

PROFILE I
MULTI-PHASE LOAN
JAMAICA
(JA-0121)

Project name: Micro and Small Enterprise (MSE) Development Program

Project number: JA-0121

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Borrower: Government of Jamaica (GOJ)

Executing agency: Ministry of Industry and Tourism (MIT)

Financing plan:		Phase I	Phase II
Multi-Phase Loan	IDB:	\$2,400,000	\$8,000,000
	Local:	600,000	2,000,000
	Total cost:	\$3,000,000	\$10,000,000

Tentative dates:	Profile I	March 2003
	Profile II	June 2003
	Loan Committee	October 2003
	Board of Directors	December 2003

I. INTRODUCTION AND PROGRAM OBJECTIVE

- 1.1 A Multi-Phase Loan Program is proposed in order to provide systematic and long-term support to the Micro and Small Enterprise (MSE) sector in Jamaica and to coordinate a sustained effort to address pervasive problems within the sector. This program is proposed in response to a request from the Government of Jamaica (GOJ) for Bank support to develop the MSE sector through improvement in the quality of both financial and non-financial services. The primary challenges of the program are twofold: (i) to strengthen the policy and institutional framework for the MSE sector and (ii) to move from a government-donor subsidized credit system for micro and small enterprises to a system under which financial and non-financial services are provided to MSEs on commercial terms.
- 1.2 The program involves two complementary and discrete phases: sequencing of the phases is critical to the long-term success of the program. Phase I is designed to include components of institutional development as well as the modernization of the regulatory and sector framework for MSEs. Once this foundation is built and certain defined performance criteria are met, Phase II would commence. The evaluation tools to be used as benchmarks for progression to Phase II would be developed to measure progress made by both the public and private sectors in the advancement towards a sustainable and commercially viable MSE sector.

II. DIAGNOSTIC AND PROBLEMS OF SECTOR

A. Diagnostic of Sector and Main Problems

- 2.1 Several diagnostic studies in the areas of financial and non-financial services served as background for the proposed program and were financed by the Inter-American Development Bank, Finance and Infrastructure Division of Region 3 (RE3/FI3) and the Micro, Small and Medium Enterprise Division of the Sustainable Development Department (SDS/MSM).¹ The main problems noted in the diagnostic are symptomatic of an underdeveloped policy and institutional framework for the MSE sector and inadequate access to both financial and business development services for enterprises working within this sector. The diagnostics also noted the absence of a cohesive strategy for the sector.

¹ Diagnostics include: i) "Improving the depth and quality of financial services for micro and small enterprises in Jamaica" by Eduardo Quant, May 2000; ii) "Diagnostic of Micro and Small sector in Jamaica" by Development Options Limited June 2001; iii) "Diagnostic of Microenterprise and Small/Medium Sized Enterprise Sectors in Jamaica" by De Montfort University, June 1997; and iv) "Microfinance issues and challenges in the Anglophone Caribbean" by Mark Wenner, March 2001.

- 2.2 The 1996 National Survey of Non-Agricultural Micro and Small Businesses indicated that there were an estimated 93,110 micro and small enterprises in operation in Jamaica in 1996. Current estimates place the number of micro and small enterprises in excess of 200,000. A more refined estimate of the number of such enterprises is expected to be derived from the ongoing informal sector study by the Bank. Results from the survey are expected during the first quarter of 2003.
- 2.3 For purposes of this program, micro enterprises are defined as enterprises employing four or fewer persons whereas small enterprises are defined to have between five and 33 employees. The primary business activities of the MSE sector are wholesale/retail (63%), personal services (11 percent) and restaurants/hotels (9.6 percent).

B. Policy and Institutional Framework

- 2.4 MIT is responsible for policy definition and formulation for MSE within the GOJ but various autonomous semi-public entities and independent government agencies also directly influence the sector's development. The decentralization of authority and regulation of the MSE sector has led to some inconsistencies within the sector. One example of such an inconsistency is that different interest rate policies are imposed upon Community Development Funds and Microfinance Organizations although both entities lend to MSE. An interest rate ceiling of 28 percent has been applied to Community Development Funds whereas Micro Finance Organizations have no interest rate ceiling.
- 2.5 Additional policy and institutional strengthening of MIT is necessary in order to promulgate an effective and consistent approach to MSE development. Furthermore, mechanisms need to be strengthened within MIT to disseminate sector information and promote effective strategies to support SME sustainability.
- 2.6 Successful MSE development in Jamaica will depend as much on alleviating the existing policy and administrative constraints as on creating an overall favorable business environment for enterprises of all sizes. Constraints that need to be addressed fully include improved business administration procedures (such as company registration) and reforms in the areas of taxes and customs. Initiatives by donor agencies such as USAID, EU and CIDA have been undertaken to alleviate some of these concerns, but these initiatives have been conceived as isolated interventions. Coordination among donors is necessary in order to maximize the benefits of such initiatives for the MSE sector.

C. Access to Financial Services

- 2.7 Surveys of Jamaican small and micro entrepreneurs indicate that access to financial services, specifically capital and credit, is one of the most important constraints for establishing and developing their businesses. According to some estimates, as much as 85% of all small and micro-entrepreneurs have no access to

credit from formal sources and rely overwhelmingly on self-financing and financial resources of family members, including transfers from overseas, as well as a variety of informal financing arrangements.

- 2.8 In the past, the majority of formal credit for the MSE sector came in the form of special Government initiatives coupled with bilateral agreements and soft loans². Public sector authorities and donor organizations provided resources which were funneled through wholesale or apex institutions³ to a host of retail credit providers which in turn on-lent the funds to the SME. Past programs did not establish an incentive framework to encourage expansion in the sector or include technical assistance to build a sustainable network of retail institutions to provide financial services to the MSE. Both providers of services and their clients depended on subsidized resources, the supply of which could neither be continued nor justified.
- 2.9 In order to increase the number of qualified financial institutions serving the MSE, actions need to be taken to mitigate the perceived high risk of the MSE sector. Reliable collateral registries and credit bureaus need to be established to facilitate this objective. Although the need for these measures is not unique to MSE, it is necessary that to the extent possible, any initiatives in these areas include MSEs. International and bilateral agencies have initiated activities in these areas and coordination among stakeholders is critical to maximize potential benefits to MSEs.

D. Access to Non-financial Services (Business Development Services)

- 2.10 The market for the provision of Business Development Services (BDS) in Jamaica is in the incipient stages of development. Most private and public sector providers are unsustainable, provide inadequate services and have limited outreach programs. They are dependent on donor funding and their technical capacity to innovate and design market-driven services needs strengthening. The lack of mature BDS providers tends to compound the general weaknesses of the MSE sector's human resource base, which is characterized by a relatively low level of formal education. As a result, deficiencies in the administrative and technical capacity of MSEs are pervasive and MSEs have few alternatives available to them with respect to assistance in these areas. This systemic weakness severely restrains the development and growth potential of the enterprises and inhibits their ability to develop innovative capacities. In particular,

² Agreements have been made between the Government of Jamaica and the Government of the Netherlands, the European Community, the World Bank, the Government of Germany, the European Investment Bank, USAID, CIDA, and the Government of the United Kingdom.

³ Apex organizations were the vehicles that initiated the establishment of a small-scale rural finance facility, with the Agricultural Credit Bank lending through first tier institutions called People Cooperative Banks (1981); the Self Start Fund (1983-1991); the first major thrust at micro-credit came with the Micro Investment Development Agency lending through credit unions, NGOs and community development foundations (CDFs) (1991); Eagle Merchant/PCYA lending to credit unions, commercial banks and NGOs (1994-98); Trafalgar Development Bank lending through credit unions and NGOs (1999) and Development Options Ltd. through emerging micro finance organizations (Lending began in 2000).

weaknesses exist in the areas of management and technology as well as improvements to the production processes and marketing strategies.

- 2.11 According to the 1996 National Survey, the main business development constraints MSEs face are low market demand, high cost of materials and supplies, lack of marketing services and inadequate training. According to the 1997 Jamaica Micro Business Development Study,⁴ a significant number of the entrepreneurs indicated that they had a need for non-financial services to help expand their businesses. Discussions with various BDS providers revealed that MSEs need additional training in understanding the production process and cost accounting. Some BDS providers also believe that MSEs need more information on the markets in which they operate as well as the general business environment in order to develop sound business plans.

III. BANK STRATEGY

- 3.1 This proposed program is consistent with Bank strategy in Jamaica and seeks to ensure that market participants gain access to needed financial and non-financial services via an appropriate institutional structure and that services are priced so that institutions providing the services are sustainable. The technical assistance programs focus on the achievement of these objectives.
- 3.2 The program also heightens competitiveness via increased productivity at the firm level, as noted in the Country Strategy Paper. This program also is consistent with the approach noted in the February 1997 Micro Enterprise Development Strategy Paper in which the stated objectives are to promote the development of a favorable policy and regulatory environment and to build strong sustainable institutions providing services to MSEs.

IV. PROGRAM DESIGN AND EXECUTION

- 4.1 **Multiphase Loan.** As previously noted, a Multiphase Loan is a suitable instrument for this operation because the proposed program includes two complementary but discrete phases. Phase II of the Program will be implemented if and only if certain performance criteria are achieved during Phase I. Performance criteria would include establishment of an acceptable policy framework for MSE Sector by GOJ, achievement of operational criteria by qualified financial institutions, and a demonstrated demand for these resources.
- 4.2 The diagnostic studies also reveal that the impact of past programs has been difficult to measure because adequate tracking mechanisms were not established

⁴ This was part of GoJ/World Bank Micro Business Development Project using a sample size of 433 entrepreneurs conducted by Development Options Ltd.

prior to the execution of the program. The requirement of periodic program reviews and clear tools to measure the potential for advancement to Phase II are characteristics of the Multi Phase Loan that should minimize such risk in this program.

4.3 Funding for **Phase I** (expected to have a duration of three to five years) will consist of approximately \$3.0 million and will provide financial assistance to:

- a. improve the policy framework for the MSE sector; support the development of a National MSE Policy with a parallel comprehensive Strategy Framework/Action Plan for the MSE sector; and build institutional capacity within the policy unit of MIT, including establishment of a knowledge exchange website;
- b. introduce best practices in the wholesale/apex network by building apex structures that promote independence, strong governance, and market rates of interest;
- c. establish a 'Financial Institutions Fund' to provide grants to eligible regulated and unregulated institutions to provide sustainable financial services to the MSE sector. This Fund would provide grants to be used for specified purposes such as the following:
 - i. Regulated institutions: encourage the adoption of best practices in credit technology and to improve know-how/expertise in MSE lending in order to the reduce costs of serving the sector; and
 - ii. Specialized, non-regulated institutions: build/strengthen institutional capacity by improving financial management practices, portfolio quality, operational efficiency, product development (savings and lending instruments) and best practices in credit technology.
- d. develop a modern, innovative and sustainable BDS market by establishing a demand-driven 'BDS Fund' that will finance assistance to strengthen eligible BDS providers (supply-side intervention). This BDS Fund will provide technical assistance for institutional and organizational strengthening using international and local best practices. Consideration will be given to BDS providers that promote competitiveness through the use of tools such as incubators, cluster information, innovative technology, and production chains. Special emphasis will be given to those providers that support youth entrepreneurship, including youth at risk; and
- e. stimulate demand of BDS through a pilot voucher program (demand-side intervention). The definition of eligible participants will be one of the objectives of the appraisal phase of the operation.

4.4 The amount of funding required for Phase I appears modest (US\$3 million) when one reviews the anticipated uses of the funds as set forth in Section 4.2. The

additionality of this funding comes primarily from the proposed improvement of the policy framework and the much needed donor coordination. Other sources of funding (such as USAID, CIDA, etc.) are being used to address specific issues confronted by MSEs and more funds are anticipated from the EU for similar applications. A strategic plan for the use of these funds is critical and the development and implementation of such a plan would contribute substantially to the realization of an effective MSE strategy. The synergy to be achieved through this type of coordination would have a far-reaching positive impact on the target sector of MSE.

- 4.5 Funding for **Phase II** totals approximately \$10.0 million and would be made available following Phase I if specified targets and indicators (triggers) have been met. The focus of Phase II will be on providing credit funds for onlending to institutions that meet pre-determined eligibility criteria and reach a target population/geographic location that is presently either underserved or unserved. It will also focus on developing a strategy to link the deposit-taking institutions to the MSE sector to achieve sustainability in the mobilization of capital. The continuation of technical assistance for both financial services and BDS may be included in Phase II if it were to be determined that it were needed.
- 4.6 Financial literacy outreach programs including such concepts as cash flow management, fundamentals of cost accounting, and inventory management need to be included in the program and targeted towards the MSEs. The timing of such a program and the appropriate delivery system for this outreach program will be evaluated during the program appraisal.
- 4.7 **Project Execution.** A Project Manager will be responsible for the day-to-day management of the project and will be housed in the MIT to facilitate interaction and policy formulation. Private firms with demonstrated expertise in technical assistance program management, financial services and BDS and without conflicts of interest will be contracted to administer the Funds. The Project Manager will supervise the work of the contracted firms as well as oversee a third party assessment of the evaluation of program objectives, including completion of Phase I and triggers for Phase II.
- 4.8 **Monitoring and Evaluation.** Impact evaluation tools will be developed and financed by this program at the onset of the program. These will include results-based monitoring tools, such as the logical framework where clear baseline indicators are determined. There will be periodic monitoring of program objectives and triggers associated with the Multiphase program. Project execution, evaluation and audits will be financed by the project.
- 4.9 **Government Role.** The GOJ/MIT will contract the Project Manager using Bank procedures as well supervise the contracts for the firms managing the Funds and the firm carrying out the independent evaluations of program objectives. The GOJ/MIT will work closely with the Project Manager and others in analyzing the

results of the ongoing evaluations to determine where policy adjustments are warranted.

V. LESSONS LEARNED

- 5.1 The lessons learned in Jamaica reveal that second-tier apex (wholesale) funding has had little impact on the MSE sector due to the lack of a sufficient number of strong retail outlets and a lack of technical assistance for building institutional capacity. Furthermore, apex structures were not protected from political pressure and interference. There has been some progress in redefining apex structures over the last several years but more advances are needed in this area.
- 5.2 Recent initiatives targeted towards the MSE sector have focused on providing funding to facilitating organizations to build the capacity of local institutions to deliver financial and non-financial services to MSE, while concurrently stimulating demand for these services. Given the number of donors working in the sector, a more coordinated approach toward interventions is necessary.
- 5.3 The diagnostic studies also reveal that the impact of past programs has been difficult to measure because adequate tracking mechanisms were not established prior to the execution of the program. The requirement of periodic program reviews and clear tools to measure the potential for advancement to Phase II are characteristics of the Multi Phase Loan that should minimize such risk in this program.

VI. RISK AND MITIGATION

- 6.1 A fundamental risk of the program is the continued implementation of discordant approaches by the various donor agencies and the GOJ with respect to the MSE sector. One of the objectives of Phase I of the program is the creation of a policy framework for the MSE sector and institutional strengthening of the responsible governmental and semi-autonomous agencies. The accomplishment of this objective should lay the groundwork for a consistent approach to the MSE sector within the GOJ and by both donor agencies and private sector institutions.
- 6.2 Given that the establishment of an adequate policy framework will take time and the sector is in need of immediate assistance, as an interim measure a stakeholder workshop to address donor and governmental programs and objectives is planned for the first semester of 2003. It is expected that one result of this workshop will be an exchange of information related to separate donor initiatives, identification of areas of concern for MSE that have not yet been addressed, allocation of responsibilities among the entities for specific tasks, and a coordination mechanism to ensure a consistent approach to issues that impact the MSE sector. This regimented approach should help mitigate the risk of program gaps, redundancies or inconsistencies.

- 6.3 The identification of appropriate triggers for advancement to Phase II of the program is critical to the success of the program. One program risk is that the triggers are not well defined or are ambiguous in nature. Special attention will be given to the development of clear quantitative and qualitative parameters to be used as triggers for advancement to Phase II. It is likely that such performance criteria would include such variables as the following: (i) performance of portfolio; successful completion of core financial/accounting/portfolio management training sessions, implementation of adequate financial management processes and procedures, including credit risk management and information systems and appropriate financial infrastructure; (ii) a sound second-tier arrangement that has implemented best practices and appropriate repayment and enforcement mechanisms; and (iii) realization of predetermined performance criteria for BDS participating providers.

VII. STATUS OF PREPARATION

- 7.1 It was agreed that GOJ/IDB would explore the utilization of a Project Preparation Facility (PPF) for approximately \$400-500 thousand to begin project preparation and execution of priority areas. Indicative areas include: i) development of program evaluation and monitoring tools; ii) definition of Phase II triggers; iii) continuation of institutional capacity building within MIT; iv) development of a mechanism for disseminating information and lessons learned; and v) development of operating rules and procedures and the qualifying criteria for the technical assistance Funds and the voucher program.
- 7.2 A technical team will be formed to focus on program preparation and operational design. Included among the technical team members will be designated participants from the MIT, PIOJ, MOF and IDB. Next steps include the organization of a two-day workshop to develop a strategic framework and action plan for the sector. Subsequently, a larger stakeholder meeting will take place to discuss the proposed IDB program for the sector. C&D and Administrative funds are being explored for financing the workshop and stakeholder meeting. The tentative date for Board presentation is December 2003.

VIII. SPECIAL ISSUES

- 8.1 A new institutional structure for the delivery of financial and non-financial services needs to be implemented with operational functions clearly defined. New operational policies and guidelines need to be developed and applied, including revised policies on wholesale and retail interest rates. The issues and risks are:
- a. Government's commitment and changes to policy over the life of program in the adoption of market-based principles in the MSE sector and building sustainable institutions. This risk will be mitigated by discussing program

strategy and benefits with current and potential government parties and holding various stakeholder meetings. Furthermore, the structure of the proposed Multiphase Loan allows for a phased approach toward development and mid-course corrections;

- b. Preliminary analysis indicates that there is demand and market acceptance exists for this type of program. Nevertheless, demand could change if other interventions were to distort the market. This risk is mitigated by the development of a coordinated strategy framework and action plan, with buy-in from participants in the sector.

8.2 **Social and Environmental Issues.** The activities to be financed in this program are not expected to have direct environmental or social effects. Although this operation does not qualify as a poverty-reduction loan, it could have indirect positive effects on poverty levels if access to financial and non-financial services were improved.