Supporting Income Generation Programs

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Section 7 Supporting Income Generation Programs

This section focuses on foundations that have developed innovative ways of supporting local income and employment generation programs through a combination of grants, loans and venture capital.

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Many foundations to promote the economic progress of low-income communities. In the pursuit of this end, they have sought for new economic options for the poor and have developed strategies that are both grantmaking and non-grantmaking.

How can new economic options be generated?

Foundations have devised a range of program strategies. Some have opted for the direct delivery of financial services to small and micro enterprises at the community level (frequently in partnership with other institutions). This support includes grants, loans and equity investment. It usually incorporates the provision of technical assistance as an essential element. The Esquel Ecuador Foundation (FEE) has opted for this type of program intervention.

Other foundations decide to focus their program on increasing the effectiveness of existing institutions specializing in the provision of financial services and/or influencing policy and practice in the field. Corona provides an example of this approach.

As with other program areas, foundations identify areas where they can bring added value and achieve high impact with their resources. The experience of the Foundation for a Sustainable Society, Inc. (FSSI) shows that by partnering with mainstream financial institutions it was able to leverage additional resources and increase the reach and quality of other programs. A few foundations such as FSSI opt almost exclusively for the use of loans and social venture capital as opposed to grants because they want to both foster an entrepreneurial spirit and recover their investment. This strategy enables them to benefit a larger number of businesses.

Summary points

Increasingly foundations are exploring new ways of stimulating the economic empowerment of low- income communities. The use of options such as the provision of credit and equity to micro-, small and medium enterprises can permit foundations focusing on economic empowerment to reach more beneficiaries and broaden their impact. These programs can be managed in-house or implemented through grants or loans to credit institutions.

Those foundations that directly manage credit, venture capital or loan guarantee programs need to recognize the risk involved. Foundations that have taken this approach require appropriate expertise amongst their staff, Board and consultants to reduce risk. Management of these programs requires special skills in areas such as the selection of credit and equity recipients. Those decisions involve assessment of business profitability in addition to social and environmental risks. It is also advisable to developing risk-sharing arrangements with other credit institutions, both public and private.

Another option is for the foundations to put their energy into strengthening existing credit institutions. Here, the foundations identify those credit and loan institutions with the highest potential to offer an effective service to borrowers and provide them with the technical and financial support they require. As part of their technical support they can link those institutions to other sources of finance and expertise. In some cases they also support increasing the availability and improved quality of small-enterprise management training in existing educational institutions, corporations and NGOs.

Example 1 The Direct Provision of Venture Capital, Technical Assistance and Credit

Esquel Ecuador Foundation

The Community Economic and Social Development Program

In 1994, the Esquel Ecuador Foundation (FEE) initiated a new program to support economic and social development at the community level. Staff was concerned at the rapidly deteriorating economic situation in the country (particularly high interest rates and a lack of access to credit) and saw a need to develop innovative approaches to build sustainable livelihoods. FEE's Community Economic and Social Development Program (PROCESO), incorporated venture capital, technical assistance for small-scale producers and credit. The Foundation planned for this new non-grant program to complement its grant programs and help it achieve its mission to improve the quality of life of the lowest income groups in Ecuador.

It took approximately two years to design the program and negotiate grant support from the Inter-American Development Bank (IDB). Negotiations started in 1992 and the agreement with IDB was signed in December 1994. Funds were received in June 1995.

The program gave preference to small enterprises benefiting women, youth, indigenous groups, civil society organizations and non-governmental organizations.

It also gave preference to those enterprises that could demonstrate clear potential financial profitability and did not have a negative impact on the environment.

Venture Capital

A portion of the grant funds from IDB were set aside for FEE to invest as venture capital in small enterprises. FEE was limited to investing up to a maximum of 40% of the total share value in each enterprise. The program provided for FEE to sell its shares, once the enterprise was profitable, offering first choice to existing shareholders. According to the guidelines the enterprise would make the decision on when to buy the FEE shares and could do it progressively. It was envisaged that FEE would recover its share capital within four years and have it available for investment in other companies.

To apply for capital, an enterprise had to present a feasibility study. This feasibility study needed to include a detailed business plan, information on existing debts, environmental and social impact analyses (including proof that the business paid employees at least minimum wage and adhered to all other requirements established in national labor legislation). PROCESO staff and consultants analyzed the feasibility studies, requesting additional information where needed. If the analysis was positive and the enterprise considered a good investment, a recommendation would be made first to a Technical Committee of the Foundation. If they approved the investment plan it would be submitted to the Board of Esquel for final approval. A legal contract would then be signed stating, amongst other stipulations, that FEE would not participate in the management of the enterprise.

Use of venture capital has been a learning process for FEE. Staff learned it is difficult to create profitable community-level enterprises only using the venture capital mechanism and have become more proactive in generating more viable investments. Also expectations for returns on investments have had to be scaled down. Nevertheless, the program has demonstrated a significant demand for venture capital. As a next step, FEE is exploring the creation of a social venture capital company, independent of the foundation and in partnership with other investors that can provide an ongoing service and generate income for FEE's ongoing nonprofit activities. Such an option will clearly depend on the general state of the economy and the existence of a legal and tax framework that permitted such an option.

Some specific lessons FEE has learned to date from applying the venture capital mechanism are:

- It was unrealistic to think that start-up enterprises managed by community groups could become viable recipients of venture capital investment or that viable enterprises would be identified through NGO networks. The investment of time and money in providing advice to community organizations throughout the country in the preparation of pre-feasibility and feasibility studies produced few results. Most groups did not realize they had to invest at least $15,000 themselves.
- Venture capital succeeded where the program sought out existing enterprises that already had strong managerial capacity and potential and were able to prepare good business plans. These constituted the majority of the 80 percent of the enterprises receiving venture capital

that survived (as opposed to two of the four created by community groups that failed).

- There was a realization that in a number of cases investment in excess of the limit would be required in order to develop a viable enterprise. In response the investment limit was increased from $50,000 to $150,000 in February 1998.
- Staff found that it was necessary to visit enterprises at least once every three months and be available for consultation at any time if difficulties or problems arise.
- Staff felt that in most cases four years is too short a time for enterprises to achieve profitability. Therefore the target of selling all shares after four years is probably unrealistic.[51]

Training and Technical Assistance

Program funds were set aside for FEE to offer training and technical assistance in enterprise development for small and medium businesses. This service was initially provided free by FEE consultants.

By 1998, PROCESO had trained 23,000 people over three years in the fields of:

- Management and administration of businesses (group enterprises and individual small and medium enterprises)
- Production processes with emphasis on innovation and increase in productivity
- Marketing
- Institutional development for technical support organizations and participating social organizations[52]

Workshops were given to groups of enterprises on subjects such as cost control and specially tailored advice given to address specific needs. In addition technical advice was given to potential applicants on how to prepare pre-feasibility and feasibility studies. An evaluation conducted in 1998 showed that 90.2% of participants had applied the knowledge acquired in their business activities; that 67.2% had become more competitive; and that 62% had increased their production, had improved the quality of their services and at the same time, raised their income and created more jobs.[53]

In addition to this general training program, PROCESO provided "technical assistance in 93 specialized events to 14 enterprises receiving venture capital."[54]

FEE believes its training and technical assistance in terms of numbers reached and response was successful. One challenge it believes, however, is to make its program more demand driven.

> It was not effective to provide technical assistance to enterprises free of charge. It should be provided on demand and be paid for. Experience has shown that enterprises attach more value to technical assistance and training they have contracted to meet specific needs. They see it as an investment. There is increasing realization that the role of FEE is to help the enterprises obtain the support and staff they need to increase their capacity. [55]

Credit

Faced with the option of directly managing a credit program or partnering with an established credit institution, FEE opted for the latter. A special fund for small enterprises was created within the Banco del Pacifico, a well-established bank with a community development department and experience in providing credit to small enterprises, both urban and rural. The PROCESO funds have leveraged Banco del Pacifico loans on an approximate 1:1 basis. Under the agreement, the Bank agreed to provide technical assistance to credit recipients.

Overall, the results of the credit program have been successful. Over 600 loans were given in the first half of 1998 alone. FEE believes it was a wise decision to delegate it to a Bank with experience in handling loans. One significant change that it made is to modify guidelines to permit enterprises with existing debt to apply, provided the feasibility study could show that future cash flows would permit the repayment of the debt.

FEE's Overall Evaluation of PROCESO

The program outlined above has evolved in the light of experience and, as FEE was learning as it went along, it needed to modify guidelines a number of times. The experience in developing the PROCESO program shows that a foundation can stimulate increased income and employment at the community level but it will need access to business acumen and partners within the private sector. FEE felt it was important to build in a learning component into the overall program, provide for external evaluation (carried out by a private auditing company), and be ready to redesign and modify the effort as it went along.

Staff now believe that the three elements of the program (venture capital, technical assistance and credit) could have been better integrated in practice. For example, they believe, credit and technical assistance should have been provided to enterprises with the potential to become recipients of venture capital at a later stage of development. The credit program could have served, thus, as a nursery for the venture capital program. [56]

Example 2

Strengthening Existing Organizations that Support Micro-, Small and Medium Enterprises

Corona Foundation (Colombia)

One of the main programs of the Corona Foundation, a corporate foundation created in 1963, is to strengthen micro-, small and medium enterprises. From 1990 to 1995 this program comprised almost 24 percent of the Foundation's grant budget. The reason for selecting this as a priority area lies in the Foundation's belief that the development of this sector is the "only way of ensuring a stable and harmonious democratic society that generates opportunities and resources for all."[57] A feasibility report preparedfor Corona examined the state of the sector and pointed out that almost 90 percent of Colombia's million enterprises were either microenterprises or small or medium enterprises, 99 percent of which had less than 50 employees. This sector generated two-thirds of the total jobs in the country. The report suggested some of the main problems of the sector were low productivity, low wages and lack of competitiveness.

In response to these problems, Corona identified three program thrusts for its business development program:

- Promotion of an entrepreneurial spirit especially amongst youth
- Support for business management development, especially for microenterprises with 1-10 employees
- Support for technological innovation with emphasis on small enterprises with less than 50 employees

These three sub-programs were intended to be mutually supportive. The method selected for pursuing each was as follows:

- Grants were made to support business education programs in public schools, and business skills programs in universities, distance education institutes and specialized operating foundations and corporations.
- Until 1998, the Foundation managed its own Business Development Fund that provided a training course in micro-enterprise management to individual entrepreneurs and helped them to negotiate credit with financial intermediaries. However, this program was phased out because Corona preferred to support other organizations to provide this specialized training and technical assistance.
- The Foundation invested in a credit institution that provides credit to microenterprises. It also helped to strengthen other existing credit programs through its support for and participation in the National Association of Foundations and Corporations for Micro-enterprise Development. Finally it provided a grant to support the evaluation of the government's National Micro-enterprise Plan, financed principally by the Inter-American Development Bank, by the independent Center for Economic Development Studies.
- The Foundation gave grants to support organizations that work to facilitate the incorporation of technological innovations by small enterprises.

As a grantmaking foundation, the Corona Foundation has taken a different approach to that of foundations such as FEE and FSSI that directly manage credit programs. Taking into account the fact that in Colombia over 100 foundations, universities and labor unions directly operate and co-finance decentralized programs in support of microenterprises,[58] it decided to focus its efforts on increasing the effectiveness of existing programs and service institutions.

As Program Director William Cartier and Executive Director Francisco Carvajalino suggest:

> Because of their autonomy, patience, persistence and regional and local roots [foundations] have the potential to build partnerships between different actors. The challenge is not only to provide technical support for new policies and programs [supporting microenterprises], but also to build "social capital" to enable innovative programs, that are sustainable and of high impact, to be implemented.[59]

Example 3

Prioritizing Non-Grant Financial Instruments

Foundation for Sustainable Society, Inc. (The Philippines)

The Foundation for Sustainable Society. Inc. (FSSI) seeks to "serve as a resource institution for the economic empowerment of organized marginal rural and urban communities in the Philippines.[60] Its main program in pursuit of this mission, is the provision of financial assistance to rural social enterprises (enterprises owned and run by local community members). The program is carried out in partnership with other governmental and non-governmental organizations. The Foundation, which describes itself as an "NGO-Managed Non-Stock, nonprofit Corporation," offers financial instruments such as loans, grants, equity and special deposits to NGOs, people's organizations and micro- and small entrepreneurs engaged in sustainable enterprises.[61]

FSSI uses major networks of NGOs, cooperatives and peoples' organizations to disseminate information on its services and invite requests for support. Applications are screened and appraised by both staff and consultants, who undertake site visits. The main criteria used in the selection process are community coverage (number of beneficiaries), ecological soundness, and economic viability. In approving projects, the Foundation also attempts to obtain a good spread both in terms of geography and ecological zone.[62]

Evaluation of the Program

The program has been operating for two years. According to FSSI Executive Director Eugenio Gonzalez, the learning to date is that:

- The micro-loan guarantee schemes have been very effective. They allow the foundation to leverage additional funds for micro and small entrepreneurs from other sources. The foundation selects as service providers banks with a proven track record in micro-lending, high repayment rates, innovative approaches and sound finances.
- It is difficult to identify candidates for equity investment. Less than 2% of funds disbursed were for equity investment. Almost 50% went to credit and almost 25% to loan guarantees.
- Particularly at a time of economic crisis such as that prevailing in Asia, FSSI has seen it critical to be prudent in the selection of partners, monitor projects closely, develop risk-sharing arrangements, provide grants for capacity building and generate additional resources.
- The Foundation has become aware of the need to be more proactive in developing plans for supporting existing enterprises or developing new businesses that produce positive ecological benefits. With increased consumer concern for environmental protection these are seen to have strong commercial potential. Examples are businesses producing natural fertilizer and coconut by-products.
- Community-based or social organization-based enterprises often lack essential business skills. FSSI is trying to partner community enterprises with successful local entrepreneurs who have a social commitment to address these needs.[63]

References

[51] Conversation with Andrea Simpson, PROCESO staff, November 1998.

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[54] *Ibid*.

[55] Conversation with Simpson, *op cit*.

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[57] Corona Foundation. Annual report. 1996.

[58] *Ibid*.

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[60] Foundation for a Sustainable Society, Inc. Operations manual. 1995.

[61] Taken from presentation by Eugene Gonzalez, Executive Director of FSSI. 1998.

[62] FSSI. Foundation brochure. 1995.

[63] Interview with Eugene Gonzalez. 1998.