsibilities are concentrated in the hands of a single person. SSIs present the following general characters:

   a. Low level of capital accumulation and difficulty to transmit it to others in view of the lack of distinction between professional and personal net worth.

   b. Slow penetration in the SSI sector of the modern types of association of capital to the entrepreneurs (partnerships, incorporated companies, etc.).

   c. Operators' apprehension of the problems of investment decision, involvement in long-cycle activities sensitive to variations of the economic situation and to an environment perceived as difficult (fiscal matters, administrative red-tape, contacts with suppliers, sub-contracting with administration, access to credit, etc.).

   d. Hence, operators' preference for short-cycle activities (trading, transport, services) and for speculation in real estate and in general a low level of interest for industrial and export-oriented operations.

   e. SSI make up an enormous aggregate of operators involved in the full range of economic sectors, a great majority of them being micro-enterprises in the informal sector. The number of modern-type enterprises is much more limited, but increasing in many countries.

3. Because of the size and diversity of the informal sector, it is difficult in most African countries to quantify the economic weight of the whole SSI sector, even those of the modern type. In a number of countries, there is no legal or administrative distinction between SSIs and the other enterprises. Even where such a distinction is made in view of the incentives they receive (in terms of promotional actions from government or specific credit policies), it is difficult to measure with some reasonable approximation their contribution to employment or investment, etc.

4. However, it seems obvious that the growth of productive activity in Africa will be largely based on the development of the SSI sector.

5. Promotional and financing policies of SSI are largely put in question in Africa today because of the number of failures in which the responsibilities, as better recognized now, are shared between governments, agencies of the international cooperation and financing sources (public and private, national and foreign).

6. The major reasons for these failures seem to be the following:

a. Deficiencies of internal macro-economic and sectoral policies whose emphasis on development of private productive activities was insufficient (entrepreneurship), even though a number of countries have given incentives to their national entrepreneurs for many years.

b. Deficiencies of national financing institutions in the allocation and management of loans.

c. Insufficient attention by governments to the needed incentives in favor of commercial banks aiming at inducing them, through specific measures, to change their traditional approach to the supply of credit to SSI.

d. Adoption of promotional policies in favor of SSI (training, follow-up of projects, feasibility studies, advisory services, garantee funds, subsidized loans, etc.) that have proved largely ineffective.

e. In too many countries, these policies have resulted in non-viable projects or have failed to facilitate SSI access to commercial bank credit. In some cases, they even have given too easy an access of high-risk borrowers to national DFCs lending. This raises the question of integration between promotional and financing policies.

7. The above-mentioned policies are put in question at a time when the economic situation has significantly deteriorated:

a. Slowing-down of economic growth and down-turn of exports proceeds;

b. Low level of private savings and difficulty to improve mobilisation in the modern sector (money and quasi-money);

c. Fall of volontary lending by external banks and deterioration of the internal financing systems (commercial banks as well as DFCs);

d. Dramatic fall of the inflows of foreign private investment and in particular, difficulty to promote partnership formulas with national SSIs, despite generous incentives.

8. However, the global economic situation in Africa presents also some favorable aspects that are barely mentioned:

a. General reorientation since 1982-85 of internal economic and financial policies (structural adjustment, opening to the internal economy, budget, money, tariffs, agriculture, etc.).

b. And stronger concentration of ODA1/ in favor of Africa, along with insufficient but enlarging application of a more generous treatment of external debt (Zaire, Mozambic, Mauritania, Senegal, Cote d'Ivoire) since 1986-87.

9. Financing of SSI in Africa has often presented the following characteristics:

a. Propensity of promoters to limit the level of their equity financing to the minimum;

b. Difficulty to complement their own equity funds with local or foreign funding to a sufficient level;

c. Propensity to excessively rely on MT/LT borrowings from the national financing sources with, quite often, the paradoxical coexistence of problematic access to credit by many operators and too easy access by others, in spite of inadequate debt-equity ratios.

d. Difficult access to short-term credit from the banks (permanent overdrafts, confirmed documentary credits).

e. Access to credit is even more difficult today in view of the drastic monetary policies, deterioration of the national banking structures and the quasi-closing of access to foreign banks lending.

10. Although emphasis of this report is primarily put on the financing problems of SSI, it is useful to stress the following points from the outset:

a. Development of the sector requires more consistent policies in favor of mobilization of internal private savings and increasing allocation of lending, but accompanied by a restructuring of lending policies and lending practice as well from the banks.

b. It also requires a restructuring of the specific promotional activities with a view to improving the inter-relation between Promotion and Financing.

1: ODA: Official Development Assistance

c. Finally, it requires a strict pursuit of structural adjustment policies. This is a prerequisite to the emergence of the national SSI operators, to the improvement of creditworthiness of Africa and to the revival of stronger inflows of private foreign investment, through traditional forms (direct investment) as well as new forms (industrial cooperation, franchising, technologic transfers, etc.). An upward trend of private investment flows through the various formulas of partnership seems to be a key to the needed process of integration of Africa into the international economy. Development of partnership implies both an improvement in the investment climate and the putting-together of promotion and financing policies able to offer reliable partners to the foreign potential investors.

CHAPTER I

EQUITY FINANCING

1. In spite of the on-going emerging process of new layers of entrepreneurs in a number of African countries, the propensity of local private savings to get invested in the modern-type enterprise is generally low. There are many reasons for that:

   - preference for alternative forms of investment on national market;

   - in certain countries, obvious propensity to invest outside;

   - the other reasons mentioned in the Introduction.

2. The traditional behavior may however change as internal policies improve the incentives. One can observe in certain countries a modernization of the traditional forms of savings accumulation ("tontines", saving cooperatives, investment clubs). It is obvious that in many African countries real and monetary savings do exist.

3. Sources of Equity Financing

   a. Personal savings of the promoters, sometimes complemented by savings of the family. Capital accumulation, however, is done rather through traditional than through modern channels for cultural, legal, administrative, fiscal and financial reasons.

   b. Equity from government sources
   (i.e., public equity participation in DFC shareholding). This source has been important in the 1950-70s but primarily as participations in larger projects.
   Equity participations by DFCs in SSI projects have been disappointing in many cases. They have found their limits because of the erosion of many DFCs own equity and of the quasi-impossibility for them to recycle a low-yield portfolio through local investors. The failures have not inclined foreign shareholders (public and private) to allow DFCs to increase their involvement in this area, with the exception of some countries (Morocco, Tunisia, Zaire, Zambia, Zimbabwe).

c. Commercial Banks

Their equity participations in the past were limited to minority positions in large projects. Their traditionally restrictive lending practice to SSI made them even more reluctant to finance them through equity. Division of labor, prudential rules issued by monetary authorities and the low level of their own equity-base practically exclude significant inflows of equity participations in the capital of SSI projects today.

d. Local Private Financial Institutions

Such institutions, with or without foreign private shareholding, do exist in a number of African countries. It would be useful to evaluate the level of their equity participations in SSI projects.

e. Foreign Financial Institutions

Institutions like IFC, EIB, PROPARCO, DEG, FMO, CDC, etc. have consistently looked after possibilities to bring equity funds to local SSI. Their participations, however, have been primarily allocated to larger-size projects. They have faced the problems of the minimum size of projects in which they may invest and of the coupling of their own interventions with those of the local financing sources to which SSI could have access.

Proparco's experience is a good illustration of the dimension of the problem of the inflow of foreign institutional equity in small-size projects.

CHAPTER II

LENDING TO SSI

The difficult access of SSI to bank lending for current operations (short-term credit) comes primarily from the even greater obstacles to the putting together of resources for setting up investments. This chapter addresses these specific obstacles:

A. COMMERCIAL BANK LENDING FINANCED ON LOCAL RESOURCES
One can approximate the amount of lending to SSI at some 10% to 20% of portfolio. The reasons for such a modest level seem to be the following:

1. Extraversion of African economies

Commercial banks have traditionally been involved in the short-term financing of trade. Long-term lending for investment was usually allocated by preference to government-controlled or to foreign-dominated companies.

2. Structure of assets and liabilities

Long-term lending is faced with the following obstacles in many African countries:

- Low level and volatility of term- or demand-deposits, even in countries where active monetary policies concerning interest rates on deposits are applied. This situation prevents a significant development of the transformation process of term- or demand-deposits into long-term lending.

- small size of national money-markets which are primarily designed for a local refinancing of short-term lending.

- Strict monetary policies: obligatory reserves, credit ceiling, strict limit to local refinancing by central banks through rediscounting.

- Rigid structures of interest rates and spreads that are fixed by the authorities. In spite of the incentives given in many countries to commercial banks for SSI lending (e.g., UMOA, lower rediscounting rates), the latter consider that spreads are not always commensurate with risks.

- Setting up of interest rates (including taxes) that are disconnected from interest rates prevailing on the international market (e.g., Zone Franc countries). Commercial banks and borrowers often consider these rates as dissuasive and as an incentive to rely more on foreign financing (for balance-of-payment purposes). However, only few commercial banks can get foreign refinancing from their correspondents for long-term lending to SSI (consideration by foreign banks of cross-border risks). In addition, such refinancing raises the thorny problem of foreign-exchange risk.

3. Perception by the banks of the SSI risks

Commercial banks reject the blame of discrimination to which they are frequently exposed, by arguing as follows:

a. Frequent inability of new promoters or existing operators to make a correct assessment of the size and solvency of market demand.

b. Lack of management skills and deficiencies in financial documents. This hinders banks in drawing valuable information material on applicants' past experiences and does not help them either to be convinced of their reliability and the viability of applicants' projects.

c. Individualism of entrepreneurs who frequently refrain from calling to external support in the preparation of their project and in the management of the ongoing operation.

d. Shyness or inferiority complex vis-a-vis the institutional and bureaucratic environment, considered as a deterring factor (long and costly administrative red-tape, fiscal constraints). This slows down the supply of information material and financial documents the lenders need (registration as operators, valid land titles, etc.).

e. Reluctance of promoters to expose themselves too much to investment risk, as shown by the difficulty to make up the minimum level of equity funds or to present required collaterals, even when they obviously are able to do so.

f. Lack of illusions on the part of lenders concerning execution of guarantees on bad debtors, in view of the length of the judiciary process.

4. Internal Organization and Skills on Project Appraisal

a. Even banks whose internal network of branches outside of larger cities is significant must centralize their skills for the appraisal of the application forms for long-term lending to their headquarters for cost reasons. The impossibility to set up and maintain teams in their branches spread out over the country delays the analysis of applications even for the SSI projects which appear the most qualified.

b. A number of commercial banks seem to perceive the enormous potential of credit demand of the SSI sector in Africa. Only few, however, are equipped with technical skills for the economic and financial appraisal of such high-risk projects.

c. In addition, they are faced with the difficulty to provide advice and follow-up (Advisory Services), activities that are essential to improving the reliability of projects and to reducing risk.

d. Finally, even commercial banks in the Advanced Countries have always shown some apprehension vis-a-vis "project financing" (project giving reasonable assurance of self-liquidation, i.e., return to equity and reimbursement of borrowed funds). The more so, in Africa where commercial banks are up to now quite often subsidiaries of foreign banks, when the question is to provide long-term financing to SSI.

5. Conclusion

Long-term financing of SSI by commercial bank lending is faced with the following obstacles:

a. Strong deterioration (at least in sub-Saharian Africa) of the financial situation of the banking community.

b. Commercial banks consider SSI as a high-risk sector: they have experienced a lot of failures and made large provisions as was the case for DFCs (see below).

c. They consider that neither macroeconomic conditions nor monetary policies have offered them enough incentives to modify their traditional lending policy in favor of SSI.

d. The difficult access of SSI to bank lending comes neither from a lack of financing resources only, nor from interest rate levels.

e. Crystallization of credit supply on short-cycle operations, which is typical of the financing of external trade and working capital in favor of large firms obviously causes eviction of the existing SSI from the market and brings on obstacles to creation of a climate of innovation in many countries.

f. The last obstacle due to the size of the external constraint lies in the preference of commercial banks for the financing of operations that generate foreign currencies. This is detrimental to SSI whose financing needs are usually conducive to major utilization of foreign currencies.

B. DEVELOPMENT FINANCE COMPANIES (DFCs)

1. General Remarks

a. The deterioration of the financial situation of DFCs is a matter of serious preoccupation for governments, foreign, public and private shareholders and international cooperation.

b. Such deterioration is materialized by the accumulation of bad debts, which in many cases is conducive to a quasi-extinction of their equity-base.

c. This situation is due to many reasons (management deficiencies, internal economic downturn, outside interferences in the decision-making process, arrears of the public sector badly affecting the financial situation of the larger non-SSI clients, etc.).

d. Paradoxically, this deterioration seems to derive, in a number of countries, more from exposure to large firms than to SSI. This "standardization" of many DFCs has frequently led to commitments covering all the sectors of the economy as DFCs were set to compete with commercial banks.

2. Difficulties found by DFCs in SSI lending

They largely amount to those found by commercial banks:

a. Lack of sufficient equity funds from promoters at the inception of projects, and/or delays in the drawing-down of such funds which have in turn resulted in the lengthening of the drawing-down of approved credits, up to the point that they no longer met the needs of the projects or corresponded to the evolution of the financial situation of borrowers.

b. Deficiencies in the application files submitted directly or through the government promotional agencies: these are either inherent to the project itself or to the financial and administrative situation of the borrowers as well as in the offer of collaterals.

c. Global costs for borrowers, often perceived as dissuasive (interest rates, commitment fees, application fees, sometimes other fees in relation to additional work).

In spite of spreads that are often high in nominal terms (up to 5%-7%) between nominal cost of resources and final cost to borrowers, the high administrative costs of the processing of SSI applications leave an insufficient real margin considering the rate of bad debts.

d. In certain countries, the vicious effects of the interventions of the promotional agencies, which have lowered the sense of responsibility of the lenders (e.g., Guarantee Funds when causing automatic decisions by lenders).

e. Frequent shortage of skills in the field of economic and financial appraisal of projects (feasibiliy studies).

f. Finally, shortage of DFC skills in the field of follow-up (diagnosis, advisory services, additional financing, etc.).

3. DFC lending on external resources

a. External lines of credit to SSI of the IDA or Caisse Centrale type or from other agencies of bilateral ODA (Canada, FRG) have not always been well adapted to DFC or borrowers needs, although their terms and conditions were generally attractive:

- constraints of the "linkage" typical of this type of ODA have often caused delays in the drawing-down of the credit lines by DFCs or the borrowers because of their inability to meet the conditions required.

- the protection against the foreign-exchange risk limited to the smallest of borrowers has often resulted, for countries with high inflation and deterioration of their exchange rate, in DFCs being indirectly affected by the exchange-risks, even though they are theoretically protected against it, as all financial intermediaries. This indirect exposure has taken the form of additional lending risks (borrowers inability to generate cash flows commensurate with exchange rate variations).

C. DIRECT LENDING FROM FOREIGN FINANCING INSTITUTIONS

Development of their direct interventions in modest-size of projects faces the constraints of the minimum level of commitment and coverage of processing costs.

It would be interesting to see whether the IFC system of the Agency Lines (loans directly granted to borrowers not selected by IFC but managed by commercial banks within the framework of protocols with IFC) might be developed by other financial institutions.

One should mention that government foreign institutions who, up to 1986 used to condition their lending upon the providing of guarantees by the governments of the host countries seem now to require garantees from local commercial banks, if not from their mother companies abroad.

D. NEW FORMS OF FOREIGN LENDING THROUGH COMMERCIAL BANKS

1. Commercial banks take the commercial risk but not the foreign-exchange risk, whether the foreign lines of credit are granted directly to them or retroceded to them by the governments.

2. These formulas make up a precious type of support in favor of the countries where external constraints are the most severe.

3. Terms and conditions, in both cases, give spreads that are generally considered sufficient. The more so, because they are usually accompanied by provisions of proper technical assistance in their favor or to central banks or promotional agencies, which means association to the processing of applicants files.

4. However, experience seems to show that these new types of financing profit most to already operating SSI or to greenfield projects of a significant size.

CHAPTER III

BORROWING PROBLEMS OF SSI

The most common complaints addressed by SSI to banks and DFCs with regard to LT financing of projects or tc short-term financing of working capital are in general the following:

1. Length and complexity of the procedures for the processing of applicant files, in particular for the country-based SSI. Several months are usually needed, which is all the more discouraging since the rate of application turndown is high and the assessment of the required financing becomes outdated when it is at last notified to borrowers.

2. Terms and conditions not always suitable to the borrower's needs:

   a. Approvals often inferior to the amounts requested and thus considered marginal.

   b. Too short reimbursement periods coming after grace periods also considered too short.

   c. Excessive requirements from the lenders in terms of production of information material, on legal justification of property on assets offered as collateral, and in terms of levels of equity financing.

3. Dissuasion of the interest rates offered, because even though they may be negative or null in real terms, they appear unbearably high, with no possibility to integrate them into costs. It is often stressed that interest rates are much higher than those offered by banks to their traditional customers. SSI borrowers are inclined to consider that their investments, expected to produce low and differed returns, justify the granting of low rates.

4. Many SSI promoters consider that, unlike the larger firms, they have no power of negociation with the banks and thus are the victims of permanent discrimination, the perpetuation of which represents in certain countries a real danger of asphyxia for the whole SSI sector.

5. Finally, other complaints not directly addressed to banks, relate to peripheral obstacles to SSI access to credit:

a. Insufficient support the SSI can get from government promotional agencies;

b. Frequent breakdown in the functioning of Guarantee Funds.

CHAPTER IV

PROMOTION/FINANCING INTERRELATION

Mechanisms of intervention of government promotional agencies are numerous:

1. Range of Promotional Activities

One can list the following items:

- training programs for the personnel involved in training support of SSI.

- technical training of promoters and managers.

- production of theoretical sectoral surveys.

- production of feasibility studies "in vitro" (=theoretical).

- inflow of durable or ad-hoc advice to project promoters on technical/financial design of projects. Such support can encompass advice on technological choice, selection of suppliers, assistance in getting administrative authorization (investment codes, etc.), setting up of feasibility studies, assistance in the preparation of credit applications.

- durable or ad-hoc supply of skills to SSI operation for management, free or against nominal fees.

- follow-up of operation (preparation of financial and fiscal documentation, etc.).

2. Diagnosis of the most Frequent Deficiencies

They can be summarized as follows:

- promotional policies are frequently conceived by governments without enough prior consultation with SSI operators or their professional bodies.

- it is too often considered that public resources allocated to promotional activities, being granted free to beneficiaries, need not to be reimbursed. As a result, they do not call for significant efforts or financial contribution from beneficiaries.

- the mechanisms of government promotional agencies cover a wide range of administrative interventions which are frequently designed without enough precision or which are too rigid and managed by civil servants not necessarily familiar with the real problems of entrepreneurs.

- an excessive emphasis on sectoral priorities based on too theoretical an approach and a lack of in-depth analysis of the "promising" subsectors with real or potential demand.

- a shortage of human resources (management skills, training skills) and an inadequate assessment of the level of public resources needed to carry out the various types of promotional activities. In addition, many countries have had to reduce the volume of public resources allocated to promotion for budgetary constraints and because the results achieved were not always commensurate with costs.

- inadequate productivity caused by frequent interference between the various agencies, the scope of their respective responsibilities being vaguely defined.

- Finally, a lack of enough consideration on the necessary respect of the autonomy of the lenders in the decision-making process. As a result, the support obtained from promotional agencies (including Guarantee Funds) has too often made SSI projects, even those with dubious viability, eligible to loan-financing from lenders lacking their sense of responsibility.

CHAPTER V

RECOMMENDATIONS

A. GENERAL OBJECTIVES

1. The Process of Economic Growth Recovery

a. The return to economic growth of the private sector in Africa implies the adoption of internal policies compatible with structural adjustment policies. It could not rely on ODA inflows or Other Public Inflows only, or increase in indebtedness with the banking sector (local or foreign). Neither could it only rely on the mechanical effect of the economic recovery in advanced countries.

b. It will call for a revival of productive investment by the SSI sector, but with the condition that the savings/borrowings coupling be deeply modified.

c. In order to contribute to the integration process of Africa into the international economy, it will also call for a revival of foreign investment, which nowadays is sought after by all African governments. Meeting this objective implies the strengthening of incentive policies in favor of North/South investment flows by African governments as well as by the international community.

2. The Cost of Capital

a. Promotion and financing policies for the SSI sector have involved enormous allocations of public and private resources for 15 years with disappointing results which have been due to the following factors:

- too deep a belief in the virtues of subsidized loans which were systematically relied upon as a necessary substitute to the lack of equity funds ready to be invested in these projects.

- greater attention from the government promotional agencies on protection of the lenders than on that of invested equity and on means to optimize its return.

b. It seems better admitted today that marginal productivity of capital in SSI projects (internal rates of return) is far from always justifying access to subsidized loans. Short payback periods of numerous SSI projects confirm this.

c. A better appraisal of opportunity costs should plead for the focussing of promotion and financing policies on the improvement of methods of project appraisal and for more attention to economic and financial viability than to the merits of leverage, the perverse effects of which are now better recognized.

3. A Third Shelter, Specialized in Lending to SSI?

a. A certain number of government authorities or analysts doubt that "standardized" DFCs can be durably rehabilitated and that commercial banks will be willing to modify their lending policies. This sometimes leads to envisageing the creation of DFCs exclusively specialized in SSI lending, with a view to redistributing part of existing credit and guaranteeing a better access to lending.

b. The following criticisms can be addressed to such a scheme:

- it may be better to reform existing structures than to create new ones.

- it is not obvious that experiences of advanced countries in this area can be translated (Small Business Administration in the USA, CPME in France, etc.).

- such a new institution, with a unique vocation and without a monopolistic position, would be endangered by the concentration of exposure to a high-risk sector.

- Even more so, because terms and conditions, more attractive by nature, would result in the inflow of the less reliable borrowers. It would impede its profitability and lead to subsidization.

- In case such outfit would have a monopolistic situation, then one could expect that, in addition to the well-known side-effects (lower productivity), it would result in a dangerous aggravation of the dualism syndrome that is typical of credit allocation in many countries.

- Either one of these formulas would be unable per se to make more funds available than the existing structures. Lending resources from the international cooperation seem to prefer their funds transiting through existing intermediaries when they are performing well, rather than through new financing structures.

c. Rehabilitation of the commercial banking systems and of DFCs with the support of international cooperation will have to tackle the following problems in many countries:

- "overbanking", at least in some countries;

- closing down of a number of DFCs;

- penetration by the financing system of the rural areas now revitalized by the agricultural policies. Some of these areas are becoming "new beds" with important layers of savings and markets with significant size of solvent demand;

- finally, a problem of choice between creating new structures or setting up specialized departments withing existing structures for SSI lending. Whatever the formula, it will have to focus on the improvement of the coupling between external and national financing sources. This objective will remain a responsibility of governments and financial institutions themselves as long as African capital markets will be unable to achieve it on their own.

4. The Importance of a Better Promotion/Financing Coupling

a. A sustained development policy in favor of SSI implies that each component benefit from higher fund flows with the condition that restructuring measures be taken and lending practices be improved.

b. Another objective more commonly accepted today is also to assign more precisely defined responsibilities to promotional agencies and to the financing system respectively, in order to make their joint action more efficient.

c. The basic idea seems to be that the wide range of actions in terms of support to project design and operation be undertaken with a view to increasing SSI credibility with the lenders:

- this should be achieved through avoiding the frequent trap of granting automatic credit eligibility to those SSI which benefit from the support of promotional agencies.

- and also through more efficient incentives aiming at obtaining higher levels of exposure of the financing system to SSI and at reducing the above-mentioned dualism in credit allocation.

B. SPECIFIC RECOMMENDATIONS

Because SSI specific situation is different from one country to another, the recommendations below are only a set of tools that should not be used systematically.

1. Better-defined identity of the SSI

a. Call for the support of international cooperation with a view to:

- improving economic and financial data on the structure and dimension of the SSI of the modern sector.

- bringing technical assistance for the organization of its professional structure, enlargement of its membership, endowment with data banks on basic industrial information material (technological choice).

- inducing to create mutual guarantee funds among its members, as a substitute to government-financed guarantee funds.

2. Improvement of the Physical Environment

In some countries, it is critical to the recovery of economic growth. SSI are even more sensitive to this environment than larger firms:

- rehabilitation of transport is vital for country-based SSI.

- rehabilitation of a minimum of telecommunication facilities is vital to proper functioning of the financing system as a whole (improvement of productivity of banks and DFC branches of the interior). It is also vital to foreign potential investors considering association in SSI projects through partnership.

3. Improvement of the Administrative Environment

It is necessary to the conversion of informal-sector SSI to formal-sector SSI. It implies a more determined political will to reduce fiscal evasion:

- simplifying the fiscal system, in particular for companies (partnerships, various forms of incorporated companies).

- simplifying administrative and legal procedures for creation, share-capital increase, founders shares in kind, M&A, cession (capital gain taxation), transmission through inheritance, etc.

- reducing administrative redtape (trade registration, delivery of land titles, mortgage).

4. Promotion Policy

a. Setting up Coordination Units to supervise the interventions of the various government offices involved with promotion.

b. Setting up specialized units for the pre-identification of SSI projects (at Ministries of the Economy or Planning, etc.) for the use of national investors and foreign potential investors as well.

c. If possible, centralizing promotional activities into structures able to cover the whole range of services to SSI, taking example on the Agence de Promotion des Investissements (API) of Tunisia, or on Mauritius (services offered in the Free Zone).

d. Reinforcing powers and means of the Investment Commissions with a view to speeding up delivery of authorizations to operate and of benefits of the investment codes, and to checking that beneficiaries meet their obligations.

e. Improving design and operation of the guarantee funds through the following rules:

- recapitalization through the use of a fraction of the counterpart funds of ODAs, with a participation of the latter in their board.

- limitation of the volume of guarantees issued in such a way that the accumulated amount be at any time a reasonable multiple of their net worth.

- limitation of guarantees to a reasonable percentage of the risks to be covered.

- significant financial contribution by borrowers in the form of commissions, and a freezing of a symbolic fraction of the borrowings up until full reimbursement.

- limitation of the guarantees delivered to the latest maturities in order to make lenders more responsible.

- Avoiding systems which create automatic linkage between obtention of guarantee and access to borrowing, and introducing representatives of the financing system to the board of guarantee funds.

5. Promotion/Financing Interrelation

a. Reducing the areas where government promotional activities are carried out to interventions "upstream of projects" (technical training, above-mentioned pre-identification units excluding purely theoretical feasibility studies).

b. Promoting through adapted incentives, increased intervention of private operators (technical consultants, advisors, auditors), as a sustitute to government support. Such intervention would justify payment of adequate fees by the beneficiaries.

c. Promoting the creation of advisory services by commercial banks through specific incentives, taking example on the Agency Lines formula promoted by IFC in Kenya and in other countries.

d. Inducing to the diffusion of practical information material on the African Project Development Facility (APDF), a joint scheme of UNDP/ADB/IFC.

6. Mobilization of Savings and Incentives to Their Investment As Equity in SSI Projects

a. Budget Policy

Within the general policy framework of the increase in the global growth rate of savings, adopting budget policies conducive to relative reduction of government tapping over total savings.

b. Fiscal Policy

- Fiscal incentives (through exoneration or alleviation of taxes) on the financial yields derived from the placing of the excess funds deposited in the monetary system by the traditional structures promoting capital accumulation.

- Same thing on interest proceeds from term- or demand-deposits of firms or individuals (e.g., anonymous LT Bonds issued by commercial banks with non-progressive withholding taxes), as already exist in some countries.

- Reduction of tax profits on SSI when they are reinvested.

- Introduction of "tax credits" on dividends declared in order to offset the cascade of impositions on stock revenues.

- Fiscal amnisty on capital repatriation of funds invested abroad which have not paid national taxes.

- Adoption of flexible formulas for the reevaluation of balance sheets, crucial to the transparency and reliability of the financial records presented to lenders, with light taxes on the resulted nominal capital gains.

c. Monetary Policies

- Introduction of active monetary policies giving the commercial banking sector extended freedom to remunerate sight- or demand-deposits (interest rates in real terms). This is one of the tools that can incite SSI promoters to accumulate in blocked accounts a level of equity critical to a better access to banking credit. But this raises, in a number of countries, the fundamental problem of reorganizing the interest rate structure, and that of the approval of an increase in lending rates by governments and monetary authorities.

- Introduction of innovations such as "Project Savings Plans" taking example on Home Savings- and Retirement Savings Plans. A Project Savings Plan would be based on the idea that potential promoters, by meeting their contractual arrangements of planned deposits, are being guaranteed access to credits tailored to their needs, eventually. Such innovation opens the right to credit, but without perverse effects, since such right is subordinated to previous fulfilment of the freely negociated commitment of the borrower to progressively but completely build up the amount of savings required by his project.

d. Foreign Exchange Regulations

In countries with unconvertible currencies but a will to attract foreign capital, reinforcement of the rank of priority assigned to the transfer abroad of dividends to foreign shareholders.

e. International Cooperatic and Equity Investment

- Capital base rehabilitation of the viable DFCs

With the condition that their management be deeply restructured, it could constitute in certain cases a source of equity for the upper segment of SSI projects.

- Activation of studies on the potentials of existing capital markets (Cote d'Ivoire, Morocco, Tunisia, Nigeria, Kenya, Zimbabwe, etc.) or on the creation of new ones with the support of international cooperation (IFC, bilateral agencies).

- Transfer of a fraction of ODA resources at present allocated to interest subsidies toward incentives devoted to an increase in the inflow of equity funds to SSI projects, taking example on the creation by the French of a Guarantee Fund financed from ODA which is going to support interventions of the newly-created SUDINVEST.

- Transfer of a fraction of ODA resources to mechanisms providing temporary guarantee of minimum returns to subscribers of stocks issued by savings institutions.

- Transposing in favor of equity investors in SSI projects the formula recently promoted by IFC, i.e., "Guaranteed Recovery of Investment Principal" (GRIP, first applied in Tunisia).

- Enlarging to equity investors in SSI projects eligibility to the protection against political risks offered by MIGA, with ODA bearing the cost of a percentage of the premiums.

7. Long-Term Policy to SSI

The recommendations below suggest involvement of governments, monetary authorities, the financing system itself, and international cooperation.

a. Budget Policy

It would seem advisable in a number of countries to reduce the excessive preemption exerted by governments on the global volume of internal credit that is acceptable and the resulting eviction effect against allocation of credit to the productive sector, which is the worst for SSI.

b. Monetary Policy

- As already suggested, more active monetary policies are a prerequisite in some countries, to the emergence of a transformation process of term- or demand-deposits into long-term lending without imposing threats on the monetary health.

- In countries where monetary policies make use of obligatory reserves, a way to induce the financing system to increasing its exposure to SSI borrowers would be to reduce the coefficients in proportion to the increase in lending financed from term-deposits.

- In countries where credit ceilings are used, the exclusion of export credits in favor of SSI from the ceiling constraints should be conducive to an increasing support of the banks to the exporters of the SSI sector, which are in limited number.

c. DFCs

- Rehabilitation of the viable DFCs will require not only a massive inflow of long-term financial resources but also a proper support of technical assistance in order to insure adoption of more cautious lending practice.

- In countries whose currencies are unconvertible and are thus exposed to a deterioration of exchange rates, it would be advisable that ODA agencies bear a fraction of the foreign exchange risk on their long-term lines of credit to SSI beyond a certain floor (e.g., Canadian cooperation in Zaire).

d. Commercial Banks

- One can expect that in countries using more active monetary policies, authorities could increase their pressure over commercial banks through specific guidelines aiming at a progressive increase in their lending to SSI, once the structure of interest rates is less dissuasive.

- It would be advisable in any case that commercial banks strengthen their skills in the field of project appraisal and provision of advisory services to their SSI clients. The Agency Lines system promoted by IFC testifies of the interest commercial banks may take in such formulas if and when international cooperation can bear for some time part of the operating costs of the Advisory Services.

e. Financial Policy of the Borrowing Countries

- The granting of concessional inflows of external lines of credit specifically allocated to SSI financing and operated by commercial banks or performing DFCs seems to have the favor of international and bilateral ODA sources (IDA, EIB, Caisse Centrale, ADB, etc.).

- These formulas provide that the financial intermediaries do not bear foreign exchange risk which is borne either by governments or by the final borrowers. When the risk is borne by the latter, which is logical, lenders may however be faced with additional credit risk. As, in the long run, governments are the ones who are bearing the foreign exchange risk and as the lines of credit are at concessional rates, it would be advisable to create "Risk Covering Funds" that would receive counterpart funds of the external lines of credit retroceded to banks and reimbursement in local currencies from borrowers. The concept of such Sinking Funds was recently adopted by Mexico for the amortization of part of its external debt. Adoption of such a formula in Africa would enable the countries borrowing very-long-term resources that may be recycled twice or three times before reimbursement to solve part of the thorny problems of the foreign exchange risks.

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