

# COMPENDIUM OF EVALUATION FINDINGS



## MICROENTERPRISE DEVELOPMENT

*We have greatly increased our understanding of “what works” in our microenterprise program and are continuing to add to our knowledge—but our current portfolio does not adequately reflect that learning. Viable microenterprise lending institutions are critical to any rapid expansion in the number of borrowers reached. Such institutions are effective in reaching poor people. Control of administrative costs is essential to their sustainability. Use of character-based lending and targeted lending to existing microenterprises can ensure low administrative costs per beneficiary.*

### Background

Microenterprises—firms employing 10 or fewer workers—account for between 40 and 90 percent of manufacturing employment in developing countries, with higher shares in the lower income countries. In rural areas, microenterprises account for the majority of manufacturing employment; in urban areas they account for the majority of employment in the commerce and service sectors. Assistance for microenterprise development has become increasingly popular among donors as a means of addressing poverty and unemployment.

By the end of the 1980s, USAID had funded 87 projects totaling \$290 million to support microenterprise businesses. In 1988-1989, CDIE undertook a “stocktaking” study of USAID’s microenterprise assistance program, reviewing 27 projects in 10 countries. The study identified three distinct USAID microenterprise assistance approaches: *Enterprise formation* assists the very poor or economically disadvantaged to start up businesses through community development programs designed to overcome social and economic constraints; *Enterprise expansion* aims to improve the performance of existing microenterprises, usually by providing minimal inputs (most often credit); and *Enterprise transformation* strives to graduate larger clients out of the microenterprise sector, usually by providing substantial technical assistance and training, as well as credit. Results of the CDIE study were published in an evaluation Occasional Paper, *A.I.D. Microenterprise Stocktaking: Synthesis Report*, (1989).

Subsequent to CDIE’s study, USAID’s Small and Micro Enterprise office, through the GEMINI technical services and research project, produced numerous studies that substantially extended the knowledge base. The results of the CDIE study, as extended by the GEMINI project, serve

as the basis for this summary. More knowledge is needed, however, particularly regarding mechanisms for providing effective low-cost technical assistance to new microenterprises. Therefore, further study of USAID’s microenterprise program, planned for 1994, will focus on sustainability.

### Findings

- **Microenterprise assistance programs reach poor and highly disadvantaged people.** The poorest often do not become microentrepreneurs themselves, but they do benefit from job opportunities created by successful, expanding microenterprises. Assistance to microenterprise manufacturing firms created more jobs than assistance to firms in the service or commercial sectors.
- **Enterprise expansion was the most successful approach in reaching large numbers of firms at relatively low cost per beneficiary.** This approach was also financially the most sustainable, with the lowest program overhead costs per loan. USAID has used this approach most successfully when the intermediary is a permanent commercial financial institution, such as a savings and credit association. This approach aims to move toward full cost recovery, which means providing minimum technical assistance and training, relying on character-based lending to reduce transaction costs, and concentrating on loans to meet short-term working capital needs of microentrepreneurs.
- **Enterprise formation and enterprise transformation had considerably higher costs per beneficiary, reached fewer beneficiaries, and were less financially sustainable** (due primarily to the high overhead costs of training and technical assistance). Enterprise formation reached the

poorest beneficiaries, but often depended on heavy subsidies. This approach has increasingly emphasized financial viability and adopted the village banking approach, giving loans to groups of 30-50 people to capitalize their own savings and credit associations. Most of the needs of new microenterprises cannot be satisfied by the provision of loans; more needs to be learned about how to provide them cost-effective training and technical assistance. Enterprise transformation promotes graduation from microenterprise status. Although involving relatively higher income clients, this approach also requires extensive use of technical assistance.

- **Most enterprise programs brought women into the development process.** Women have a significant presence in programs that assist urban commercial enterprises. The proportion of women beneficiaries was highest in enterprise formation and lowest in enterprise transformation. Programs using group lending techniques often worked best with a primarily female clientele.
- **Trade-offs exist** between concentrating on generating profitable and sustainable businesses and targeting special disadvantaged groups. The most successful programs emphasized the development of sustainable services. Those targeting special disadvantaged groups or community development were less successful.
- **Even the best performing enterprises have difficulty graduating to commercial financial markets.** The gulf between these successful small enterprises and the types of well-established clients that most traditional commercial banks serve and the loan sizes they accept remains unbridged in developing countries. Institutions currently lending to small firms in a self-sustaining fashion are seeking to close this gulf by becoming more like commercial banks.
- **Average loan size is an issue.** USAID, in response to Congressional earmarking and reports language, adopted a policy of providing loans under \$300 for a significant portion of its microenterprise program, under the rubric of “antipoverty” lending. However, in more than two-thirds of the projects examined by the 1989 stocktaking, the USAID loans exceeded \$300. Only projects emphasizing short-term working capital lending made loans below this level, and these loans were especially prevalent among enterprise expansion programs. Although there are some advantages to small size loans, they are just as costly to administer as larger loans, thus not as cost-effective.

## *Recommendations*

- **Focus on enterprise expansion programs.** “Credit only” programs for established microenterprises represent a proven, viable, and relatively cost-effective approach to microenterprise development.
- **Promote sustainable intermediaries.** The key to rapid expansion in the number of microenterprise borrowers is the graduation of microenterprise lending institutions to commercial sources of funds. That requires these institutions to evolve into financially viable entities with market-based interest rates, low administrative costs, and savings mobilization from microenterprises. A few microenterprise lending institutions, notably the BRI in Indonesia, have reached full commercial viability. ACCION and the Grameen Bank in Bangladesh are approaching sustainability.
- **Exercise caution with technical assistance-intensive programs.** Microenterprise programs with large technical assistance and training components have generally performed poorly. Where special circumstances require them, they should be developed as pilot, experimental programs designed to teach more about how to provide such services cost-effectively. Such programs appear to perform better when they identify and address only a few critical constraints. Selection of one or more specific industries may increase cost-effectiveness.
- **Insist on performance tracking.** USAID has not developed an effective system for tracking the performance and results of its microenterprise activities.

For further information, please contact CDIE's information clearinghouse by phone at (703)351-4006 or by fax at (703)351-4039. PN-ABG-025.