FINANCIAL SUPPORT PROGRAMMES FOR THE INFORMAL SECTOR: SOME LESSONS FROM EXPERIENCES

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1. INTRODUCTION

The informal sector is being increasingly recognized as a separate economic sector, with its own characteristics and potential to contribute to economic and social development, and to create jobs in particular. The slow-down of economic growth in the Third World during the 1980s has stimulated renewed interest in the role of the informal sector as an instrument for employment creation and poverty alleviation.

Since the early 1970s informal sector support programmes have mushroomed in Latin America as well as in Africa and Asia, encouraged by the injections of financial assistance from bilateral and multilateral donor agencies. The main instrument of intervention has been credit, for it is generally believed that lack of access to finance is the most pressing of all problems of the sector.

There is a large body of literature providing for alternative models of extending financial assistance to the sector. Some lessons for what is likely to work and what does not are beginning to emerge. Given the phenomenal potential of the sector in Ethiopia, any more indifference would be an unaffordable luxury. It is widely recognized that there is a need to draw up policies and strategies for the development and promotion of the sector, and to provide adequate support systems as well as an appropriate legal and institutional framework.

This endeavour would require adequate and reliable information. In this regard, the experiences of other countries can provide a great deal of scope for transfer of learning as a basis for innovative approaches for the development of the sector. To this effect, this paper is an attempt to provide an overall overview of some of the financial assistance programmes that have been implemented since the early 1970s. This paper is by no means a comprehensive analysis of the issue at hand.

The paper is arranged as follows. A brief summary of the salient features of the informal sector, the policy issues and overall support measures are discussed first as a background, and this is followed by a review of relevant international experiences on the various financial assistance schemes. Based on the experiences of countries, possible lessons are drawn in the third part. Finally, concluding remarks are forwarded.
1.1 Some General Considerations

1.1.1 Informality: The Most Intractable Phenomenon

Many of the working population in developing countries eke out a meagre living outside the formal and regulated sector of society, without even a minimum of social protection. It is frightening to observe that the number of these people - who are caught up in the struggle to earn their living in what has come to be called informal sector - is growing day by day. The human implications are staggering, especially for those living in the ever-growing mega-cities of the Third World.

The informal sector is by all accounts a very heterogeneous phenomenon. It encompasses a wide variety of economic activities that tend to be overlooked in the official statistics, including all sorts of manufacturing activities, construction, trade and commerce, repair and other services. The activities are typically carried out in small units established, owned and operated by one, or a few individuals with little capital; they are usually labour-intensive activities which result in low-quality but relatively cheap goods and services.

The problem of according a feasible definition for the term informal sector has occasionally given rise to confusion and debate in the area. The multi-criteria definition given by an ILO Mission to Kenya in 1972, which most studies have used, and describes the sector as "a large group of enterprises characterized by unobstructed, easy entry into markets; use of local resources; family ownership; small-scale operations; use of appropriate technology with high labour intensity; reliance on training provided outside the formal education system, and operation in unregulated, competitive markets" (ILO, 1972). The Marxist vision proposes a functional definition of the sector and view informality as a product of the unequal development of capitalism in non-industrialized urban areas (Chickering and Salahdin, 1991). In general, definitions tend to focus on either functional attributes (size or complexity of operation, for instance) or legal status.

The multiple definitions of the term has definitely been a source of problem on both theoretical and empirical grounds. First, it raises the issue of measurement in the sense that it opens a room for different approaches to be used in estimating the size of the sector. Second, choice of definition is obviously crucial in selecting strategies for reform. The policy responses of those who view the sector from its functional attributes often focus on providing various forms of direct assistance to the sector. Those who focus on legal status tend to worry about institutional issues and propose for reform on improving the institutional settings.

It is clear, therefore, that different definitions will result in different conclusions about the sector. Most definitions appear to be governed by the interest of the perceiver, the purpose of the definition and the stage of development of the particular environment. Without a clear
definition, however, it is impossible to be clear about what the problem is, or what to do about it.

1.2 Informality: causes, problems and prospects

The main reasons for the expansion of the sector around the world are, inter alia, stagnating wage employment opportunities, corrupt bureaucratic procedures, and internal migration. The slow growth of the formal economy, with its failure to create adequate employment, is believed to be the main cause for the informality in the developing world. Mainly an urban phenomenon, the sector is claimed to gather a large number of the poor in developing countries.

Because of their unique economic and organizational characteristics, informal sector enterprises are well placed to have important economic, social and political roles in employment creation, resource utilization, and income generation. Generally, three main reasons can be pointed out for paying attention to the informal sector especially in developing countries (Chickering and Salahdin, 1991):

- the majority of the population are poor and most of them are in this sector;
- the formal sector is structurally incapable of absorbing the existing large number of unemployed and underemployed; and,
- the informal sector is a reserve of productivity, creativity, initiative, and earning power, and it provides opportunities for self-employment, and thereby empowerment, for the poor.

The most perceived attraction of the sector in developing countries has therefore been that it has a large capacity for labour absorption. In the words of P.F. Drucker:

in the developing world the first priority will be to create jobs for the large masses of young people. This will have to take precedence over nationalist pride and traditional beliefs...It is a matter of survival - and survival has no priority (Drucker, 1981).

The paradox is that the participants lose their full rights as citizens by operating outside the legal economy. The sector is said to be constrained by a host of internal and external factors the most important of which are illiteracy among the businessmen, lack of access to adequate output and input markets, to technology and credit facilities.

Most of the concerned people in the area of the informal sector development regard credit problems as the prime, if not the sole, obstacle to the promotion of the sector, and to the
ultimate realization of its potential impact on employment and income. The main reason is the repressed financial system that rations credit away from the informal enterprises.

Research indicates that most of the funds used for developing informal sector come from own-savings and borrowing from friends, relatives and local moneylenders. Most informal entrepreneurs of which the great majority are never reached by institutional banks-overshadowed to borrow from the traditional non-institutional credit sources, such as moneylenders, at varied and high interest rates. It is widely believed that for these enterprises access to credit is much more important than the interest rate (Neck and Nelson, 1987; Malcolm Harper, 1992).

The availability of finance (i.e., easy access to credit, especially for working capital) when it is needed, quickly and without stringent conditions, is crucially important to informal units, and should, therefore, be an important consideration in the promotion of the sector.

1.3 An Overview of Policies and Support Programmes

The most important determinant of the long term survival and success of any business enterprise is the overall policy environment. The roots of the informal sector problem can be found out in the bureaucratic model of development which focuses on government promotion of large-scale enterprises and advanced technology as the essential tools in a successful development strategy (Chickering and Salahdin, 1991). This resulted in the reluctance of many governments to implement laws in favour of the sector. The ILO report from Kenya prudently states that "Informal sector activities are largely ignored, rarely supported, often regulated and sometimes actively discouraged by the government" (ILO, 1972).

Very recent developments show that governments decided not to be neutral with respect to the informal sector. What is more, it seems that there is a general awareness on the side of policy makers that they should somehow remove anti-informal sector policies that would remove or eliminate barriers that have the effect of marginalizing the sector from full economic and social participation. There are, of course, many places where the policy environment is still fiercely repressive, and others where there is effectively no policy at all, particularly in Africa.

The main policy issue now is whether the sector should be treated within the broader policy context, or pro-informal sector policies should explicitly be enacted. The advocates of the overall policy approach believe that any policy action regarding the informal sector should be in accordance with its aims and objectives in a broader context. The sector is expected to harmonize with the formal and other economic sectors to make up the total economic effort. The basic assumption behind such a view is that the informal sector occupies a subordinate position to the formal one and, therefore, has no inherent growth potential, which implies that it does not respond to growth-oriented policy measures that treat it as an independent entity (Aldemir de VALE SOUSA, 1988).
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Some Newly Industrialized Countries (NICs) such as Singapore, Hong Kong and the Republic of Korea question the value of providing special government assistance for the sector. These countries have been observed to stress the need to create an overall economic environment conducive to enterprise and efficiency through appropriate macroeconomic policies.

Although there is much evidence to support the contention that policies biased in favour of large enterprises are ineffective, some countries have been successful in implementing some selective policy biases against small enterprises and the informal sector. Research on Taiwan and South Korea supports this (Robert, 1992).

In some countries, however, overall policies have proved to be inappropriate. The experience of Bangladesh suggests that an interventionist government policy is not always necessary for a flourishing informal sector unless it is carefully designed and comprehensive (Robert, 1992).

The weight of evidence is in support of the fact that traditional macroeconomic measures, which may suit the needs of the organized sector, are of little or no use to the informal sector as long as they do not take its particular problems into account, and are indeed detrimental to certain segments of the informal sector which might otherwise survive (Neck and Nelson, 1987; Harold Lubell, 1991; Malcolm Harper, 1992). Moreover, the often observed lack of determined state action on the part of the government to see the policies through has exasperated the problem.

The structural adjustment programmes of the 1980s modified or cancelled a number of the special advantages received by the formal sector as quantitative restrictions were removed, tariffs were lowered, currencies were devalued, and in some cases, interest rates were raised. In many instances, the changes affected the informal sector producers favourably in spite of (or because of) the difficulties faced by the formal sector as a result of the programmes (Harold Lubell, 1991; Robert, 1992).

Hence, the policy climate for the informal sector of the 1990s is more favourable than in the past as a consequence both of the wave of the World Bank-fostered Structural Adjustment Programmes (SAPs) of the 1980s and of the increased interest in the informal sector on the part of the international agencies and national governments. Although implicit discrimination against small and micro-enterprises is being markedly reduced as a result of the policy shifts noted, the whole issue of getting governments to take a positive attitude toward the informal sector is still a major challenge.

Very recently, therefore, some people began to be skeptical about overall policy measures and to propound independent actions which would require special programmes exclusively aimed at the informal sector. And this brought into the scene direct financial and non-financial assistance programmes to promote the sector which can be provided by institutions, associations, agencies, corporations, companies, firms and practitioners, distributors and individuals. They may deal with any or all of such functions as training schemes, management and extension services,
technical assistance, credit facilities, co-operativization measures, and research and development activities.

Most countries have institutionalized programmes to assist informal businessmen. Although data from developing countries is insufficient, there is some experience from developed countries (North America and Europe) and from India that most support programmes that have been launched are found to be successful. One of the first of the countries of the Third World to incorporate promotion of informal activities into its development plans and programmes as an explicit national goal was Colombia although attempts to implement the proposed programmes were far from successful.

Some other developing countries, such as India and the Philippines, have implemented highly structured and integrated systems for promoting the informal sector, and government support for the sector has grown consistently over the past 10 to 15 years. The most successful case of implementing informal sector support measures in developing countries is India, where the government policy, guided by a philosophy of compromise between modernization and Ghandian outlook, contributed to the growth of the sector.

Actions to support the informal sector that have been initiated in the past are mixed mainly due to the ineffective design of programmes and projects; an inappropriate policy environment; and an inadequate institutional infrastructure. A common denominator has been a lack of reliable, precise and relevant information on the sector. Lack of defined roles of the various institutions providing support has also contributed to the failure of some programmes. At the same time, a common observable problem is the duplication of activities since most institutions are capable of providing a wider range of services.

The experience of the 10-years old World Bank financed programmes in the Philippines, India, Mexico, Indonesia, Morocco and Kenya indicates the difficulty of identifying a wholly satisfactory formula to complement financing with effective technical management. This is mainly due to the heterogeneity of the enterprises, and of their needs, and the wide variety of developing country circumstances.

If assistance to the informal sector units is to be more effective, a co-ordinated effort involving governments, private businesses, financial institutions and NGOs is required. Above all, flexibility seems to be needed in co-ordinating inputs so that programmes are simple, and assistance can be found by the informal entrepreneur in the right place at the right time.

Most support programmes are carried out by the government. As a rule, however, informal units are not reached by governmental assistance since owners of many informal enterprises avoid registering with the authorities out of fear that they might become victims of further inconvenience once their existence is officially recognized. Registration, however, is often a precondition for qualifying for participation in governmental support programmes.
The involvement in the programmes of other bodies such as NGOs is, therefore, imperative. Non-Government organizations (NGOs) have been quite active in both industrialized and developing countries, although in the later case there is far more involvement in the areas of financial and managerial or technical assistance to small and informal enterprises. The use of international NGOs is crucially important in (Less Developed Countries (LDCs)) with deficient or distorted policies towards these enterprises. Another reason for the involvement of NGOs in the promotion of informal enterprises is the extent and the capacity to which governments are able to deliver the necessary services to the clients at the local level.

Besides, in most cases, the operations of NGOs was observed to make ideal partners for organizing communities at the grassroots level and for carrying out group-based programmes, including the setting up of revolving loan funds and short term courses on skill up-grading.

It was also realized that some attempts by governments to provide financial assistance to small enterprises have had limited success (Neck and Nelson, 1987). It is true that LDCs have the greatest need for government involvement, yet these are the very governments which can least afford the cost of enterprise promotion.

The controversial issue here is one of whether NGOs work together with the government. NGOs sometimes view the government as being too bureaucratic and rigid, and governments being always suspicious of NGOs. Where procedures to accomplish goals and objectives are in conflict, it may be impossible for governments and NGOs to develop a working relationship. While the goals of NGOs may be enterprise-specific, governments may view the enterprises within a wider range of goals. The extent to which governments co-ordinate and support NGOs activities will depend in part on political necessity.

Therefore, it is up to the NGO, the government and the proposed beneficiaries to agree on specific programmes to be offered by the NGO. But the appropriate role of the government in promoting the activities of NGOs in LDCs has yet to be defined. One thing is, however, for sure: whatever assistance is provided by NGOs to informal enterprises will relieve the government of providing such assistance.

Any support measure for the informal sector should of necessity take into account the heterogeneous nature of activities. The sector covers such a large variety of activities that it is useful to break it down into sub-groups and sectors for operational purposes. Different types of informal activity require different measures of assistance depending on, for instance, scale of operation, means of production or entrepreneurial skills required. This means that the right combination of assistance measures has to be decided case by case.

It has been the case that most support programmes often try to give utmost priority to the creation of credit schemes in response to the widely held perception that credit is the most pressing input constraint. However, some contend that the relative importance of these schemes
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may differ from the perceived importance, and that capital shortages are often symptomatic of other problems (Neck and Nelson, 1987; Harold Lubell, 1991).

Increasing the availability of credit can clearly contribute to enterprise development and to job creation. One of the most encouraging but also the most confusing aspects of credit to small enterprises is whether credit can be effective both in promoting economic change and business growth, on the one hand, and in creating impacts which are equitable, on the other.

Much of the current debate in the area of credit is one of whether and how credit can be provided both beneficially and profitably in such a way that it will end up helping the enterprises to become self-sustaining ones. In other words, the long term effects of financial assistance on the informal sector are debatable.

But some argue that one common feature which makes it possible to provide credit on a self-sustaining basis, but through a delivery system that allows the necessary access for microenterprises, is the high rate of return that is earned by such units, in relation to the very small amounts of capital that are employed (Malcolm Harper, 1992).

Another issue relates to the fact that credit is not an end in itself. We have to see to it that the delivery of credit makes a difference making clients self-sustainable, and that whether it should be complemented with other forms of support. One should not believe, therefore, that better access to finance, and finance alone, is all that most people need to be successful in their efforts at enterprise.

From the foregoing, it is evident that inappropriate policy measures may distort the structure of the informal sector. It is also clear that specific measures of support to the sector, unless carefully designed, actually discourage or even prevent their efficient operation. Moreover, country experiences indicate the difficulty, if not the impossibility, of moving from support measures that are general to a precise and widely accepted one; measures which apply to all countries, all sorts of economic activities and all stages of economic development. This would imply that any intervention aimed particularly at the informal sector should be suitably differentiated in order to take account of the extremely heterogeneous nature of the sector in each country.

2. FINANCIAL SUPPORT PROGRAMMES: EXPERIENCES

Financial support for the informal sector ranges from direct grants, subsidized loans and credit guarantees from governments to loans from the credit market against collateral and at interest rates ranging from reasonable to very high. Financing institutions may also assume widely different forms of ownership, and management and operation. The most important ones include:
government development banks and finance companies; commercial banks; credit and saving institutions, etc. Moreover, financial support can be individualistic or group-based and/or minimalist (financial support only) or integrated (including technical assistance, training, etc.).

Assistance with informal sector financing in developing countries is an area where noticeable progress was made in the past two decades. However, in spite of the progress achieved, the issue of access to credit for these units is far from resolved. The evolution of financing schemes in the past are treated in what follows.

2.1 The Conventional Approaches

2.1.1 Development Finance Companies (DFCs)

Until the mid-70s, the most important source of finance for small and informal businesses was from government development banks and finance companies which have assumed various forms in different countries. The most important being Development Finance Companies (DFCs) that were the first to establish institutional credit facilities for small enterprises, albeit on a modest basis. The World Bank used these in earlier projects in, for example, Cameroon, Colombia, the Republic of Korea, and the Philippines.

However, after the mid-70s, it soon became clear that using DFCs as the only source of financing small and informal enterprises had some operational problems- mostly too much centralization and slow appraisals- and serious financial problems of their own. One remedial measure proposed particularly in French-Speaking African countries has been to abolish the classic distinction of functions between DFCs and commercial banks.

2.1.2 Commercial Banks (CBs)

Private financial institutions such as commercial banks emerged in the past decade as a potentially useful alternative source of credit for small and informal enterprises. In some countries, such as Indonesia, the commercial banking system has become the most important source of term loans to these enterprises for both investment and permanent working capital.

One major advantage is the large branch network of CBs, permitting-most importantly- direct knowledge of, and frequent contact with, entrepreneurs in their local environment. Furthermore, they are usually able to offer a greater variety of banking services, and are more experienced in debt collection than DFCs or government development banks.

However, CBs tend to perceive loans to small enterprises as particularly risky and involving prohibitively high administrative costs. This is primarily because these enterprises cannot provide sufficient collateral of material security in the form that the institutions are accustomed to obtain from borrowers.
This argument seems to have some validity, but the *collateral necessity syndrome* is only part of the problem. The balance seems to be in the exaggerated level of collateral demand by the institutions, and lack of proper records on the part of the clients that is a primary tool to help establish their credibility to the lending institutions (Malcolm Harper, 1992).

Besides, it is a well established fact that private financial institutions such as commercial banks are not interested in development objectives since they are profit-oriented.

### 2.1.3 Specialized Financial Institutions (SFIs)

In quite a few countries (such as Malawi, Liberia, Zambia, Sri Lanka and Thailand), instead of using a DFC or CB as a main source of credit with the various arrangements, it has been decided to establish special financial institutions for lending to small and informal enterprises. In almost all the cases, the efforts to improve access to external finance for the enterprises met with a certain degree of success.

However, a review of performance of nine different SFIs by the Netherlands Development Financing Company brought very clearly that there is no ideal solution that could serve small enterprises best, and that none should confine itself to financial or banking services only for such a programme to be successful (Neck and Nelson, 1987).

In addition, special financial programmes, like SFIs, although set up to assist poor microenterprises, resort to exclude the poorest of the poor for they, too, face the same problem of information like those of the conventional lending institutions. Such programmes, therefore, may ease the credit constraints for some borrowers but they do not resolve the rationing problem inherent in credit markets (Malcolm Harper, 1992). The most promising approach in the long run to improve microenterprise’s access to finance is thus to deal directly with the information problem.

Two important problems can be identified as far as the conventional approaches are concerned:

- the already held conception that lending to small enterprises as risky;
- too much centralization in the operation of DFCs and SFIs

The following approaches have therefore been suggested and worked out in response to these problems.

### 2.2 The Risk-Sharing Approaches

One possible way to overcome the problem of the unwillingness of private financial institutions to lend to the informal sector enterprises is to set up schemes that offer these lending institutions
a guarantee to cover some or all of the losses incurred when borrowers default. Here, in effect we are referring to the interactive role of either governments, groups and/or NGOs as catalysts and intermediaries in easing the accessibility of financial institutions to the enterprises.

2.2.1 Government-guaranteed Lending

A variety of arrangements has been observed as to who constitute the source of the guarantee fund. The most frequently observed form is a Credit Guarantee Fund (CGF) set up usually with government financial support to provide the money to compensate for the default (or accepting commitment by the government as opposed to setting up specific fund).

The most significant decision that has to be made in launching a guarantee scheme relates to the proportion of risk that will be covered by the funding organization. In some cases, as in Japan, France and a few other industrialized countries 100% of the risk was shared by the fund. There is however the contention that lending institutions should assume some risk, but it must not be as high a proportion as it discourages them.

Such schemes are initially developed in Europe and are being overwhelmingly practised in France, Italy, Britain, and the Netherlands with some success. Although there is some experience from developed countries, and from India and from the Republic of Korea, data from LDCs is insufficient for a full analysis of the factors determining the success or failure of CGFs. The consensus of opinion is that informal sector development in developing countries requires measures and programmes involving expenditure from the government budget in the form of a subsidy of one kind or other.

Most LDCs have therefore established CGF’s most of which were established by governments, usually covering an important part (70 to 80 per cent) of the default risk. The limited experience of setting up of government-funded guarantee schemes in developing countries shows that generally they have not proved very successful. The various measures to that effect have not had the desired effect, except in a few countries such as India.

These schemes generally face two problems: one is their viability, and the second concerns whether or not they actually contribute to additional lending to the targeted clientele. This approach appears to be feasible when private financial institutions adopt them, but when it is adopted by a publicly funded development programme the end result is often to cover the defaulted loans from the government budget. A recent analysis of a microenterprise programme in the Gambia, the Indigenous Business Advisory Service (IBAS), as an example, shows that the most common reasons for the failure include:

- the inability of the programmes to secure the confidence of the banks that claims will be honoured, without delay and without prolonged argument about the quality of bank supervision;
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- the inability of the banks themselves to use the schemes adequately, for, in some cases, the high risk made banks to be less vigilant in appraisal; and,

- corruption and political influence, which in some cases have led to poor decisions regarding investment.

The review of the various schemes in both DCs and LDCs suggests that:

- A guarantee scheme to work effectively and avoid an duly high level of claims, must ensure that banks will approve of loans only when they are convinced that the project is viable, and the client credit worthy, and that they will make all possible efforts to collect the loan repayments; This implies that:

  a) the guarantee organization should not have to rely entirely on the loan appraisal of the lending bank for its approval; and,

  b) the organization should somehow involve the banks in adopting the schemes.

- the guarantee schemes are more successful when they are decentralized, i.e., on a local or regional basis, so as to relegate slow decision making in approving funds.

2.2.2 Group-guaranteed Lending

An alternative approach to the risk-sharing issue has been the formation of Credit Guarantee Associations (CGAs), or as they are often called, Mutual Guarantee Systems (MGSs), whereby a group of people come together to undertake a common guarantee for a loan application of a member of the group in favour of the lending institutions. This concept of credit guarantee is considered as an attempt to decentralize guarantee schemes, and is believed to present a potential strategy to overcome some incentive and information problems.

Marginal interest has been observed in recent years in developing countries in these schemes, which often take some forms of "self-help" groups( and solidarity groups as in Latin America) amongst enterprises. However, it is observed that there are often local informal initiatives for such groups to guarantee each other's loans in many developing countries (Neck and Nelson, 1987; Harold Lubell, 1991; Malcolm Harper, 1992).

This approach is advantageous in various ways.

First, the group undoubtedly exerts considerable pressure on its members to repay the loan as has been shown by the experiences of "peer group" pressure in such organizations as the
Grameen Bank in Bangladesh. This can be more effective where the members have their own constitutional arrangement to make pressure on whoever defaults.

Second, the contribution of the members towards the creation of the basic fund of the association represent important savings on their part. Finally, one of the important elements of the MGSs, particularly in LDCs, is the chance of extending mutual support promoted within this type of self-help to areas of activities other than financial ones.

But, it should be remembered from the outset that the MGS can function as financial intermediary between the banks and the borrowers instead of the government or donor agencies does not mean that the government should disappear from the scene. Governments have usually supported the schemes by, for instance, providing reinsurance, which provide financial institutions with additional security, and by providing part of the capital needed to start the scheme. The appropriate approach is for the government to match the contribution raised by the group members from other sources in an agreed ratio.

The literature provides evidence of some successes, but also failures, in following the group approach. The Grameen Bank is the most important and widely applied group-based credit programme which has found fertile ground in many parts of the world from Asia to the cities of North America, and it is a case of most successfully implemented lending model in Asia (notably in Bangladesh).

Notwithstanding the great effort to replicate the Grameen Model in many parts of the developing world, the examples in Africa remain few. The Malawi Mudzi Fund is a Grameen replication Programme which began granting loans in 1990, but it now appears to be experiencing fundamental problems.

One of the donor organizations which has made a special effort to help establish these schemes is the Friedrich Ebert Stiftung (FES), a German foundation working in LDCs with aids of funds from the German government. Although the FES believes primarily in the use of CGAs, its reports indicate that it has encountered special difficulties in introducing the approach. It has helped to set up guarantee schemes in various countries including Kenya, Honduras, Chile and Senegal, to quote only few examples. Perhaps the most interesting case is the attempt in Kenya during 1983-1987.

The Kenyan experience shows that there is an inadequate understanding of the limitations and obligations of a CGA, and that there is unrealistic expectations on both sides, the reluctance of the target groups to be involved in self-help and mutual support activities. It was also observed that the banking sector was not sufficiently aware of the potential of such schemes, and hence was not co-operative. It is however important to recall the fact that those who took part recognized the value of savings and independent capital formation, and viewed the creation of the funds in this light.
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The other schemes in which the FES participated in Chile, Honduras and Senegal involved centralized guarantee schemes to which FES matched funds made available by governments. This schemes met with varying degrees of success but involved only small number of borrowers and limited sums.

Another effort to use the mutual guarantee concept in LDCs was the most recent attempt to set up a Cottage Enterprise Financing Project (CEFP) in the Philippines by establishing MGAs. The project was approved in late 1990 but has had some problems in the early stages of implementation. Here also the banks have proved less than co-operative, and generally the cottage enterprises have not been very keen to enter into an MGA or to make the required initial contribution.

It is clear from the cases that have been quoted here that CGAs have neither been easy to develop and operate in LDCs nor have they generally been effective. Although the theory suggests that such schemes have a positive effect on repayment which arises because of the incentive of group members to repay the group loan, there are cases where some groups totally default. Besides there is no commonly accepted norms in financial circles concerning the levels below which losses in lending can still be judged tolerable. The implication of all these is that the design and implementation of successful group lending is a complex task.

It would however be premature to assume that, because of the many difficulties involved in developing an effective guarantee fund, the whole concept should be considered unsuitable for a developing country. Some experiences of schemes in Korea, Philippines, Sri Lanka and Colombia in fact have shown that if a sufficient initial effort is made over a number of years and if the concept of the CGA becomes acceptable to the banks and if a greater understanding on what the scheme involves can be developed among the people, a relatively effective system can be worked out, whereby the default rate would be sustainable by a guarantee system backed by an adequate guarantee fund. However, much more work is needed to understand the conditions under which group lending works (Malcolm Harper, 1992).

2.2.3 The Role of NGOs

Most NGO assistance programmes have been in the form of projects designed for specific groups at the local level, and have contributed for the improvement of financial services for self-help organizations. It has been pointed out that NGOs can be most effective in initiating self-help activities.

The experience of Friedrich Ebert Stiftung in promoting self-help in Africa revealed that there is still a large scope of potential and incompletely used opportunity for poor people at the grassroots to improve income and living standards by organizing group effort and pooling of resources.
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The most recent NGO-run credit programme in Kenya, substantially modelled on the Grameen Bank, shows that a group-based approach can be effective if it finds cultural grounds with in the community. It has also indicated that the establishment of sound group practices for effective credit repayment and sustainability is not only built on institutional effectiveness and commercial viability, but also achieved through the establishment of groups in which participation and trust are built, and that this is attuned to community values inherent in traditional African culture.

What is more, ideally, groups formed by the credit programmes can not be simply credit groups but must be community groups for self-help, self-determination and self-reliant development building on the established tradition. This experience of Kenya, however, shows that the transformation from social welfare credit to commercially viable credit and the building of viable financial institutions takes time.

The fact that the solidarity group innovation helps to improve the repayment performance is out of question, but loan supervision remains a time-consuming and implicitly costly operation when undertaken by NGOs. In each of the PISCES-II projects (funded by USAID) administration of the credit fund was difficult since small local NGOs have little experience in administering loans (Harold Lubell, 1991).

Moreover, some experts believe that NGOs will encounter similar problems to those faced by governments if they enlarge the scope of their operations beyond local levels. There is also the problem of programme continuity when institutional assistance is withdrawn and the project has to rely on local resources.

In this regard, the experience of some Asian countries shows that NGOs cannot achieve much in isolation but need to work with commercial banks, with other programmes designed to promote enterprise development and with government.

NGO credit supply programmes are conceived not only as immediate relief measures, but used as an instrument for providing access to the formal banking sector. Over the past decade several NGOs in L. America have expanded their credit to the point where they have been forced to seek new sources of finance than only from the donor agencies, as such sources proved inadequate in volume and too slow in processing.

Some NGOs have, accordingly, links with formal financial institutions in their own country, or have established independent banking or credit organizations, and are able to mobilize an increased flow of funds. ADEMI in the Dominican Republic, Paraguayan Foundation in Paraguay, ADMIC in Mexico, and ACTUAR in Colombia are some of such NGOs. Another example from Africa is GAPI in Mozambique, the FES-run consulting office which is now in a process of transformation into a full-fledged financial institution for microenterprises.

Whilst some of the ground work is being done in terms of NGO mediating between clients and the banks in the graduation of successful enterprises, and this has helped some microenterprises
lending programmes to expand by narrowing the cultural gap between clients and banks, yet the development of such linkages is still in its infancy and in general NGOs still encounter serious constraints in obtaining finance from commercial banks for on-lending to microenterprises. Therefore, long term sustainability and the generation of local loan funds remain distant goals.

In most cases, however, NGOs are regarded as a last resort, and are criticised, particularly in their provision of financial services, because of the small-scale nature of their activity, their desire to operate outside government influence and control, and for not thinking like bankers—the inherent danger of NGOs for falling into the "welfare trap" by substituting, instead of encouraging, self-help.

2.3 Minimalist or Integrated Approaches?

The focus of most support programmes for the informal sector has been credit and technical assistance. And the availability of finance is considered to be the single most important ingredient of most support programmes to the sector. One crucial issue, on which there has been a divergence of opinion in the area, is whether or not programmes designed only for financial assistance are effective.

Critics of special financial assistance for enterprises argue that such one-sided approaches are likely to fail unless they are merged into other assistance programmes. These non-minimalists rightly emphasise that credit is not the only need, though important, of microenterprises. The viability of financial institutions is, therefore, heavily related to the availability and quality of non-financial services.

Research indicates that the absence of non-financial assistance greatly reduces the willingness of banks to expand microcredit, even if there are special measures (credit guarantees, etc.) to spread the risk. Therefore, many financial institutions in some form or another are involved in the provision of non-financial services to their clients.

However, there has been a general reluctance on the part of many countries to provide financial and non-financial services through one single institution, for it involves conflicting aims and responsibility.

There were of course cases where such monopoly of single institution successfully operated. The most striking example of a financial institution providing non-financial services is a Small Enterprises Promotion Ltd. (SEP) in Zambia. The aforementioned nine different SFIs by the Netherlands Development Financing Company (FMO), the Small Enterprise Financing Organization (SEFO) in Liberia, the Central de Credito Co-operativo (CCC) in Peru, and the Planters Development Bank (PDB) in the Philippines, all felt that credit cannot be provided in isolation and must be a package which include technical assistance, training and other forms of help.
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The major characteristics of such integrated approaches is that government financial support and subsidies are not considered permanent and should therefore not be relied upon; the main justification being self-sustainability of the enterprises. The other reason forwarded is the inadequacy of the provision of services by non-financial institutions. In many cases the performance of these institutions was poor and enterprises tended to shy away from the bureaucratic practices involved.

It is therefore not surprising that financial institutions became increasingly inclined, as they could rely on themselves, to provide better quality and delivery of at least a minimum of non-financial assistance to their clients (in spite of the possible disadvantages, costs and risks).

If a technical and financial components are to be merged into one programme, the question remains as to how the two components will be co-ordinated for maximum benefit to participants. It is also necessary to consider the general consensus that cost-effective ways of extending technical assistance to the mass of informal sector participants have not yet been found (Neck and Nelson, 1987; Harold Lubell, 1991; Malcolm Harper, 1992).

The extent to which technical assistance should be a part of financial assistance and whether specific training should be a prerequisite for financial assistance are, therefore, still outstanding questions.

Experience with a considerable number of microenterprise support programmes has shown that minimalist credit programmes, those with little or no training and technical component added to the credit component, have been successful in increasing and maintaining the incomes of their borrowers (Harold Lubell, 1991).

The 1989 USAID evaluation report on 38 projects in 20 countries all over the Third World has concluded that the so-called minimalist credit model has a better record of achievement than the more ambitious transformational programmes. The more recent experience of working minimalist approach in Kenya is also in support of this evidence, though some problems have been observed.

However, some feel that the success of such minimalist programmes may be due partly to the fact that funds are limited so that the credit is rationed to the more competent potential borrowers by the process of selecting among candidates for loans. An exception would appear to be the Grameen Bank of Bangladesh, whose loans are extremely small and whose borrowers extremely numerous. Others have contended that the needs of the vast majority of microenterprises cannot be satisfied merely by the provision of small working capital. It is still not clear how to meet the needs of less viable enterprises on a cost-effective basis.
3. THE ETHIOPIAN CONTEXT: WHAT LESSONS ARE THERE FROM EXPERIENCES?

Ethiopia is one of the African countries where the informal sector has been neglected at policy levels, and very little is known about the sector. The problem of attaching a precise definition to the term informal sector is also evident in Ethiopia. The distinction between "large" and "small" has never been clear, let alone "informal". The main reason appears to be lack of attention to the sector by the authorities. The balance is due to the unavailability of adequate information regarding the sector.

Studies conducted so far are limited in scope as well as coverage. The available studies about the urban informal sector indicate that it shares much of the characteristics of informal sector in Africa (ILO/JASPA, 1990). It is also generally believed that the urban informal sector provides job opportunities for the larger part of the urban labour force. So there is a need for a more comprehensive study that throws some light concerning the proper role of the sector in the development of the national economy in general and in employment creation in particular.

The potential for expanding the scope of the informal enterprises (particularly the traditional small-scale manufacturing and handicrafts sector) in the country is estimated to be considerable. This is evident from the fact that they mostly use indigenous technologies and that the activities show perfect adaptation to local raw material. In addition, they can more easily adjust the level of production to the size of the local market for its output, and this can be in tune with the Ethiopian reality, where small urban centers generate a limited demand for a variety of products. Given the capital scarcity, heavy unemployment, low level of industrialization, technology and productivity, etc., informal enterprises remain very important in the national economy.

They have, however, sever problems of their own which would require the development of appropriate policy and programmes if they are to play a significant role in the economy. The most important problems include:

- lack of sufficient training,
- lack of raw materials,
- lack of access to finance, and
- production and marketing problems.

There is some evidence that the Ethiopian case supports the contention that small-scale and informal enterprises are denied access to the formal credit. Studies indicate that they have limited access to formal financial sources and resort to alternative sources of credit, mainly friends, relatives, and local money lenders at high interest rates ranging between 100% and 300% per annum.
The other most common sources of informal credit have been the traditional social groups which play crucial role not only for business financing, but also in the economy of most members of the country. In Ethiopia a variety of traditional resource mobilization and saving mechanisms exist in both urban and rural communities. Such traditional and social financial institutions have deep rooted social and cultural origins and include RUB (a lottery-based resource mobilization), IDIR (much larger and with a purpose of pooling resources for future crisis), and MAHIBER (with social objective similar to IDIR).

The bad news is that most of the funds mobilized are spent on consumption rather than productive and investment purposes. There is, therefore, a large room, on the one hand, to exploit such traditional social groupings as a means of easily introducing group activities, and, on the other, to divert resources for the self-sustaining activities on the part of the community.

In general, institutional, traditional and cultural barriers represent forces that hinder many classes of informal enterprises from participating actively in formal credit markets. Some studies based on limited surveys indicate that the underdeveloped nature of financial institutions, government financial policy, and the immature potential in entrepreneurship handicap these enterprises.

The overall lending and credit policy in the past was against the private sector in general, and it has had no role as far as the informal sector is concerned. Whatever credit was available, to small enterprises, it was provided to registered service or producer co-operatives. Lack of registration on the part of the informal enterprises has therefore partly prevented the sector from getting access to formal credit.

Therefore, it is only if the right environment is created for the informal sector participant that they can facilitate the utilization of indigenous resources, generate substantial employment, etc. Therefore, the development of small and informal enterprises in Ethiopia calls for the creation of the right environment, appropriate policy measures and diverse institutional supports.

Presently there is a tendency of liberalizing the economy, which can be considered as a first right move to place the informal sector on equal footing with the organized sector. Very recently the TGE appears to be concerned to tackle the alarming problem of unemployment by an integrated development strategy. The formulation and implementation of an integrated and sustainable employment generating programme may be a step in this direction.

The private formal sector employment could not expand to any meaningful extent due to several policy and administrative constraints. Generally, assessment of the available employment data indicates that there are limited wage employment opportunities. Moreover, in the light of the enormous number of the demobilized army and the retrenchment of a number of civil servants due to the implementation of SAP, the prospect of the informal sector to create productive employment cannot be overemphasised. Besides, given the severe shortages of capital,
managerial resources, and skilled labour, the promotion of informal sector can be an important approach to development in general and poverty alleviation in particular.

What lessons are there from experiences?

1. First of all, the social and economic contributions of the informal sector should be recognized and defined explicitly in national development policies and plans.

2. In view of the absence of a universally accepted definition of the informal sector, it is appropriate for the country to urgently develop its own definition according to national, social and economic conditions. This would require a timely undertaking of nationwide survey for a more detailed understanding of the sector in general, and the key constraints in particular.

3. In view of their potential particularly, for employment creation in the country, small enterprises in the informal sector require intensified government actions which could involve assistance that is substantially different from assistance to small enterprises in general, and require special delivery channels, which is able to take into account the unique features of low level of schooling, skills, capital and know-how, and be capable of adopting participatory, informal approaches.

4. The critical importance of finance to the sector should call for special government attention. General financial sector reform and development may not be the only route to a sustainable credit system that can meet the specific needs of the informal enterprises. This is rather only the first right move. What is more, the design and proper execution of special credit assistance programmes which would consider the following:

- proper realization of the heterogeneity of the sector in respect of size, type of activity, etc. which requires different approaches for different sectors and target groups. This implies that financial services for the informal sector should be designed on the basis of the needs of the clients.

- A corollary to the above is that for a financial support programme to be efficacious, it should be designed in such a way that there is a close interaction with the potential beneficiary community.

- Evidence suggests that problems in delivering credit can effectively be dealt with through decentralized approaches rather than nationwide and top-down approaches so that there is close relationship to targeted beneficiaries.
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- This would entail vigorous promotion of group-based credit in the context of a community development approaches. The enterprises should be encouraged to organize themselves voluntarily on a self-help basis that may help in reducing costs of promotion, allow for more aggressive follow-up and collection efforts, and above all, providing important information to officials on client needs.

- collaboration with funding and donor agencies and NGOs should be enhanced, particularly the role of NGOs as an intermediary between lending institutions and the clients should be promoted. NGOs should be encouraged to participate actively in financial programmes, particularly those aimed at special target groups and sectors in which the special characteristics of NGOs make them extremely valuable collaborators.

- The main lesson is probably that great caution should be exercised in developing credit programmes. The whole review of the economics of credit reveals one important lesson above everything else: that there are many distinct approaches to micro-credit. The question of choice is one of relevance. The choice of appropriate system should be based not on ideology nor on precedent, but on what is suitable for local situations. The institutions that may evolve and the organizational culture should be in accordance with the unique environment of the operation of the programmes. The respective roles of the institutions need to be identified accordingly.

4. CONCLUSION

It is widely recognized that the informal sector of a country may significantly contribute to development if it is properly exploited, and if the necessary support is given to the sector. There exist a broad spectrum of interventions that could be used to promote the activities in the sector. In designing the appropriate approach, consideration needs to be given to the viability of whatever measure is taken to the peculiar nature of the enterprises in the country. Decision must be based not on what is done in this or that programme elsewhere but on what is most suitable for Ethiopia. The mere replication of the method developed elsewhere, regardless of local circumstances will almost certainly be doom to failure. Therefore, a wider appreciation of the need to design an appropriate approach should be emphasised.

A crucial issue in determining which form of direct interventions is most appropriate is the identification of the key constraints facing the enterprises. When asked to identify their primary constraint, informal enterprises will usually state that it is the lack of credit. Yet in-depth analysis frequently reveals that other constraints may be more crucial. A detailed research and analysis need to be carried out to identify the types and forms of assistance most needed by the enterprises.