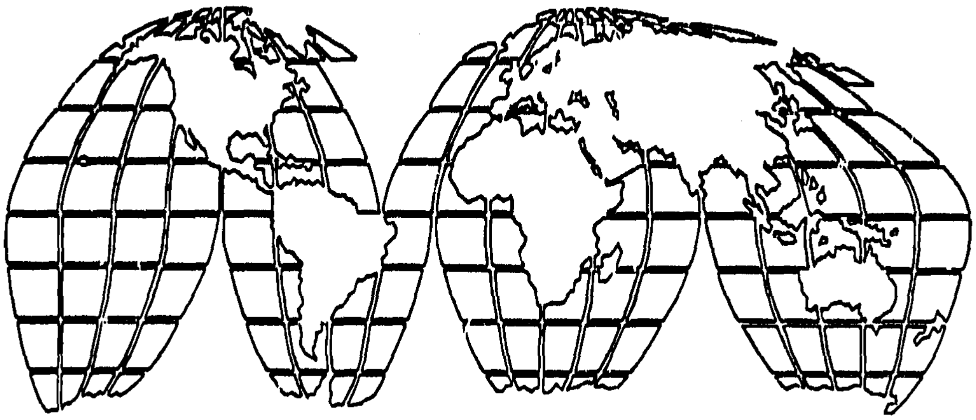
I 5d 67506

A.I.D. EVALUATION HIGHLIGHTS NO. 6

December 1989

The A.I.D. Microenterprise Stocktaking Evaluation



Center for Development Information and Evaluation
U.S. Agency for International Development (A.I.D.), Washington, D.C. 20523

This issue of A.I.D. Evaluation Highlights provides A.I.D. management with a short summary of the impacts, findings, lessons, and issues identified in a comprehensive Stocktaking Evaluation of A.I.D.'s Microenterprise Assistance Program. The study, which was completed in 1989, included field visits to 10 countries, covering 24 projects and additional analysis of data on another 8 A.I.D. projects.

SUMMARY

A.I.D. recently completed a CDIE-coordinated Stocktaking Evaluation of its Microenterprise Assistance Program. This major study provides a comprehensive analysis of microenterprises—who runs them, what they are doing, the problems they face, and the various approaches A.I.D. has used to accelerate their development.

The study highlights the heterogeneous character of microenterprises and the fact that they include a wide range of firms operating with various degrees of economic sophistication. An important contribution of the Stocktaking is the identification of three broad types of microenterprises and the assistance approaches A.I.D. has used to meet the needs of those three types of firms. Each approach has different objectives and different ways of achieving those objectives.

The study found that the poor are being reached. Although the poorest 20 percent generally do not become microentrepreneurs, they benefit from the employment opportunities generated by microenterprises. In addition, A.I.D. projects have been successfully reaching women entrepreneurs.

The Stocktaking found that in two-thirds of the projects, the average loan size greatly exceeds $300. A $300 average loan size only makes sense if the goal is to provide a limited and very narrow type of assistance, for example, short-term working capital loans.

There is often a tradeoff between concentrating on generating successful and sustainable businesses and the goal of targeting special disadvantaged groups. The most successful microenterprise programs tend to focus primarily on developing profitable and sustainable businesses rather than achieving social goals.

The study found that A.I.D. projects have had limited success in graduating microenterprises to nonconcessional, formal credit markets. As an alternative, the study recommends that rather than try to graduate firms, the programs themselves should graduate to nonconcessional sources of capital. These funds would then be retailed to the microenterprises by the program.

The study found that the enterprise expansion approach, which provides short-term working capital and minimal technical assistance and training, is the least costly method of reaching the largest number of beneficiaries. When the problems faced by microenterprises go beyond just credit, A.I.D. has much less knowledge of how to deliver cost-effective technical assistance and training.

BACKGROUND—WHY A STOCKTAKING WAS NEEDED

Over the last few years, within A.I.D., Congress, and the development community, there has been growing interest in microenterprise assistance. All agreed that it was an important area and that more needed to be done, but there was no agreement on exactly what the problems and solutions were. There were many different approaches that at times seemed to be at odds with each other.

In the summer of 1988, A.I.D. decided that it needed to learn more about its microenterprise program. The outcome was a Stocktaking, coordinated by A.I.D.'s Center for Development Information and Evaluation (CDIE), which had two objectives: (1) to take stock of existing A.I.D. programs and examine the different approaches being used and (2) to see what works best under which conditions. A.I.D. wanted to find out which characteristics separated the successful from the unsuccessful approaches.

The Stocktaking included a number of studies: an issues paper, a desk study of existing microenterprise evaluations, a statistical analysis of the present portfolio, field evaluations in 10 countries, and a synthesis that pulled together all of the studies. The synthesis report draws on a review of 32 microenterprise development projects.

A.I.D.'s MICROENTERPRISE ASSISTANCE APPROACHES

The term "microenterprise" naturally directs attention toward firm size as its primary distinguishing feature. In fact, in A.I.D.'s October 1988 Microenterprise Guidelines, one of the primary characteristics of a microenterprise is its small size (10 employees or fewer). Although size is a useful way of classifying enterprises, the study found that microenterprises are a heterogeneous group and there is a broad continuum of economic activity. Some microenterprises are at the low end, in survival-oriented activities on the fringes of the economy, whereas others are at the other end, in more complex and sophisticated microenterprises. An important contribution of this Stocktaking is the recognition of this diversity and the identification of three distinct assistance approaches that A.I.D. has used to match the economic constraints and opportunities of different types of microenterprises:

The enterprise formation approach. At the lowest level are the very poor or economically disadvantaged who want to start a business. Assistance usually takes the form of a community development program designed to overcome the social and economic constraints that prevent the poor from becoming entrepreneurs. These programs tend to have a high cost per beneficiary, with social benefits being more important than economic benefits.

Enterprise expansion approach. The goal of the second approach is to improve the performance of existing microenterprises. This approach usually relies on a minimum of inputs (usually only credit, although sometimes limited technical assistance and training) to reach a large number of firms at a relatively low cost per beneficiary.

Enterprise transformation approach. This approach strives to graduate larger clients up and out of the microenterprise sector. It is more costly per beneficiary reached than the other approaches, because it requires much more technical assistance and training. Table 1 identifies some of the main differences among the three microenterprise approaches.

THE IMPACT OF MICROENTERPRISE ASSISTANCE PROGRAMS

The Enterprise Formation Approach

Enterprise formation programs target highly disadvantaged groups and women, who are the

Table 1. Key Indicators in A.I.D. Microenterprise Stocktaking

	Program Approach		
Indicator (avg. amt.)	Enterprise formation	Enterprise expansion	Enterprise transformation
Beneficiaries			
Number served yearly	328	87,871	264
Women	59%	42%	27%
In manufacturing	54%	40%	60%
Loan size			
Dollar average	$508	$705	$3,261
Relative to per capita income[a]	1.2	2.0	10.2
Program Cost			
Per beneficiary	$948	$575	$2,549
Per dollar loaned	$ 3.24	$ 0.46	$ 1.08
Real interest rate[b]	3%	17%	0%
Lending for fixed assets	25%	20%	45%

[a] Loan Size in Relation to Per Capita GDP. This indicator compares loan size with income level. If an LDC has a per capita GDP of $150 and the average loan size is $300, the ratio would be 2.0. This indicator helps compare programs in countries with different levels of income. For example, a $300 loan in a country with a per capita income of $300 is quite different from a $300 loan in an LDC with a per capita income of $1,000.

[b] Real Interest Rate. This indicator deflates the nominal or stated rate of interest by rate of inflation.

poorest of the self-employed and the unemployed in economically remote areas or marginal urban areas. Despite the odds and the attendant risk of failure, the Stocktaking found that, under the right conditions, it is possible to design and implement programs that successfully develop viable microenterprises. In addition to the business promotion side, the projects often include community development and social services designed to improve the welfare of a distressed group of people.

All of the projects were able to deliver services to highly disadvantaged people and were able to generate positive (though often relatively small) beneficiary impacts. The programs generally focused their resources on a limited number of beneficiaries; often, only a few hundred people were reached each year. The program in Bangladesh was the exception, reaching more than a thousand beneficiaries a year.

The clients of these programs were indeed poor, but they were not necessarily the poorest in the areas of project activity. Nearly all of the programs reached a large proportion of women, both through explicit targeting and by focusing on the neediest groups in the local communities.

In spite of rather selective screening, a relatively high number of microenterprises participating in these programs failed (often 50 percent). This result is not unexpected, in light of the difficult business climate faced by a relatively inexperienced entrepreneurial group. The precarious economic conditions of the clients often meant that earnings were not reinvested in the enterprises, but rather were used to meet consumption needs.

Since enterprise formation programs deal with the poor and economically marginal, they usually include a high level of support, training, and technical assistance services. Economies of scale are often difficult to achieve, because the programs must be highly adaptive to the needs of the target population and loans are usually quite small. As a result, the cost per beneficiary tends to be relatively high, as does the cost per dollar loaned. Institutions that operate these programs are rarely financially self-sustaining.

The Enterprise Expansion Approach

Programs classified under the enterprise expansion approach do not try to transform their clients. Rather, these programs offer services—primarily credit—that enable microentrepreneurs to increase their sales and income and, in some cases, to generate new jobs. This approach is often called a "minimalist model," because it provides only one or two inputs and very limited support services. Typically, it is a financial services program, providing small working capital loans to a large number of borrowers.

The majority of programs target existing enterprises, looking for microentrepreneurs who have already successfully demonstrated their business skills. The programs generally develop a balance between "poverty alleviation" and "business development," although most microentrepreneurs would argue that business development is the means to alleviate poverty.

Enterprise expansion programs usually are oriented toward commercial and retail activities and, because of the high rate of female participation in informal sector commercial enterprises, tend to have a high proportion of women beneficiaries.

The most successful programs provide simple and quick loan application and disbursement, limited training, repayment terms that correspond to the cash flow of enterprises, and assurances of additional loans upon repayment. Program clients are less concerned with interest rates than with the simplicity and timeliness of the credit process. The Stocktaking found that microentrepreneurs are able and willing to finance their businesses (operations and expansion) at positive, real interest rates—interest rate subsidies are not needed.

Compared with the other two approaches, the cost per beneficiary and the cost per dollar loaned is generally very low for the enterprise expansion approach. The key to keeping costs low and achieving financial self-sustainability is the ability of an organization to focus on providing working capital credit, to employ efficient risk-reducing screening techniques, to charge market-level interest rates, and to maintain tight controls over loan delinquencies and arrearages. Some programs are already financially self-sufficient, and many of the others are moving in that direction.

The Enterprise Transformation Approach

The enterprise transformation approach seeks to accelerate the development of microenterprises that have demonstrated strong growth potential into even more productive, better managed, and more dynamic businesses. Programs are designed to help microentrepreneurs surmount barriers to entry at the small-enterprise level, thus positioning them on the road to graduation out of the informal sector. In effect, in many cases, the goal is to move them up and out of the microenterprise category.

Assistance is most commonly targeted to firms in the manufacturing sector rather than to firms in the retail, commerce, or service sector. The typical program provides clients with an intensive, often tailored mix of training, credit, and technical assistance. In all cases, loan approvals are based on detailed feasibility analyses of the proposed investment projects. As a result, loan application procedures can be complicated and the time from application to disbursement can be lengthy. A relatively large proportion of loans are provided for fixed capital (rather than working capital), and the average loan size tends to be significantly larger than under either the enterprise formation or the enterprise expansion approach. Interest rates tend to be quite low and in many cases the real interest rate is negative. These programs typically reach a small number of clients and, except when specifically targeted, do not reach a high proportion of women. This is because programs tend to emphasize manufacturing firms where women generally do not predominate. Cost per beneficiary tends to be high, but it is justified on the basis of the expectation of large long-term benefits.

FINDINGS

Reaching the Poor

A.I.D. projects clearly have demonstrated that it is possible to deliver services (training, credit, and technical assistance) to poor and highly disadvantaged people in remote locations. Although the poor are being reached, the very poorest usually do not become microentrepreneurs. In addition to a lack of skills and experience, they lack a minimum threshold of household resources necessary for success. However, the poorest do benefit from the jobs created by successful and expanding microenterprises.

Reaching Women

Most microenterprise programs are well suited to the goal of integrating women into the development process. The proportion of women beneficiaries is highest in programs that specifically target women and those that target assistance to urban and commercial microentrepreneurs—sectors that have proportionally high numbers of women participants. The enterprise formation projects (with their heavy emphasis on community development and reaching the poor) have the highest share of women beneficiaries (59 percent). Enterprise transformation projects (which include more manufacturing firms and generally larger firms) have the lowest share (27 percent). Enterprise expansion projects are in the middle, at 42 percent. Projects that focus solely on women or those with a high percentage of women participants generally perform no better or worse than those that focus on men. To the extent that problems develop, they are due to factors other than gender.

Sustainability

A.I.D. is interested not only in developing projects that generate substantial development benefits, but also in making sure that benefits continue to flow long after assistance ends. Therefore, it is important to develop programs and institutions that have the financial, organizational, and management capacity to be sustainable.

Programs that emphasize training and technical assistance (such as the enterprise formation and enterprise transformation approaches) generally have high overhead costs. Although management and program operations can be highly effective, financial sustainability all too often remains out of reach, and these programs tend to be heavily dependent on concessional assistance.

Programs in the enterprise expansion category are designed to support sustainable firms through a sustainable institution. They place a high value on moving toward full cost recovery, which means a minimum of technical assistance and training, while concentrating on providing loans to meet the short-term working capital needs of microentrepreneurs. Of the three approaches, the enterprise expansion approach is reaching the largest number of beneficiaries at the lowest cost per beneficiary and the lowest cost per dollar loaned. Programs that follow this approach have the best chance of achieving financial and institutional sustainability.

Business Development, a Means To Improve Welfare

The majority of A.I.D. microenterprise projects are implemented by private voluntary organizations (PVO's). These include religious and charitable organizations that apply a strong equity and social welfare emphasis to their microenterprise programs. This helps ensure that the poor and disadvantaged are reached, but if the emphasis is not balanced, the financial success of both the microenterprises and the lending institution can suffer.

The Stocktaking found that the more successful microenterprise programs focus first and foremost on the development of profitable and sustainable businesses. They target disadvantaged groups, but they focus primarily on supporting viable and sustainable business enterprises. Business development is a *means* to improve welfare.

Another important factor is whether an implementing institution expects to receive concessional assistance indefinitely. Programs that try to become self-sustaining, even when the goal is not reached or is even unattainable, generally perform more cost-effectively than programs that expect to continue receiving concessional assistance. If financial sustainability is an initial and major project goal, the project generally will do better.

Loan Size

The A.I.D. Microenterprise Guidelines include a number of criteria designed to target credit to new enterprises, to smaller enterprises, and to lower income beneficiaries. One technique is to limit the size of loans. According to the Guidelines: "The average loan size should not exceed $300 unless there are indications that larger-sized loans are needed to achieve the objectives of the program." The Stocktaking found that in two-thirds of the projects the average loan size was above the $300 guideline.

Although the average loan size exceeds the recommendation in A.I.D.'s October 1988 Microenterprise Guidelines, it is important to note that the projects examined in the Stocktaking were developed, implemented, and in many cases, completed before the Guidelines were developed.

Graduation

Graduation is a stated objective of many microenterprise programs and is included in A.I.D. Microenterprise Guidelines. Graduation in this case means the graduation of assisted microenterprises from donor programs into formal commercial markets; the key is the movement from a concessional donor project to the marketplace. While graduation from concessional assistance is a sound objective, almost all projects have difficulty graduating even their best-performing microenterprises. Formal sector banks are reluctant to deal with small borrowers who lack the type of collateral that they usually expect.

The Stocktaking suggests that A.I.D. should try to graduate microenterprise programs or institutions to commercial sources of funds rather than try to graduate the individual enterprises. The microenterprise institution would raise nonconcessional funds from the capital markets and then retail the money to microenterprises.

LESSONS LEARNED

The Credit Needs of Microenterprises

A.I.D. should place priority on supporting the development of commercially viable, nontargeted financial institutions that can, among other things, meet the short-term liquidity needs of microentrepreneurs. Businesses, regardless of size, require access to financial services. In almost all microenterprise programs, credit is an important element that provides necessary services to large numbers of beneficiaries. A.I.D. microenterprise programs have developed innovative screening and lending procedures, and they have performed well by commercial standards. A.I.D. should continue to follow this successful approach.

Training and Technical Assistance

Training and technical assistance programs should be supported, but only when they respond to clearly identified business needs of microentrepreneurs. There is a danger that programs might push extensive training efforts that go beyond the needs of their clients. Because training and technical assistance are usually the most expensive components of microenterprise assistance, they must be limited in scope and closely linked to the immediate business needs of the microenterprises being served.

OUTSTANDING ISSUES

Loan Size

The actual loan size in A.I.D. microenterprise projects and the suggested loan size in the A.I.D. Microenterprise Guidelines differ; there may be a need to change one or the other. Although the Guidelines call for an average loan size of $300, the Stocktaking found that in actual practice only one-third of the programs met that standard. Given that nearly all of the projects were started before the Guidelines were in place, it would seem that either the Guidelines will have to be changed to reflect actual practice or projects will have to shift their emphasis to much smaller loans. Credit programs that meet the $300 standard typically provide only small working capital loans. If A.I.D. shifts to the $300 loan limit, it will also have to shift its program emphasis to a working capital type of loan program.

Costs and Benefits

For each project, the Stocktaking was able to identify the cost per dollar loaned and the cost per beneficiary reached, but data were rarely available on the benefits of microenterprise programs. In judging the economic value of an approach, it is important to have both sides of the equation—costs and benefits. The Stocktaking did an excellent job of quantifying the costs by assistance approach. More effort is needed to quantify the benefits of microenterprise programs.

The Need To Develop New Approaches

The Stocktaking identified how to reach the most beneficiaries at relatively low cost—the enterprise expansion approach. That type of program focuses on a service (small, short-term loans), a market (usually the urban informal sector), and an appropriate technology for delivering the service efficiently and at a low cost. If financial self-sustainability and cost-effectiveness are considered the criteria for successful program performance, A.I.D. should continue to place priority on the enterprise expansion (or credit minimalist) approach. However, the Stocktaking does suggest that there is a need to go beyond programs that focus principally on the working capital constraint. The enterprise expansion approach, which focuses almost exclusively on working capital credit, reaches only a very small proportion of the client population. The needs of the vast majority of microenterprises cannot be satisfied merely by providing small working capital loans. A.I.D. needs to learn how to use other approaches to reach entrepreneurs who need inputs other than working capital and those located in less densely populated areas.

This summary was prepared by Joseph Lieberson and is based on A.I.D.'s 1989 Stocktaking Evaluation of its Microenterprise Assistance Program. The Stocktaking was coordinated by A.I.D.'s Center for Development Information and Evaluation and included a conceptual overview paper, an issues paper, a statistical analysis of the program, 10 individual country studies, and a synthesis report. This Evaluation Highlight draws together the analysis and findings of those documents. The views and interpretations are those of the author and are not necessarily those of the Agency for International Development. Any comments or inquiries about this Stocktaking Evaluation should be sent to the Center for Development Information and Evaluation, Bureau for Program and Policy Coordination, Agency for International Development, Washington, DC 20523-1802.