



SPECIAL
SECTION



Small Business BTC Success

Inside Microenterprise

A Sewing Microenterprise

ON THE SECOND FLOOR of a dingy warehouse in central Lima, Leydi Caycho Valencia works at a sewing machine putting appliqués on fabric for baby's clothing. Her business, called Natural, operates out of a well-lit 9-by-12-foot corner space where she and her four employees work churning out cheerily adorned jumpers and smocks for tots.

In the last three years, Caycho's business has expanded, thanks to loans from microfinance institutions. Caycho started out with one sewing machine, but with small credits from Acción Comunitaria del Perú, a microfinance institution and affiliate of ACCION International, she was able to buy three more machines and hire employees. Getting credit not only allowed her to acquire the sewing machines, it also helped her save money.



“The benefit of credit has been that we could buy the machines at the cash price, which reduces the price by half,” Caycho says. She also uses a portion of her loan to buy embroidery thread for the appliqué. Caycho receives credit from Mibanco, a recently created Peruvian bank that specializes in microfinance for micro and small business. She is currently paying off a US\$1,600 loan, which she will amortize in five months with monthly payments of US\$365.

Located in the heart of Lima’s humming garment district known as Gamarra, Caycho’s business has expanded despite the slowdown that has afflicted the Peruvian economy since 1998. She plans to invest the full amount of the loans in her business—“The objective is to keep growing”—but she would also like to improve the business. “For those of us in small businesses, I think there should be more support; we should be given more knowledge,” she says.

Good Credit, More Loans

Just a few corners away from the warehouse where Caycho has her store, Carmen Castro Mendez sells fabric, especially cotton knit for polo shirts, at a stall inside a building. Castro had sold merchandise as an itinerant operating on the street until the city dislo-

cated street vendors in 1998. Five years ago, she got her first loan from Acción Comunitaria del Perú for US\$550, which she used to buy cloth. Married and the mother of three schoolchildren, Castro paid that credit off in two months and, based on her good record, got more loans.

“Bit by bit I made myself known, and now I can ask for the amount that I want,”

Castro says. Late last year, she got a loan for US\$4,250, which she planned to pay off in less than four months with biweekly payments of US\$650. She

ing, she would like to open another store. Her dream is to produce fabric, but that would require additional thread and machines—and much more capital, she says.

Expanding a Leather Microenterprise

Far from the bustling streets of Gamarra, in the barren desert outskirts south of Lima, Luis Cadillo runs a small company that he set up several years ago to make leather belts. Now his enterprise is diversified, and his workers make purses, wallets and backpacks in the back rooms of his home in the Villa María del Triunfo squatter settlement.

Since 1997, Cadillo has developed his business with the help of loans from Edyficar CARE, a microcredit institution that has converted from a non-governmental institution to a



Luis Cadillo and employee in his leather shop

did not know the interest rate she was paying, but like many other micro-entrepreneurs she knew exactly how much she had to pay and has never missed a payment.

“I have grown a lot. I have more clients because I have more merchandise,” says Castro. To keep on expand-

regulated lending agency. With the first loan, Cadillo bought two sewing machines; with his second credit, in 1998, he bought leather and other supplies and set up a store for selling his products in downtown Lima near the Congress building. In 2000, he formalized his business by

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incorporating, a step he wanted to take to get access to bank loans that offer a lower interest rate than those of Edyficar CARE. “To grow, I calculated that I would need loans,” he says. Last year, Cadillo had loans of US\$2,800 from Edyficar CARE and US\$2,100 from Banco de Crédito del Perú, which charges an annual interest rate that is 2.5 percentage points lower.

Having a store, the goal of many small-business producers, reduces Cadillo’s dependency on selling to big corporations—which began to delay payments for his products when the El Niño flooding hit, he says—and provides needed cash flow. “It doesn’t give me great profit, but it allows me to be up-to-date” with payments, he says. He has also found new wholesale clients, including private schools and universities, that buy his leather goods to give as gifts for Mother’s Day and other occasions. Today, Cadillo has two stores—including one in the industrial park of Villa El Salvador, an evolving squatter settlement nearby—and the majority of his sales are made at his stores.

Cadillo has a clear vision for his business. In the short term, he wants to increase production, which will require hiring more staff and buying machines that can sew thick seams and handle other specialized functions, and consolidate his sales in Lima by opening two more stores, one in the Gamarra district and another in the eastern suburbs.

For the long term, he has his sights set on the export market. But to reach that goal, Cadillo needs more skills. “I’ve reached my ceiling. I need to prepare, to take courses and seek the advice of professionals,” he says.

Microcredit Triples Bunk Bed Production

Saws buzz, sanders whirr and sawdust flies in the open-air workshop of Orlando Leon Fabian, whose business produces bunk beds for sale in Lima’s wholesale market, La Parada. Leon set up shop in his home four years ago and began by making 15 beds a week. Today, he can boast nine employees and seven machines that produce 100 bunk beds a week in a spacious walled-in workshop he built of brick.

Each step in the evolution of Leon’s business was made possible by credits provided by Edyficar CARE (see sidebar, page 54). Leon first heard about the loans from his father, who learned through his work with the international aid agency CARE in the northernmost part of Greater Lima that loans were available in Villa El Salvador.

Leon got in touch with the local office of CARE, which at the time ran a microcredit operation as an NGO. He used the loan to buy wood. Later, the microcredit institution was converted to a regulated institution, Edyficar CARE, from which Leon obtained additional loans.

“When it became Edyficar CARE, I realized they are using more documents—it’s more controlled, more serious,” he says. For Leon, there is a strong advantage to working with a specialized microfinance organization. “When you go to the bank, there are lots of problems. They ask for lots of guarantees, you have to have your house well built,” he says. He has always made his loan payments a week ahead of time and has put the

money to work tripling his production.

These Peruvian entrepreneurs are representative of hundreds of millions of micro and small businesses across the developing world. They are able to create businesses and jobs, find markets for their products, keep up sales—and even grow—during economic slumps, take on loans and repay them responsibly and on time. Access to credit turns out to be a launching pad for these small businesses, and time and again the entrepreneurs have shown that they can invest wisely, make their enterprises more productive and generate jobs.

These entrepreneurs and their colleagues and employees make up about 70 percent of the employed in Peru, working in an estimated 2.7 million microenterprises, and produce some 40 percent of the gross national product. Microenterprises are, by definition, firms with less than US\$20,000 in assets and less than US\$20,000 in credits. The entrepreneurs underpin a robust microfinance sector in Peru, an unusually diversified and layered group of organizations that serve microbusiness and are linked to the formal banking system.

In Peru, microcredit institutions run the gamut from non-profit institutions—typically run by NGOs—to regulated institutions—Edyficar CARE—to a microfinance bank—Mibanco—to conventional banks that offer microcredit. The 35 regulated microfinance institutions have a combined loan portfolio of nearly US\$250 million, some 270,000 loans and profit rates that range from 15 to 40 percent annually.

“Peru is a laboratory” for microcredit programs, says Vladimir Radovic, representative in Lima of the Inter-American Development Bank, which maintains 15 projects in microfinance and has invested more than US\$28 million in microcredit portfolios. “That has an immense multiplier effect,” he says.

A range of services are available in Peru to help make the microfinance institutions more efficient and more rigorous in their lending and to stimulate micro, small and medium businesses. In recent years, the government created a tax incentive to encourage NGOs to convert their microcredit operations to regulated institutions, like Edyficar CARE. Technical assistance aimed at institutionally strengthening the microcredit lenders is financed by the IDB’s Multilateral Investment Fund. Regulated institutions are supervised by the Superintendency of Banks and Insurance, which alerts them when their portfolios are running off course. Microlenders that want to raise capital in financial markets can get ratings, which identify their strengths and weaknesses.

The rich and diverse experience of microfinance in Peru shows what can be achieved and the challenges that lie ahead. While the microcredit institutions serve an estimated 500,000 clients, many small entrepreneurs remain frustrated in their ambitions because they do not yet have access to credit. “Fewer than 10 percent have credit,” says Felipe Portocarrero, a microfinance consultant and economics professor. “It’s a lot and a little because 10 years ago they had hardly

any credit.” In rural areas, the outreach and coverage of microfinance are vastly less than in Peru’s cities.

Another challenge is to provide a greater variety of financing for the small entrepreneurs. “The market has no depth,” says Portocarrero. He proposes that ways be found to get funds that would allow microfinance institutions to provide credits for major investments—such as modernization of equipment and machinery—with repayment periods of four to five years. Also, home improvement loans would help the legions of microentrepreneurs who work at home to finish their homes and improve conditions in the vicinity of their storefront or workshop, he suggests.

Compelling success stories abound. But a closer look needs to be taken at microenterprises to determine whether they are sustainable and to identify the economic activities that offer opportunities for small businesses to flourish. Observers of small business salute the flexibility of the microentrepreneurs to adapt to the market, changing their product and finding ways to maintain sales, such as offering credit. But certain businesses—clothing manufacture, for one—are extremely vulnerable to international market shifts, and in recent years Chinese clothing imports have clobbered many Peruvian producers. Shopkeepers and vendors can see their sales sink as soon as the economy takes a downturn and their clients trim spending.

Within the framework of a global economy, niches can be found for small businesses. Outsourcing services such as office cleaning and maintenance and telephone line repairs could be opportunities for contracting small businesses, says Portocarrero. But as the entrepreneurs themselves admit, they lack the knowledge needed to improve their businesses. “They don’t have the complete package of support, access to technology, training and marketing” that would ensure the sustainability of microenterprises, says Odette Zamalloa, sectoral specialist at the IDB office in Lima.

Bunk Orlando Leon Fabian, BED Producer

1996: First loan used to buy wood: doubled production to 30 beds a week

1997: Second loan used to buy wood: tripled production to 100 beds a week

1999: Third loan used to buy supplies and machines

2000: Fourth loan used to buy bricks and materials to build a workshop, which employs nine men working seven machines, including lathes, two circular saws, a sander and a polisher.