Within recent times, the government of Trinidad-Tobago has begun anew to promote and actively encourage entrepreneurial attitudes and small-scale enterprises (SSEs) as a matter of deliberate public policy. The fact that many multilateral financial institutions, international aid donors and NGDOs (non-governmental development organizations) are prepared to make funds available for this purpose no doubt contributes to this recent upsurge in the popularity of the small business sector.

Small and micro-enterprises are promoted because they are said to present a range of self-employment opportunities with scope for significant backward linkages with the agricultural and basic goods sectors. They are labour intensive, viz. there is a low capital/labour ratio. Creating one job in the small business sector costs a mere fraction of what it costs to create a job in the large-scale sector. Small firms are likely to be substantially less import-dependent than their larger counterparts, making constructive use of local raw materials and traditional skills. In fact, products from the small-scale sector can contribute to export earnings while at the same time conserving foreign exchange. Moreover, small producers can supply cheaper goods to the domestic consumer, which is important when real incomes are falling. Increased incomes among small entrepreneurs will stimulate domestic demand for a wide range of goods and services, thereby contributing to the increased pace of economic activity. It is for these reasons that governments seek to implement small business promotion policies.

For decision-makers concerned with the promotion of small businesses, providing the financial resources needed to start up firms and keep them going is an important issue. Finance is arguably THE KEY ISSUE in small business development. Financial support for the sector may be supplied through the employment of a variety of policy instruments. Ultimately, the objective is to channel a greater share of scarce resources to small entrepreneurs with viable and bankable projects. Yet, by and large, there is a fair consensus that the single greatest hurdle facing the small entrepreneur is access to capital.

That financial resources and their efficient allocation generally present a problem for policy-makers is undeniable. Money is a problem whether it is in short supply, whether it exists in adequate quantities, and perhaps especially when it is in abundance. Capital is not equally available to everyone in society. Some enjoy privileged access to institutional credit, either because of government policy or because of long-standing relationships with commercial banks. Large firms tend to have a decided advantage in this regard. Anderson (1982), for example, points to "the exceedingly unequal ways in which industrialization and financial policies have favoured large scale in most developing countries"; while FitzGerald (1989) argues that obtaining investment funds is easier for large rather than small-scale enterprises since larger enterprises and conglomerates have closer contacts with bank managers and directors. According to FitzGerald:
Preferential access to funds is not the result of financial repression, but of a perfectly rational capitalist accumulation strategy on the part of large-scale enterprises.

There is an impressive humanist argument which views credit as a human right which creates entitlement to resources. The more credit one can receive, the more resources one can command and the more powerful one is. Credit equips a dispossessed person to give fight against the economic odds around him. According to this viewpoint, there is nothing in the nature of credit that keeps it away from the poor (see Yunus, 1988).

This paper attempts to address the issue of small business financing in Trinidad-Tobago. In particular, it seeks to establish the existence of an “access problem” and examines the problem in a way that the “blockage points” are revealed more sharply. It assesses the effectiveness and efficiency of policy instruments adopted since the declaration of Small Business Year in 1970 to funnel increased financial resources into the sector. Two approaches are identified and discussed: the programme approach and the financial market approach. The paper is concerned to show not only that the demand for finance exists, but that the more critical policy challenge is to find the most effective channel(s) of supply given the government’s stated objective of bringing about “the widest possible public participation in business enterprise.”

Financial Development, Economic Development and the Small Business Sector

The role of finance and the financial system in economic development is of paramount importance. Gurley, Shaw and Goldsmith, among others, have long ago pointed to the intimate relationship between financial development - usually considered in terms of enhanced financial intermediation - and economic development. They argue that financial development contributes to the process of capital accumulation and, by extension, economic growth as it facilitates the transfer of resources from capital-rich to capital-short sectors of the domestic economy. Resources are directed into sectors, normally expected to be the high-productivity sectors, where the return is likely to be highest. The importance of finance to enterprise growth is underscored by Jackelen (1988), who observes that:

While capital is not the only factor that allows for the growth or creation of enterprises, it is the most vital as without its creativity, drive and innovation cannot be transformed into material actions.

The function of the financial system is to collect the savings of surplus units and to allocate funds to deficit units. This is what is meant by financial intermediation. It is claimed that financial development in the form of enhanced financial intermediation stimulates growth because it separates savers from investors, thereby allowing funds to be shifted to people with superior investment opportunities. One critical assumption is that financial institutions or intermediaries will allocate resources carefully, according to the anticipated profitability of projects.

Another aspect of financial development implicit in the theoretical arguments is that it changes the allocation of funds away from own-investments and informal credit markets towards official, formal sector financial institutions. For developing countries, this typically means the removal of funds away from own-investments (primarily in small firms or low-yield agriculture) and the unregulated money market (which may finance consumption as well as small firms), which funds are then assigned to banks and used largely to finance bigger, formal sector firms predominantly in urban areas. Financial development is thus likely to make more funds available for industrial finance, albeit mostly for large-scale producers.

Industrial finance ought to be of major concern to development planners, both in the broad sense of financing the overall industrial effort and in the more narrow objective of locating the resources to facilitate the creation and/or expansion of the industrial corporation. Firms require two types of financing. The first requirement is for investment or fixed capital which is long-term in nature and is used for the purpose of installing productive capacity (i.e. plant and equipment). Secondly, firms require working capital which is short-term in nature and is
necessary to finance the production and distribution cycles. Both needs can be satisfied from a variety of sources: owner’s capital (such as equity shares or retained savings), bank loans, traders’ credit, or unorganized, informal money markets.

Mainstream finance theory suggests that long-term assets (i.e. investment capital) should be financed using long-term debt or owner’s capital, while short-term assets are to be financed with short-term capital. As Kitchen (1986) points out:

A general principle of finance is to match the maturity of assets and liabilities. Thus it is desirable to finance long-term assets with long-term financing, whether it be long-term debt or equity (which in principle is indefinite). The corollary of the general principle is that short-term assets (current assets or working capital) can, and generally should be financed with short-term funds.

Unfortunately, in many developing countries it is not always possible to match long-term assets and debt. This is so in part because the commercial banking sector has traditionally avoided long-term debt financing and risk-taking. They have generally tended to be financiers of trade rather than financiers of industry, as commercial credit is usually short-term in nature. As a consequence, gearing ratios tend to be fairly high, particularly in small and medium-size industrial enterprises.

The difficulty of matching long-term assets and liabilities in developing countries is compounded by chronic shortages of financial resources and by the narrowness and imperfection of capital markets. It is this latter point which leads Meyer (1988) to write that:

...a sound financial system is necessary for economic development. The development challenge is to create a competitive, viable financial market in which entrepreneurs of all income levels with appropriate projects will find loans, and all entrepreneurs and households will find suppliers for their checking, deposit and savings needs.

In the context of Trinidad-Tobago in 1970, there was no “sound financial system” which could be relied upon to mobilize savings for investment in manufacturing enterprises of whatever size, large or small. The financial landscape was dominated by foreign banks which extended loans and advances primarily to finance trade, as evidenced by the fact that the commercial houses made up the greater part of their corporate clientele. From 1970 onwards, the government sought to exert greater local control over the financial sector through a policy of localization and the establishment of indigenous commercial banks, but the behaviour of the banking sector still reveals an insuperable aversion to high-risk ventures. Small firms especially continue to have a problem of access to adequate supplies of capital.

The “Access Problem”

Studies done on the role of lending institutions, and especially commercial banks, in providing capital to the corporate sector reveal the relative unavailability of long-term debt or ‘seed’ capital to start up business enterprises. Farrell et al (1983), in a study of corporate financing and business use of bank credit in Trinidad-Tobago, use survey data to show that most firms have access to some form of bank credit, mainly by way of overdraft facilities. Overdraft borrowing is used primarily for stock purchase and other working capital requirements in most firms; it is not expected that overdrafts will be employed to any great extent in the financing of fixed assets. Nonetheless, 31 percent of the firms included in the sample had used overdraft borrowing to finance some portion of capital investment. Thus not all firms are able to gain access to long-term capital when necessary, and so are unable to match asset and liability maturity.

Mortgage loans and other longer-term bank borrowing were not found to be significant for most firms; fixed investment has usually been financed by internally-generated funds, though external financing was found to be important in a few cases. Also worth noting is that 49 percent of the firms sampled had capital projects either deferred, scaled down or completely abandoned due to inadequate collateral support, unavailability of finance or the high cost of credit.
Farrell et al. conclude that, generally speaking, bank financing has been relatively insignificant in the overall financing of firms, and particularly small firms. Their evidence suggests that such credit as is obtained is used for specific purposes which other forms of financing may be unable to adequately cover. Availability of finance also appears to be more important than its cost to most firms, though other factors such as market size, management and technical capabilities also bear significantly on the scale of operations.

Henry's (1990) findings seem to support the case advanced by Farrell et al (1983). He acknowledges that long-term debt or 'seed' capital is an indispensable requirement for establishing a business. Of the firms included in his survey, 34 percent had received start-up capital from friends and relatives; 52 percent used debt capital obtained from commercial banks. Other sources of capital included government programmes and "social capital", the latter referring to resources of the social group, loans from church and other organizations (e.g. credit unions), as well as the informal credit market.

Henry's conclusion is that there is a shortage of long-term 'seed' capital while working capital is easier to come by. This constitutes a serious barrier to an effective small business development strategy. From the study, it is obvious that small firms must tap multiple sources of finance, so that debt capital to start up an enterprise is often made up a combination of loans from friends and relatives, and one or more other source(s).

The I.S.E.R. studies conducted under the auspices of the 'Future of the Caribbean Project' reveal a similar pattern. (cf. Ryan, and Barclay, 1992; Ramsaran, 1993). Out of a total of 168 small firms included in the sample, 36 percent identified capital as the major hurdle in setting up a business. Some 41 percent of respondents got start-up capital from commercial banks; 26 percent used personal savings; 23 percent were assisted by family members; and 11 percent used "other sources". Personal savings could include severance payments, sou-sou "hands" or spouse's savings. Some even organized public dances (fêtes) to raise the necessary capital.

Interestingly, Afro-Trinidadian and East Indian respondents complained more than other ethnic groups about access to start-up capital. Many had difficulty in securing loans, and where they did, the amount of the loan was inadequate. Afro-Trinidadians also depended least on the commercial banks for working capital requirements and tended to use profits and accumulated savings to keep their businesses going. Others used the banks for working capital, principally through overdraft facilities. Thus Ramsaran (1993) writes:

> It seems, therefore, that once the business is established, obtaining capital becomes less of a difficulty since the commercial banks tend to make funds available to keep the business running.

Barring methodological and definitional differences, the findings of the 3 studies referred to above would seem to indicate that the problem of small firms is access to long-term debt or 'seed' capital for starting up the business. This initial capitalization is applied to the purchase of plant and equipment and is therefore quite essential, for without it there is no business. Banks appear unwilling to grant long-term loans to finance capital investment. On the other hand, it seems that credit is available to existing small firms mainly in the form of overdraft facilities which are used for working capital requirements. These funds are short-term in nature and relatively expensive, interest being charged by the day against the outstanding balance. Problems arise when short-term capital is applied to long-term investments, resulting in firms being too highly geared.

If we accept that small firms have difficulty getting debt or 'seed' capital out of commercial banks, then we must also accept that there is an "access problem". For although commercial banks are only one of an array of financial institutions in the financial system, they are a dominant force in the system. According to Bourne (1988c):
Commercial banks are the pivot of the Trinidad-Tobago financial system. Apart from being the largest established formal financial institutions, their provision of financial services extends to the widest range of economic activities, economic transactions, and geographical areas. As a group, commercial banks account for more than one-half of financial asset holdings of the non-financial liabilities. Although subject to the regulatory control of the Central Bank, the sheer dominance of their size creates a countervailing power, making the regulatory authorities responsive to the banks' perceptions of their own needs.

Bourne also illustrates statistically that commercial banks are the main source of loans and advances in the financial system, accounting for 77 percent of total loans and advances in 1984 (Bourne, 1988a). Moreover, they are the major source of credit to the local corporate sector (Bourne, 1988b).

Indeed, commercial banks have quite a decentralized network of branches throughout the country (118 offices in 1989), provide the safest depository for savings, accounting for the largest share of savings in the financial system (80 percent in 1991); and are the main source of loans (80.7 percent in 1991). In terms of the latter, the private sector has consistently received the largest allocation, on average about 50 percent. Of the total of all loans to the private sector between 1980 and 1992, 3 activities - manufacturing, construction and distributive trades - on average accounted for some 64 percent.

Sectoral demand for credit depends not only on the deposit capacity of the banking system, but also on the cost of credit to the borrower. This refers to both interest rates and attendant loan charges. Bourne (1988c) has shown that loan rates have been uniform among banks and fairly high throughout the late seventies and eighties. He argues that price uniformity implies either collusion or some kind of price leadership, and suggests that because of the oligopolistic nature of banking in Trinidad-Tobago there is a tendency towards collusive loan pricing.

High interest rates have worked to the advantage of large firms over small ones. Banking is one sector in which scale economies apply absolutely, as there is a minimum sum below which cost covering charges are no longer attainable. From a lender's viewpoint, the cost of a loan is composed of the interest paid on the sources of funds, the costs of appraisal and screening as well as loan administration, and a provision for credit risks. Regardless of the size of a loan, these costs, and especially the cost of project appraisal, are more or less constant, with the result that for smaller enterprises requiring relatively small loans, there are higher costs per dollar loaned. UNIDO (1989) estimated that the costs of administering small loans are approximately 2.6 - 2.7 percent of the total costs of the loan, compared with 0.3 - 0.5 percent for larger loans.

Project appraisal costs in particular serve to drive up interest rates on loans to small firms. At the heart of loan appraisal costs is the cost of collecting information. Because less is known about some borrowers and about some sectors, and because more needs to be known about unfamiliar or particularly risky proposals, appraisal costs differ sectorally according to the sectoral distributions of prior and required knowledge. In addition, if delinquency rates differ by sector, then so too will collection costs (Bourne, 1988c). The end result is that the price of bank credit to small firms is beyond their capabilities.

Kitchen (1986) emphasizes the unprofitability of small loans for commercial banks, using the example of a bank which lends $1000 to a small firm with a 5 percent margin between its borrowing and lending rates to demonstrate his point. The loan will yield a return of $50 per annum which is "less than the cost of one man-day of professional employee's time, yet has to cover the cost and time of visits, and the cost and time of recording-keeping, even assuming that no difficulties arise with the loan." Jackelen (1988) rationalizes this by arguing that formal sector financial institutions are designed to handle much larger individual transactions than those required by small firms; the overheads of even the most efficient bank make this type of lending prohibitively expensive and it cannot be compensated for by adequate spreads over the cost of funds.
Quite apart from high interest rates, small firms' access to capital is blocked at other points. Unaccustomed to dealing with banks beyond the bounds of perhaps a savings account, with little or no experience in preparing project proposals and loan applications, and possibly even intimidated by the very atmosphere of a bank, small entrepreneurs have great difficulty in fulfilling the banks' requirements. Interviews and informal discussions held with credit personnel at two of the largest banks in Trinidad-Tobago in 1990 revealed that the most common problem is the paucity of the project proposals submitted by applicants. These are often unable to stand up to even the most cursory scrutiny of loan officers.

Another problem has to do with the financial management and accounting practices employed by small businessmen, who previously had to satisfy no one but themselves in this regard. Bank officials complain that small businessmen are unable to perform what they consider the most elementary accounting exercises, such as simple profit-and-loss accounts, flow-of-funds analyses and forecasts. Thus small entrepreneurs cannot supply adequate information to the banks' loan appraisal staff to enable them to form an accurate opinion of the financial position of their firms. A further complication arises because of the failure to distinguish between the activities and assets of the firm and those of the entrepreneur and his family.

The lack of managerial expertise is really a sore point with the banks. Small entrepreneurs may be skilful technicians, craftsmen and artisans, but few have managerial know-how which would inspire confidence among bankers. Absence of a satisfactory track record of managerial competence and business success easily qualifies the venture as a high-risk undertaking, and disqualifies it for bank credit. This is likely to be a greater hurdle for newcomers who are approaching the bank for a first loan rather than for entrepreneurs who are already known to the bank.

This question of risk is critical. It is because of the perception that small firms are more likely to fail that banks are reluctant to deal with them. As I indicated earlier, commercial banking in Trinidad-Tobago has historically been allied to trade, not industry. Risk avoidance was always the hallmark of the local, conservative banking community.

There is no doubt that the mortality rate for small firms is high. Levitsky (1989) accepts that "there are real risks in lending to SSEs, not because borrowers are inherently dishonest but because of the instability and high mortality of SSEs." But this merely begs the question. Why is the small-scale sector characterized by instability and high failure rates? One plausible reason could very well be the problem of access to capital. In other words, because small firms have unreliable access to financial assistance, they may be more prone to collapse; but because they are more prone to collapse, their access to capital is blocked.

As a consequence of the perception of greater risk, the collateral requirements are exceptionally high. The I.S.E.R. studies, for example, confirmed my own earlier finding that excessive collateral is demanded, sometimes as much as 100 percent of the loan amount (cf. Ryan and Barclay, 1992). However, self-employed or potentially self-employed people in the neediest category are seldom able to provide the type of security most preferred by banks, usually real estate, and may not have accumulated savings equal to the amount of the loan. In fact, small entrepreneurs of this category most often go to the bank with nothing but an idea.

The perception of high risks combined with disproportionate transaction costs also causes the banks to invent, as it were, a number of punitive charges which must be met by the borrower. These charges have as their net effect further increases in the cost of capital, as Levitsky (1989) points out:

It is not surprising that even where commercial banks are prepared to lend to small enterprises, they aim to cover the high transaction costs through special payments for loan applications, additional commissions, compensating deposits, collection of interest in advance, all of which is more a way of raising the effective rate of interest to cover high transaction costs than to cover the higher risk perceived in such lending.
Clearly, some of the problems identified above spring from the misconceptions and misunderstanding of the banks. Small entrepreneurs believe that it is the credit officers who are at fault, arguing that they are insensitive to the needs of small firms. This may be true, and recently one notices that there are orientation seminars for credit personnel from the commercial banks and other financial institutions aimed at breaking down the myths and creating a sense of sympathy and understanding for the peculiar problems and needs of small firms. What is necessary is a mechanism which introduces bank officials to small entrepreneurs and their world; officials need to be aware of the special characteristics, psychology, experience and profile of small businessmen, which is entirely different from that of big businessmen. Indeed, the banks’ appraisal procedures should be designed to take greater account of the “quality” of the small entrepreneur.

But to lay the blame solely at the feet of the credit personnel is surely a mistake, for they are merely “cogs in a wheel” within the banking system. The more serious problem pertains to the preferential access enjoyed by a privileged elite to bank credit. The banks in Trinidad and Tobago have special, carefully nurtured and cherished relationships with large-scale industrial and commercial enterprises, and especially the conglomerates. Directors of the major companies listed on the stock exchange, for instance, also sit on the boards of the banks, forming an unbreakable network of interlocking directorates. These companies perforce have preferential access to capital. Moreover, the directors and upper-level executives of the banks share a common background with their counterparts in industry: old boys’ networks, masonic lodges, clubs such as the Queen’s Park Cricket Club, the Country Club and Union Club, associations such as the Chamber of Commerce. Finally, they are bonded by family, kinship and ethnic ties. Here I am inclined to agree with Schmitz (1982) when he poses the following question:

The main question here is whether the higher interest rates paid by the small producers and their difficulties in gaining access to credit merely reflect an underlying reality of unstable and risky conditions of production (and hence repayment defaults) or whether they are due to distortions in the views and practices of those in charge of the credit institutions. (Emphasis mine).

Access to long-term ‘seed’ capital is therefore a genuine problem for the small-scale entrepreneur, and for a variety of reasons. Access is blocked by privileged elites in the large-scale sector who “squeeze out” the smaller firms. The perception of greater risk in lending to small firms motivates the commercial banks to introduce unreasonable collateral requirements and high interest rates. In policy terms, the problem has accordingly been defined as a problem of access to cheap capital. The programme approach which forms the basis of the discussion in the following section, is premised on the assumption that providing long-term capital to small-scale enterprises at concessionary rates of interest is the best way of fostering a vibrant small-scale sector.

The Programme Approach

Where private lending institutions such as commercial banks prove unreliable, the typical response has been to set up special windows at state-owned banks or, alternatively, to establish development banks and other institutions exclusively to provide financial support to small firms. In the literature as well as in practice, the term “development bank” is commonly used to refer to investment banks for the financing of private projects which deserve to be promoted on general economic grounds. Their task is usually to provide medium- and long-term funds; other bank transactions, especially of a short-term nature, and debit business, are not normally offered. Complementary consultative functions such as management and marketing guidance and technical assistance are often offered as part of an integrated package of assistance.

Programmes of this type service a specific target population consisting of those sectors and categories - geographically or sectorally determined - which are deemed to be important to the overall development strategy, but which lack adequate alternative sources of capital. Financing is offered in suitable forms to borrowers whose credit standing or credit worthiness does not meet conventional banking criteria or
who, for one reason or another, are denied access to the formal credit market. Thus:

...development banks apply a major part of their potential capacity for the performance of banking functions to the aim of narrowing down the qualitative gap between the latest demand for banking services and the supply of such services by the rest of the banking system.... (Jonas, 1975).

In Trinidad-Tobago, the instrument adopted to pursue the policy objective of creating a “People’s Sector” was a programme of assistance to small firms based upon a triad of institutions, namely the Industrial Development Corporation (IDC), the Development Finance Company (DFC) and the Agricultural Development Bank (ADB).

Bourne (1991) discusses the performance of DFCs not only in Trinidad-Tobago but in the CARICOM area generally. The ADB is more thoroughly examined by Crawford (1984). In this paper my primary focus will be on the IDC. My decision to focus largely on the IDC’s programme of support and financial assistance stems from the fact that (a) it was the main instrument of the triad to deal with small firms, and (b) its target population or beneficiaries was intended to be the very smallest (and poorest) of entrepreneurs.

The Industrial Development Corporation

The IDC, originally established in the 1950s when the Lewis model was very much in vogue, was to facilitate industrial development in the widest sense. Its task was envisaged in terms of providing industrial infrastructure - factory shells on industrial estates - and financial assistance to fledgling industrial enterprises, both foreign and local. It was to offer guidance through the bureaucratic maze and was expected to play a particularly important role in the introduction of pioneer industries. From 1970 when Small Business Year was declared, the IDC’s mission also included the provision of long-term finance of up to $50,000 (later increased to $150,000) to small-scale enterprises and a special Small Business Unit was set up within the IDC in accordance with a Cabinet directive. This unit was responsible for the implementation of the programme from 1970 to 1989, at which time a new Small Business Development Company (S.B.D.C.) was established.

With the formation of the Small Business Unit came the first meaningful attempt to define a small business. As a rule of thumb, business units whose capital investment did not exceed $50,000, represented by land, buildings, leasehold property, machinery, plant and equipment, stock-in-trade, work-in-progress and, in some special cases, furniture, were to be considered small businesses and could accordingly qualify for loans under the programme. Highly innovative and “desirable” enterprises with a maximum capitalization of $100,000 could qualify if it was demonstrated that they had tremendous growth potential and could generate substantial employment.

Over a period of nearly 20 years, the sum total of money loaned (principal) by the IDC’s Small Business Unit was $124,869,882, an average of $6.57 million per annum. Of this, some $62,330,247 (approx. 50 percent) was repaid by the time the programme was discontinued in 1989. The value of the loan portfolio in that year was $70,037,612. As at October 31st, 1989, the total number of customers comprising the loan portfolio was 2,053, of whom 1,948 or 94 percent were in arrears. In fact, of a total of 3,980 loans approved over the period under review, only 403 were ever repaid on time.

Regionally, loans tended to be concentrated in the major urban population centres, namely Port of Spain and San Fernando. The rapidly expanding population centre of Caroni, which includes the town (now borough) of Chaguanas and many new housing settlements, received the third highest number of loans. Together, these 3 areas accounted for roughly 78 percent of all IDC loans for small business development. Not surprisingly, an extremely small number of loans went to enterprises in non-urban counties and to Tobago, which always considered itself to have been excluded from the oil boom largesse of the ’70s and early ’80s. Nevertheless, Tobagonian firms received 394 loans in all, 9.8 percent of the total, and it is not unfair to comment that Tobago, with a population of roughly 40,000 makes up about 3 percent of the
national total, so that it could be argued that the smaller island did in fact receive far more than its proportionate share of IDC credit.

What can we infer from all this? These figures suggest that the IDC’s programme of support and assistance to small-scale enterprises loaned a not insignificant amount of capital to a fairly reasonable number of small entrepreneurs spread over Trinidad-Tobago, but with a tendency to concentrate on urban population centres. Several sectors benefitted from IDC loans, though the amorphous category ‘Business and Personal’ received alarmingly high allocations. (Alarmingly high because one assumes that all loans were business loans and none were personal!)

Nevertheless, the programme appears to have been ineffective. Too many of the 977 small enterprises listed in the IDC’s Register of Small Business (1980) were either non-existent or existed in name only by 1989. It is clear that some were merely shadow companies set up in order to secure loans; others had simply run into difficulties and failed. The vibrant “People’s Sector”, so earnestly promoted in 1970, had not become a reality by 1989. To quote from a policy document of 1989:

Attempts were made in the past to widen participation in business enterprise. These took the form, inter alia, of small business promotion units which were established at the Industrial Development Corporation, the Development Finance Company, and the Agricultural Development Bank.... However, with little exception, it can be said that these attempts have not met with the success that was initially anticipated. (G.O.T.T., 1989)

In the following section, I mention the more salient causes for the ineffectiveness of the IDC’s small business programme.

Problems Encountered at IDC

Several reasons can be adduced for the ineffectiveness of the IDC’s programme. Among other things loans were approved and sometimes knowingly granted for purposes which were entirely unrelated to small business. Many of these were classified in the amorphous category ‘Business and Personal’, but it extended to other categories as well. During the boom years, for example, activity in the construction sector peaked and loans were approved for the purchase of trucks. Quite apart from the question of the long-term viability of such projects, transactions of this sort were undoubtedly more suited to a private commercial bank than a subsidized credit programme. Similar loans were given for the purchase of vehicles to be used as taxis.

There were numerous cases where loans were applied by their recipients to purposes other than those for which they were granted. Some loan recipients, particularly during the windfall years when the revenue position was favourable, utilized IDC funds to finance extravagant shopping trips abroad and the purchase of household appliances and consumer durables. Indeed, some even absconded permanently to the U.S.A. and Canada with loan funds. These instances point to critical weaknesses in the IDC’s credit technology as well as lack of control and proper loan supervision. Moreover, they suggest an almost total absence of evaluative safeguards, as no effort was apparently made to link disbursement of funds to performance and the achievement of predetermined targets.

The programme was not only characterized by ineffectiveness; inefficiency was also its hallmark. The use of subsidized credit seems to explain much of this. Concessionary interest rates, once seen as the ideal way to provide finance capital to small firms, had an overall negative effect on the programme. Subsidies seem to breed incompetence and complacency, in addition to inviting political intervention and corruption. Entrepreneurs were not motivated to repay their loans and little energy was spent on loan recovery. It came as no surprise, therefore, that when the IDC’s programme was wound up in 1989, 94 percent of the existing customers were in arrears.

Not unexpectedly, the development of this “dole mentality” resulted in high default rates, high mortality rates of small firms, low rates of loan recovery and continuous programme decapitalization. The programme relied almost exclusively on transfers from the state, and what were supposed to be revolving funds did not
actually revolve at all. Here, I am reminded of the following statement by Meyer (1988):

When resources are abundant, survival becomes unlinked from performance and self-evaluation is not a priority. Administration is lax, costs are not controlled, and there is relative indifference to loan recovery.

The debate over interest rates figures prominently throughout the literature on SSE credit policy, as it does in the literature on rural and agricultural credit programmes. At issue is whether or not the provision of subsidized credit represents a distortion in resource allocation and factor markets. The most recent trend is to move away from the earlier practice of offering concessional rates, towards the application of current real market rates of interest. Anderson (1982), for example, argues that in order to achieve an efficient allocation of resources between large and small enterprises, interest rates should not only reflect the estimated cost of lending to small firms, but also of losses incurred while the lending institution develops the screening procedures to maintain repayment discipline. Jackelen (1988) also favours commercial interest rates on the grounds that the long-run equity effect is likely to be greater:

While in a moral sense it seems extremely unfair to charge less to the rich and more to the poor, in a commercial sense it is logical and ultimately fair if it dramatically expands the access to capital in a society.

A related issue which must be mentioned is the failure of the IDC’s small business programme to link credit delivery with savings mobilization. This shortcoming was common to the DFC and the ADB as well, although there was provision for savings in the latter institution. On the other side of a loan, after all, stands a deposit, and it is myopic not to connect the two. Several writers (e.g. Seibel, 1988; Meyer, 1988; FitzGerald, 1989) have commented on this tendency for credit programmes to ignore savings as a means of internal resource mobilization, and savings habits as a psychological basis for investment and repayment behaviour. Obligatory contributions to a savings fund by small borrowers helps develop desirable attitudes of thrift and instills discipline. At the same time, it also reduces the programme’s dependence on the Treasury, if only marginally. As Meyer (1988) points out:

Low loan rates imply low rates paid on deposits; this thwarts an institution’s ability to mobilize deposits. Without deposits, a lender is dependent on donor and/or government funds.

My own view is that this failure to address the question of savings, combined with the availability of special funds at concessionary rates of interest, is at the crux of the high default and mortality rates described earlier.

“Galloping bureaucracy” also became very closely associated with the IDC programme, thereby creating a new “access problem”. Simply put, many small entrepreneurs in search of funds found the IDC’s procedures too cumbersome and drawn out. Many respondents in the I.S.E.R. studies complained that after months of filling in forms, visiting the IDC offices and answering the many questions of programme officials, they abandoned the IDC in favour of speedier (sometimes informal) alternatives. Some abandoned their projects altogether. And, as one observer commented in the press, getting a loan from the IDC was not the end of it; there were also licensing, taxation and customs requirements which involved “cross-examinations that would rival the trials of Nuremburg”.

To be fair to the IDC, it was not entirely at fault as other government departments and agencies were also responsible for other critical aspects of the programme. The Ministry of Industry and Commerce, for example, retained responsibility for licensing and other matters, while the Central Bank controlled access to foreign exchange. The net effect, however, was that small entrepreneurs were faced with mountainous red tape, bureaucratic inertia and complicated regulations which crushed and stifled their morale and their enterprises.

The system was also insensitive to costs accruing to the borrower. Often we tend to forget that the borrower is a small businessman striving to eke out a livelihood for his family. Costs accrue to him directly through expenses incurred in the preparation of documentation and transportation to and from the IDC office.
Indirectly, there is the opportunity cost of devoting time to these activities. Thus the overall cost to the borrower could be high even before there is any hint that the loan could actually be approved, let alone disbursed.

Small entrepreneurs were therefore pushed into seeking access to other sources of capital. In particular, as the study done by Farrell et al cited above showed, some were compelled to resort to using short-term bank credit in the form of overdraft funds to finance long-term investments. Others approach the traditional money-lenders for capital at usurious rates, suggesting that, contrary to the original definition of the problem, the concern of small businessmen is not only access to funds at reasonable cost, but also the speed of disbursement. If the funds can be made available in as short a time and with as little formality as possible, cost becomes almost insignificant. An incredibly large number of small businessmen also begin their operations using own or family savings.

Ultimately, over-bureaucratization has been a source of much frustration for small entrepreneurs, to the point where successful small firms, and particularly owner-operated enterprises, are often sold out to larger firms whenever the opportunity presents itself. Herein lies a great irony: concomitant with the desire to foster widespread participation in business activity, we have witnessed an increasing tendency towards conglomeration and the concentration of ownership in fewer and fewer hands.

In a peculiar sort of way, then, the IDC’s small business programme may well have reinforced one of the structural weaknesses that it was intended to address in the first place: inequitable distribution of wealth and income.

In the following section, I examine the more recent approach to small business financing. This approach, conceived within the neo-orthodox economic model, shifts the emphasis from the state-funded programme to a greater reliance on the ability of market forces to allocate risk and resources efficiently.

The Financial Market Approach

Since 1989, there has been a new approach to the problem of financing small firms. In view of the corruption, lack of control and high bureaucratic costs inherent to the state-operated and state-funded programmes, the new approach emphasizes the role of the financial market in efficient resource allocation. The model of the programme approach, in which a state-funded agency directly supplies capital at concessionary interest rates to small borrowers, has been abandoned in favour of a programme in which the commercial banks and other financial institutions are centrally involved in the provision of credit and the state merely guarantees loans to small entrepreneurs.

The shift in emphasis from programme to financial market must be seen in the context of the new economic liberalism and structural adjustment. An important element of the latter is financial liberalization and the deregulation of capital markets. It involves the removal of administrative controls on interest rates and the borrowing and lending of financial intermediaries. Usually accompanied by a fiscal package designed to increase personal and corporate savings, the ultimate goal of financial liberalization is to mobilize savings out of the informal sector through enhanced financial intermediation - including higher interest rates - and to improve efficiency in the allocation of resources for investment. In some countries, this strategy has actually led to an increase in the private savings rate, but it is doubtful whether it has altered the sectoral allocation of resources in favour of small firms (see Fitzgerald, 1989).

Institutionally, the new approach has heralded the introduction of a new implementing agency, the Small Business Development Company Ltd. (SBDC), which has assumed central responsibility for the portfolios previously administered by the IDC, DFC and ADB. Its primary objective as stated in its Memorandum of Association is “to promote and encourage business awareness with a view to the establishment and development in Trinidad and Tobago
of small businesses and micro-entrepreneurs and by extension to assist in the economic development of Trinidad and Tobago." The SBDC provides four (4) major services: business advice and extension services; entrepreneurial development and training; an information bureau for prospective entrepreneurs; and a loan guarantee plan. It is this latter function which is of immediate relevance.

**The Loan Guarantee Plan**

One of the major problems identified earlier as a barrier to small businessmen's access to long-term bank capital was the lack of adequate collateral. A loan guarantee fund is designed to address precisely that problem. It works like a sort of risk insurance in which a certain specified portion or, in some cases all, of a loan is covered by the guarantee. In the event of non-repayment or default the guarantor, in this case the government through its agent the SBDC, will undertake to repay the lender the outstanding balance of the loan. Guarantees enable lending institutions to minimize their exposure to risk and possible losses involved in extending credit to doubtful customers, and therefore serve as a substitute for collateral on loans to individuals and small firms who have no convincing track record and are otherwise denied access to bank credit. In essence, the guarantee is intended to widen access to institutional credit.

The Guarantee Plan is backed by a fund, initially targeted to reach TTS50 million. At the end of 1993 the Guarantee Fund stood at TTS19 million which has invested in government-backed securities and fixed deposits.

On the surface, the Guarantee Plan appears very simple to operate. The banks act as lenders and consider loan applications for small entrepreneurs in the same way that they would consider any other loan application. They are mandated to exercise the usual degree of care in project appraisal and screening. If an application is found to be suitable, it is passed along to the SBDC for guarantee approval which must be granted within one (1) week. Thus an attempt is made to tackle the issue of the timeliness of loan disbursement. The banks monitor the loans but report regularly on the status of each loan to the SBDC.

Under the new arrangements the term "small business" is used in a generic sense and for the purposes of the activities of the SBDC includes medium-size businesses and micro-enterprises. The overriding definition is that to qualify as a small business the entity must not possess fixed assets exceeding $1,000,000, exclusive of the value of land and buildings. For guarantee coverage, a distinction is made between new enterprises and existing ones. Small and medium-size firms already in operation for over one year are eligible for a guarantee of up to 50 percent of the amount of the loan. Loans for business start-ups or for small or micro-enterprises in operation for less than one year qualify for a maximum guarantee of 85 percent. It is assumed that existing enterprises would be in a better collateral position and able to put up the security for the remaining 50 percent of the loans. In any event, the SBDC will not guarantee to a lending institution more than $150,000 per loan, with repayment periods of between 5 and 7 years.

Interest charges on loans under this facility cannot exceed the base commercial lending rate by more than one (1) percent. The practice of using 'special' funds has not been adopted. Borrowers must also meet the legal fees of the transaction, a 1 percent charge towards defraying the administrative costs of the SBDC, and a further 0.5 percent per annum on the outstanding balance as a guarantee premium. The latter also goes to the SBDC. Apart from those mentioned here, banks are prohibited from levying any additional fees or service charges.

The success of the Guarantee Plan ultimately depends on the extent and eagerness of the banks' participation. It would be sheer folly, however, to expect traditionally conservative banks to suddenly change their attitudes towards small entrepreneurs simply because the government has put a guarantee system in place. Their initial approach to the Guarantee Plan was extremely cautious, as evidenced by the length of time which elapsed before the banks actually signed the agreement which set it up. In the end, the signatories to the agreement included all but
one of the 8 commercial banks (Citibank, the only wholly foreign bank in the country, did not sign), the Cooperative Credit Union Bank, and a finance company which is associated with the Maritime Insurance Group.

By the middle of 1993, there were 7 additional lending institutions. These included 4 Credit Unions, Fund-Aid, Association for Caribbean Transformation and the Amalgamated Finance Company.

From the inception of the Guarantee Plan in 1990 to the end of 1992, over 1200 guarantees were issued to small and micro-entrepreneurs in a range of economic activities. In 1990, there were a total of 98 guarantees issued at a value of $2.1 million. In 1991, the Plan's first full year of operations, 758 guarantees were issued at a value of $9.6 million. Unlike in 1991, however, 1992 was a year of tight liquidity in the financial system as the Central Bank sought to use monetary policy instruments to reduce the money supply.

Tight monetary policy throughout 1992 resulted in a liquidity crisis and conspired to bring about a slowing down of lending from 1991 levels. Thus in 1992, the second full year of the Guarantee Plan, there was an observable decline of about 50 percent overall in guarantee portfolio activity, with a total of just 385 guarantees being issued at a value of $5.2 million.

During the period interest rates went from 12.88 percent to 13.50 percent and then to 14.50 percent in 1991 alone. In 1992, the basic prime rate moved from 14.50 to 15.50 percent. Lending by the financial system taken as a whole declined considerably in 1992, and it is not surprising that funds flowing to small firms decreased. Interest rate increases have made small business lending unattractive to the major lenders, and especially the banks, since the agreement establishing the Plan sets a constraint on the interest rate at one (1) percent above prime. Thus the rate of return to the lender may not be commensurate with the costs involved in loan supervision, resulting in only the more risky projects being sent to the SBDC for guarantee coverage.

The constraint on the interest rate is significant here. As pointed out above, one of the main reasons for banks' avoidance of SSEs is the intrinsically high transaction costs, i.e. the cost of appraisal, screening and loan administration, relative to the size of the loan itself and the profits which would accrue to the bank from interest payments. While the Guarantee Plan certainly reduces the risk which would otherwise have to be borne by the bank alone, the costs incurred in appraisal and monitoring remain unchanged. Moreover, the banks also have the additional responsibility of furnishing the SBDC with information on loan performance at regular intervals, something which could only result in a further increase in administrative costs. These costs can perhaps only be defrayed by applying higher interest rates.

There is no reason to suppose that commercial banks in Trinidad-Tobago will relax their rigid appraisal procedures for small firms either. On the contrary, indications are that they have tightened up on appraisal methods, meaning that it is more rather than less difficult for small firms to gain access to bank funds. The tight liquidity situation in the financial system attendant upon the increases in the cash reserve requirement and the rediscount rate also work against smaller establishments. Commercial banks are likely to show a marked preference for doing business with large-scale industry in spite of the guarantee offered. One is reminded of a statement by Levitsky (1989) that:

The disappointing experience of guarantee schemes in developing countries until now has been that most of these schemes have not been able to cover the costs incurred in administration and claims, and encountered great difficulty in attaining the confidence of the commercial banks.

On the whole, there are somewhat mixed views on the efficacy of credit guarantee programmes as a means of inducing banks to grant loans to small businesses. Some writers (eg. Meyer, 1988) doubt their capacity to increase lending to the sector in any meaningful way. The consensus of a conference held in Lusaka, Zambia to discuss the issue of small
business financing in Africa was that guarantee programmes are unsuitable. They are generally costly and complex to design and manage. Others (e.g., Dadkhah, 1984; Kitchen, 1986; Levitsky, 1989), while recognizing the inherent drawbacks of guarantee plans, are more optimistic about their potential for increasing the flow of funds from the formal financial system to small-scale enterprises.

In the case of Trinidad and Tobago, it is perhaps too soon to determine whether the introduction of a loan guarantee has induced the banking sector in particular to increase lending to small firms. The evidence is far from conclusive. For the two (2) full calendar years for which we have information, the participating commercial banks have loaned approximately TT$28.2 million to small and micro-enterprises under the SBDC’s guarantee, $18.3 million in 1991 and $9.9 million in 1992. This represents a minuscule portion of the total loans outstanding to unincorporated businesses for the same years, $819.3 million in 1991 and $1,119.6 million up to the end of the third quarter in 1992. Nevertheless, these loans would probably not have been approved in the absence of the guarantee.

It is therefore difficult to conclude by saying that the loan guarantee plan is either successful or unsuccessful. This will require more rigorous analysis. However, $28.2 million over a two-year period is certainly better than nothing at all. In the final section, some suggestions are made for increasing the flow of loan funds from the commercial banks to the small-scale sector, and for broadening the options available to small businessmen for raising capital.

Conclusion

I have attempted within the given constraints to discuss, albeit perhaps in a preliminary way, some of the major issues of small business financing in Trinidad and Tobago. The paper is premised on the assumption that promoting small business is a worthwhile endeavour with tangible benefits to society. I have argued that capital is an essential prerequisite for business start-up, growth and development. The long-run success of small firms depends on their being able to receive adequate amounts of both start-up or ‘seed’ capital for initial investment in plant and equipment, and working capital to finance recurrent expenses. The former is long-term in nature, the latter short-term. In the short-run, there is no business without capital, for without it the firm can never become a reality. Any policy aimed at stimulating entrepreneurship and small business development without addressing the critical question of access to finance is doomed to fail.

In this paper, I have sought to define the “access problem” and examine its scope. The findings of three (3) separate studies show that while small firms, once established, have little difficulty in securing overdraft facilities at commercial banks, prospective entrepreneurs are unable to secure long-term loans to start their businesses. Some small businessmen use expensive overdraft facilities to finance capital investments, with the consequence that long-term investments are met with short-term funds and gearing ratios are high.

For almost twenty (20) years there was a programme approach to providing financial services to small businesses. A special Small Business Unit was set up at the IDC for this purpose in 1970. Although the IDC was not the exclusive implementing agency, it is the focus of the discussion in this paper. After almost 20 years, the programme had extended 3,980 loans worth a total (principal) of $124,869,882, of which $62,330,247 (roughly 50 percent) was repaid by October 31, 1989. Several reasons have been adduced to explain why the programme failed to have the anticipated impact.

From 1989, in the context of a structural adjustment programme dictated by the major international financial institutions, the practice of lending special funds provided by the state at concessionary rates of interest was discontinued. The move to deregulate and liberalize the financial markets, typically associated with the neo-orthodox IMF/IBRD model, is expected to yield an optimal allocation of risk and resources. There was therefore in 1989 a shift from the programme approach to one which has been described as a financial market approach. At the heart of the latter approach is a loan guarantee plan offered by the new SBDC to participating lenders.
Initially, the Guarantee Plan was approached with caution and scepticism by the commercial banks. As the banks became more familiar with the workings of the Guarantee Plan, however, and as their confidence grew, they did make use of the system. In 1991, a year of fair liquidity in the financial system, the banking sector extended $18.3 million in loans under the SBDC's guarantee; while in 1992, tight monetary policy (a situation unlikely to change in 1993) resulted in a significant decline in guarantee activity. The total amount loaned by the commercial banks to small firms under the Guarantee Plan was actually halved in 1992 to $9.9 million.

The tight liquidity situation has taught us an important lesson. It suggests that the commercial banks and other financial institutions are not to be relied upon entirely to finance the small business effort. In times of scarcity, the banks are subject to many pressures and demands for funds from the public sector (including state enterprises) and the large-scale commercial and industrial sectors. In the competition for investment funds, larger and better connected firms will enjoy preferential access to capital and other economic inputs, and will probably “squeeze out” the smaller entrepreneurs.

Perhaps what is necessary is a régime of fiscal and other incentives aimed at inducing commercial banks to allocate a greater share of their loanable funds to small business lending. One bank, Republic Bank Ltd., has actually done that of its own accord. Other banks must be encouraged to follow suit. Removing the constraint (of 1 percent above prime) on the interest rate which is contained in the agreement between the SBDC and participating lenders also appears desirable, since this would allow the rates on small business loans to be market-determined. Such measures would possibly result in increased lending to small and micro-enterprises under the SBDC’s guarantee portfolio, but would undoubtedly also cause an increase in the price of capital to small firms.

In short, the SBDC’s loan Guarantee Plan can work effectively to induce increased levels of lending to the small-scale sector if there are policy measures to support it. Banks are undeniably the most efficient channel of supplying credit to small firms. They are, however, motivated by the pursuit of profits and “bottom line” considerations. They are unlikely to increase lending to small firms unless it is demonstrably worth their while. Making it worthwhile could entail increasing the cost of capital. The credit unions offer an ideal option for those prospective entrepreneurs who are unable to cope with high interest rates.

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