The Practice of Microenterprise in the U.S.

Strategies, Costs, and Effectiveness

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Executive Summary

Microenterprise: A Story People Want to Hear

Among strategies that address the problems of poverty, unemployment, and community deterioration, the strategy of microenterprise holds a unique place. Over the last ten years, the field of microenterprise assistance has grown from a handful of programs to more than 200 in 44 states. Cumulatively, these 200 programs have served over 200,000 individuals, loaned over 44 million dollars, and assisted over 54,000 businesses in disadvantaged communities. Every month, new programs are established in different towns and cities across the country.

Since the inception of the strategy in the U.S. some ten years ago, media attention has been constant. From its appeal as the epitome of the American dream, to its unique position as a strategy that enjoys bipartisan political support, to moving stories of impoverished women who craft a life for themselves, microenterprise is a story that people want to hear. Skeptics worry about the "faddish" quality of microenterprise assistance, and express reservations about its ability to work for large numbers of the poor. Advocates proclaim, on the other hand, that there is a place for microenterprise, and argue that many of its principles and methods represent best practice in working effectively with low income populations. Bankers wait on the sidelines to see if microenterprise programs can perfect a method for lending to this largely minority population, eager to investigate an emerging market.

In the midst of this swirl of attention, experimentation, and expectation, the field is slowly growing up. The oldest programs have passed their tenth anniversary, and leaders are beginning to talk about the next phase of development for the field. Practitioners and donors alike are eager to turn their attention to performance, standards development, and effectiveness. The field has now grown beyond the demonstration phase and is ready to define itself more clearly, push for quality performance, and begin to claim its place within the broader community development field.

The Philosophy of Microenterprise: A Social Contract that Builds on the Skills and Talents of Individuals

The philosophy of microenterprise assistance in the U.S. and in the developing world recognizes the fundamental ability of people to apply their individual talents, creativity and hard work to better their lives. Microenterprise programs build on the unique ideas and skills of entrepreneurs and would-be entrepreneurs by providing business assistance and small amounts of credit to support the development or start-up of businesses. The services of credit and technical assistance are offered in a supportive context that conveys the message that people can, and do, improve their lives through initiative and hard work.

Rather than emphasizing a person's deficiencies when they enter the program, such as their lack of training for a certain job, or low educational attainment levels, microenterprise programs begin by recognizing a person's strengths--the skills, aptitudes, interests, and experience that they already have. This philosophy is affirming and transformative: it starts where people are and recognizes their economic worth. The act of extending the loan to an entrepreneur who does not generally have access to credit elsewhere conveys the program's belief in the entrepreneur. In fact, the word "credit" is derived from the word "credo," which means "to believe." In the context of other employment and income assistance programs that target disadvantaged individuals, microenterprise is unique in its appreciation for the *potential* of target participants.

The approach taken toward clients in microenterprise programs is not a traditional non-profit charitable approach where services are handed out to those in need. Rather, microenterprise programs enter into a form of social contract with their clients: there are explicit responsibilities that the program participant must meet and there are tangible services that the program offers in exchange. In microenterprise programs, this contract is very clear: you must repay your loan, attend your training program, and manage your business in order to receive further assistance.

Microenterprise in the U.S.: A Growing Field

Five years ago when this study began, the microenterprise field in the U.S. was very small but growing rapidly in terms of numbers of programs and clients served. It was attracting the interest of policymakers at all levels of government. Most programs were funded from a variety of sources, but the field as a whole was funded primarily by private philanthropic support. Anecdotal stories about business success, income growth, and the potential for the strategy to significantly contribute to poverty alleviation trickled out of a handful of programs. There was a growing hunger for information about the field.

The Self-Employment Learning Project and the Methodology Employed in This Study

In this context, the Self-Employment Learning Project (SELP) was created in 1991 with support from the Ford and C.S. Mott Foundations to document and evaluate microenterprise program strategies and the effects of program services on clients and their businesses over time in seven senior programs across the country. SELP is a five-year study that includes three components: one, a longitudinal study of client and family-level impacts based on a sample of 405 clients[1]; two, a multi-site monitoring system that collects information on clients and their businesses as they enter the program and tracks program and portfolio performance every six months; and, three, case study research on the strategies, costs, and effectiveness of the seven participating agencies. This paper reports on three years of case study research on the seven agencies participating in the study. It uses data gathered from 1992 through 1994 supplemented with information gathered for the internal program-level monitoring component of SELP. Week-long on-site case studies were conducted at each agency which consisted of focus groups of entrepreneurs, structured and unstructured interviews with staff, board members and community members, and a review of program documentation, financial statements, budgets, and staff time allocation forms.

This report is organized into the following four sections:

- ***The Program Strategies*** section presents a typology of the strategies used by agencies, examines their evolution over time, considers how they are designed to reach specific target groups, and discusses the range of training and technical assistance services offered.
- ***The Program Costs*** section presents information on trends in total costs, the proportional range of costs applied to training and lending functions, and an initial consideration of the relationships between costs and outcomes.
- ***The Program Effectiveness*** section reviews the range of ways to assess the effectiveness of programs and presents data on portfolio performance, scale of programs, prospects for sustainability of programs, and a discussion of measuring the effectiveness of training and technical assistance.
- ***The Challenges for the Future*** section reviews the implications of this study for the further development of the field.

Key Findings on Program Strategies

- ***There is no single "microenterprise methodology"--instead, there are a range of strategies and services that are offered to distinct client groups within the diverse U.S. microentrepreneur population.*** Most microenterprise programs offer more than one "program" or microenterprise methodology---for example, a highly specialized, long-term training program for welfare women may coexist within an agency with a short-term intensive weekend workshop on marketing for established small businesses owners. The seven agencies in this study operate a total of 17 different programs for different client groups.

  Across the range of programs, many core features are shared by the seven programs in this study, as follows:

  - ***A focus on poverty alleviation;***
  - ***A strong emphasis on client self-selection and client choice;***
  - ***A commitment to providing clients with opportunities to develop incrementally--with risks increasing as skills, confidence and experience are developed;***

1 Findings based on the longitudinal survey of entrepreneurs which include information on individual business and household experiences and outcomes over time are detailed in separate publications including, *Enabling Entrepreneurship: Microenterprise Development in the U.S.: Baseline Year Report of the Self-Employment Learning Project*, and other publications which are forthcoming. The longitudinal survey will be completed in 1997.

- *A non-charity orientation that emphasizes client responsibility, and a business approach that utilizes market interest rates and enforced standards for repayment and program participation; and*

- *A recognition of the importance of training and technical assistance in all strategies from the most "minimalist" to the most full-service.*

■ ***Microenterprise programs can be divided into three principal types, defined by the service delivery package offered:***

1) ***Credit-led individual loan programs,*** where the primary service offered is credit with varying degrees of training and technical assistance provided;

2) ***Group lending programs,*** based on the developing country Grameen Bank or Accion International models where peer groups of clients guarantee each others' loans; and

3) ***Training-led strategies,*** where the primary service offered is business training, and access to credit is an option.

■ ***A hallmark of microenterprise programs is their ability to effectively reach large numbers of minorities, women, and the poor. The programs in this study universally serve large numbers of low-income, minority and female clients, as follows:***

- ***73% of clients are women;***

- ***60% of clients are from a minority ethnic or racial group, and***

- ***43% of clients have household incomes below the poverty level***

■ ***Training and technical assistance is a critical service component of the programs in this study.*** Even for the programs that are not training-led, most require entrepreneurs to attend a core business training, and programs have almost universally increased their focus on training and technical assistance.

Key Findings On Program Costs

■ ***The cost effectiveness measures of the programs in this study compare very favorably to those of other employment and training, business assistance and job creation strategies for low-and moderate income participants. Program costs reflect the level and mix of services offered, the business experience of clients, and overall program volume.***

■ ***The average cost per client served was $1,707 in 1994. The cost per welfare client was $2,535 for ISED and $6,487 for Women Venture's SETO Program, which compares favorably to other nationally recognized programs such as the San Jose Center for Employment Training ($6,000 to $7,000 per client) and the Riverside County GAIN program ($3,000 per client).***

■ ***The average cost per job created or retained was $5,813 in 1994. This compares favorably with leading public sector job creation programs who are targeting moderate income individuals at an average cost of $3,532 per job created or retained. The increase in cost to reach lower income individuals is attributed to increased training costs for longer term training for people with lower skills levels, administrative costs for staff to work with local welfare offices, and additional costs in outreach and supportive services.***

■ ***The average cost per assisted business was $3,018 in 1994. The range of costs was $1,437 to $4,903 per assisted business.***

■ ***The average cost to make and manage a loan was $1.47 per dollar loaned. The range of costs was 67 cents to $2.95 per dollar loaned.***

- ***Even for programs who are extremely cost-efficient, long-term organizational financial stability and sustainabilty continues to be a key challenge for the field. The ability of programs to achieve financial sustainability or self-sufficiency of their credit operations is influenced by a number of factors including:***

  - ***Organizational culture and structure;*** programs which view themselves as predominantly credit-led place a high emphasis on achieving self-sufficiency in their lending operations; programs pursuing training-led strategies tend to see credit as only one component of their operations, and self-sufficiency as a less important measure of success.

  - ***Loan size, term, rate, and value of outstanding portfolio*** all have an effect on the self-sufficiency of credit operations because they determine the level of interest earned on loans made by the credit program.

  - ***Total capitalization (or size of loan fund) and capital structure*** are key determinants in the level of self-sufficiency because they determine the level of income that can be generated through interest on capital that is temporarily not held as loans to clients.

  - ***Operating costs of credit operations*** (such as personnel and administrative costs) also affect the ability of programs to achieve self-sufficiency in lending operations.

  In pursuing the goal of overall sustainability--or continuity--of program operations agencies have utilized three principal strategies:

  - Generating new sources of earned income (in addition to lending revenue);

  - Seeking to reduce costs through partnership and linkage arrangements; and

  - Creating solid relationships with funders, particularly with sources that provide stable, ongoing support.

Key Findings on Program Effectiveness

Program effectiveness is assessed in this study on two fronts: the effectiveness of providing credit and the effectiveness of providing training.

Findings Related to the Effectiveness of Credit Operations are the Following:

- ***Programs face significant challenges in increasing their pool of borrowers.*** These challenges include: client readiness, client credit-worthiness, program competition in urban areas, and the relative scarcity of potential entrepreneurs in rural areas. In 1994 the level of use of loan portfolios (relationship between the size of outstanding portfolio and loan fund capitalization) ranged between 12% and 47%. Programs are attempting to raise the level of use by addressing a variety of factors including:

  - Assessing the real levels of demand for credit on the part of distinct segments of their clientele;

  - Considering whether they should diversify their client pools and loan products to generate increased loan activity and higher returns;

  - Changing loan policies to reduce losses; and

  - Determining the right composition of sources and types of capital to grow and maintain a fund.

- ***The majority of programs have experienced periods of delinquency and loan loss which were attributable to a number of factors:***

  - Programs were relatively young and situated in a new industry where lending methodologies were not clear and still being established;

- There were a variety of management information system difficulties which resulted in inabilities to track loan performance closely;
- There were changes and reductions in front line staff reducing borrowers' feelings of responsibility to programs; and
- Given that loan pools are relatively small, problems with a few loans often caused significant variation in delinquency and loan loss from one reporting period to the next.

Findings Related to the Effectiveness of Training and Technical Assistance Include:

■ ***There is considerable demand for non-credit training and technical assistance services; almost all programs have large numbers of non-borrowing clients.***

■ ***Appropriate methods for assessing the effectiveness of microenterprise training and technical assistance are being developed and refined over time as the importance of this component of program methodology becomes increasingly clear. Key questions include:***

- Are training efforts cost-effective?
- Are they becoming more efficient over time?
- Are agencies providing the level of training and technical assistance that is most appropriate for given clients?

Preliminary indicators of the effectiveness of training and technical assistance are being developed and include:

- Completion rates of participants (currently 45% - 80%);
- Willingness of clients to pay for training and technical assistance services; and
- Satisfaction of clients with the training services they receive.

■ ***Given the widespread demand for training and technical assistance, programs are increasingly considering charging fees to clients for their services.*** Some clients are willing to pay at least a portion of the cost of training and technical assistance, but programs are constrained by clients' ability to pay, some funding sources which may prohibit charging fees and, in some cases, competition from other training and technical assistance providers in the community.

■ ***The large demand for training and technical assistance has resulted in programs' re-defining what is meant by institutional sustainability, or the ability of programs to maintain a certain level of operations, to include both maintaining services and achieving self-sufficiency in credit operations.***

■ ***The scale of microenterprise programs (in terms of numbers of clients and numbers of loans or other services disbursed) is a key ingredient of program efficiency and continues to be a major challenge for U.S. programs.*** Few organizations in this study have established extensive growth, or "scale-up," as a goal for their microenterprise programs. This differs dramatically from programs in less developed nations.

Several key factors inhibit potential demand for services and preclude "scale-up" as a program goal. These factors include:

- Population dispersion in rural areas which makes outreach difficult;
- Lack of trust of outsiders, and in other community members, that prevents program penetration or the use of methodologies that depend on group solidarity;

- The presence of competition from other programs;
- The relatively small scale of the self-employment sector; despite recent large increases in the number of self-employed Americans, there are far fewer self-employed in the U.S. (an estimated 8 - 20%) as compared to 60 - 80% of the population in the developing world.
- The need for further development and adaptation of methodologies to effectively deliver training, technical assistance and credit;
- The still early stage of development of program services and the allocation of staff functions to accommodate growth while continuing to deliver efficient and effective services. Modifications include determining optimal staff-client ratios, client loads, and allocation of staff time to various lending and technical assistance functions; and
- The lack of workable information systems that facilitate staff work with clients and provide them with timely and needed information.

In order to meet the challenge of scale, programs have experimented with three models for expanding services:

- ***Partnership programs*** such as state-wide credit models linking a central loan fund and staff to local credit delivery agencies and technical assistance providers;
- ***Microenterprise programs embedded within service providers with larger missions*** such as programs that incorporate business development services within a larger economic development program; and
- ***Mixed service models*** that work with a small number of clients in a comprehensive, intensive way while providing more limited services to a larger group of other clients with short term service needs.

Challenges for the Future

- ***There is a need for greater stability in program funding.***

  Instability in funding--particularly for program operations--has slowed agency progress toward higher levels of performance. Programs face continual struggles to raise the funding required to maintain their operations without staff lay-offs or resorting to reductions in important components of program operations.

- ***Those programs that appear to be most cost-efficient are those that offer both short-term, targeted interventions to large numbers of people (such as weekend workshops, specialized training in key business areas to targeted groups of business people) with longer-term, more intensive strategies for a smaller number of clients (such as longer term training to welfare recipients, or long term credit relationships with small, yet established businesses).*** This strategy allows these programs to capitalize on the diversity of the U.S. microentrepreneur population and affords them scale in client outreach, and significance in terms of client outcomes for their most needy participants.

- ***One of the key unanswered questions about U.S. microenterprise programs is the scale of operations that might realistically be achieved, and how this scale relates to the segment of the small business or microenterprise market that the field is attempting to reach. Finding an answer to this issue of scale will require the creation and evaluation of various models for achieving greater scale in program operations.***

- ***The microenterprise field needs to create performance measures.***

  The issues of performance, effectiveness, and efficiency have begun to come to the forefront in meetings of microenterprise practitioners. From the perspective of the overall microenterprise field, what is needed is a process to develop key performance measures and to create and disseminate the analytic tools and management information systems that can be used by all programs to collect, analyze, and use this type of data over time. Microenterprise programs need to become more active in measuring their effectiveness over time and in using measures such as client to staff ratio, cost per loan, cost per business start, or cost per job in their management process.

- ***The field also needs to look in particular at how to evaluate its training effectiveness.***

  There is little understanding at present of how programs can assess, in a quantitative way, the effectiveness of their training efforts. Creating such measures is particularly important as it becomes more clear that domestic microenterprise programs invest a considerable portion of their operating dollars in training and technical assistance activities.

- ***Although the grass-roots, diverse nature of the U.S. microenterprise field is very consistent with our nation's traditions of local initiative and local control, the lack of a clear or compelling single methodology appears to have hindered the development of best practice management policies, staff skills, and methodologies.***

  In general, programs have had to develop their own specialized business training curricula, and have experimented with a range of loan underwriting, monitoring, and servicing criteria and practices. This contrasts with the experience of microenterprise programs internationally where significant investments were made in learning about and promoting methodological development and innovation and broadly disseminating these best practices.

- ***There is a need to support institutions that can provide for advancement of the overall practice and field of microenterprise development.***

  Investors in microenterprise -- both federal and state governments and the private and philanthropic sectors -- could do more to support broader learning and innovation within the microenterprise field. By moving to support institutions that can provide for advancement of the overall practice and field of microenterprise development, two important things would be accomplished. First, investors would enhance their own understanding of the field, thereby improving their own program designs and investment choices. Second, by strengthening practice across the field, these investments in methodological advancements would result in increased funding, as well as improved services to microentrepreneurs across the nation. At this juncture in its development, the field has come far--and shows no signs of slowing down its growth. In order to ensure the highest quality of performance, supporters of the microenterprise movement must move to support a set of coordinated actions to address the issues and challenges raised in this report.