A.I.D. Evaluation Special Study No. 65

A.I.D. Microenterprise Stocktaking: Synthesis Report

December 1989

Agency for International Development (A.I.D.)

Washington, D.C. 20523

PN-AAX-227

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A.I.D. MICROENTERPRISE STOCKTAKING: SYNTHESIS REPORT

A.I.D. EVALUATION SPECIAL STUDY NO. 65

By

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U.S. Agency for International Development

December 1989

TABLE OF CONTENTS

TABLE OF CONTENTS (cont.)

TABLE OF CONTENTS (cont.)

LIST OF TABLES AND FIGURES

FOREWORD

During 1988 and 1989, the Agency for International Development (A.I.D.) undertook a major stocktaking of its experience in microenterprise development. The stocktaking examined different approaches and techniques that have been used in efforts to assist microenterprises, including alternative institutional delivery mechanisms. The study was designed to identify the patterns of A.I.D. project interventions that generate success, aiming to establish the most successful programs, institutions, and delivery techniques among A.I.D.-funded project interventions. It required an examination of different types of microenterprises and an analysis of A.I.D. project approaches to see what works best and under what conditions.

The stocktaking includes a series of studies. First, a statistical review of A.I.D.'s microenterprise portfolio provides a data-based context for the stocktaking exercise. Second, a conceptual overview paper of published evaluations identifies many factors that are important to project success. The paper develops a conceptual framework for analyzing the types of problems microenterpreneurs face. The stocktaking also includes field assessments of A.I.D. microenterprise assistance projects in 10 countries. These assessments provide an excellent opportunity for development specialists to examine in a systematic, consistent manner a large number of project approaches operating under a variety of economic conditions.

The final part of the stocktaking is this synthesis report, which pulls together the findings of the conceptual overview paper and the field assessments to develop lessons learned and recommendations for microenterprise assistance programs.

Janet Ballantyne
Associate Assistant Administrator
Center for Development Information and Evaluation
Agency for International Development
December 1989

ACKNOWLEDGMENTS

Many people have been directly involved in this project. Thomas A. Timberg of Robert R. Nathan Associates, Inc. (RRNA) provided strong intellectual leadership and guidance throughout the entire effort. Dennis De Santis of Development Alternatives, Inc. (DAI) led two of the field assessment teams and was responsible for editing and producing the 10 field reports. Mohini Malhotra (RRNA) tirelessly wrote and rewrote the project profiles and contributed in countless other ways. Tessie Tzavaras (DAI) made important contributions to the analytical side of the project and was an inspired micromanager of the entire effort. Tony Barclay, senior vice president of DAI, created a supportive environment within the company and was responsible for much of the refinement of the final text. Wendy Weidner and Russ Webster of RRNA and Jessica Robin, Bill Grant, Peg Clement, Sandy McKenzie, Priscilla Tucker, Robin Johnson, and Lois Hughes of DAI all provided important contributions at critical points in the study. Linda Robinson, Lori Anaheim, Cereta Dudley, Carol Kulski, and Tony Johnson from DAI's Publications Office were tolerant and professional in meeting numerous last-minute deadlines.

Special acknowledgment must be given to Joseph Lieberson and Cressida McKean of the A.I.D. Bureau for Policy and Program Coordination, Center for Development Information and Evaluation (PPC/CDIE) who provided continual support and guidance to this project. They took a serious interest in the substance of the work and carefully read and reread every draft, each time providing valuable comments and contributions. In addition, they gave wide circulation to early drafts, a process that yielded far more comments, ideas, and insights from within A.I.D. than could possibly be accommodated in any single report.

As we attempted to wade through the growing literature on microenterprise development, we called on many people for their first-hand insights into projects programs and for new ideas. We are especially grateful to Maria Otero (ACCION International); Don Mead (Michigan State University); Tom Dichter (Technoserve, Inc.); Don Snodgrass (Harvard Institute for International Development); Al Berry (University of Toronto); Jacob Levitsky (the World Bank); Cheryl Lassen; Shari Berenbach; Jeff Ashe; Marguerite Berger (International Center for Research on Women [ICRW]); Michael Farbman, Elizabeth Rhyne, Ross Bigelow, Andrea

Baumann, and Tom O'Keefe (A.I.D.); Clay Wescott and Eric Nelson (DAI); Mayra Buvinic (ICRW); Suzanne Kindervatter (Overseas Education Fund); and Bill Doyle, Bob Ondrusek, and Mary Reintsma (RRNA).

Although they are inclined otherwise, those acknowledged are relieved of any responsibility for the content of this report.

SUMMARY

This report presents the results of a review of 32 microenterprise development projects and programs supported by the U.S. Agency for International Development (A.I.D.). The purpose of the study (the stocktaking) is to identify important lessons that can be drawn from A.I.D.'s experience in supporting microenterprise development to improve the quantity and quality of information available to the Agency's policy-, program-, and project-level decision-makers.

Approaches to Microenterprise Development

There are significant differences in the developmental goals and approaches of microenterprise development programs. These differences are a reflection of the breadth and heterogeneity of the microenterprise sector and the divergent interests of the institutions promoting microenterprise development.

Three approaches to microenterprise development have been identified in this study: the enterprise formation approach, the enterprise expansion approach, and the enterprise transformation approach. Each approach takes on a different developmental challenge, assists a different target group within the microenterprise sector, and operates with different developmental goals.

Programs following the enterprise formation approach aim to integrate highly disadvantaged groups or individuals into the microenterprise sector. The challenge confronting these programs is to develop viable businesses, owned and operated by relatively inexperienced entrepreneurs, generally in economically isolated areas. Enterprise formation programs target the poorest of the self-employed and the unemployed in the communities in which they operate. Services provided by enterprise formation programs most often consist of direct training and technical assistance integrally linked with, and often preceding, the provision of credit.

Programs following the enterprise expansion approach offer services--primarily short-term credit--that enable microentrepreneurs to increase their sales and income and, in some cases, to generate jobs through incremental improvements in performance. This approach emphasizes small, achievable improvements across a relatively large number of firms. The expansion approach is used by programs that target services to microenterprises and by financial institutions whose services are not

targeted but are available to microentrepreneurs. Programs targeted to microenterprises often provide a limited amount of training to improve the quality of the clients as borrowers. Some programs focus more heavily on training and technical assistance, but these are exceptions among the enterprise expansion programs. The nontargeted financial institutions in the sample served broad geographic regions; programs that explicitly targeted microenterprises worked primarily in the informal sector of large metropolitan centers.

Programs following the enterprise transformation approach seek to accelerate the development of microenterprises into more productive, better managed, dynamic businesses--to graduate clients from the microenterprise sector. Successful transformation programs can result in increases in income and employment in the short term, but, more important, they can set in motion a sustainable, long-term process of enterprise growth. The enterprises aided by these programs are only slightly larger, on average, than those assisted by the enterprise expansion approach. Programs following the enterprise transformation approach most often provide an integrated mix of credit, training, and technical assistance to a select group of microenterprises. However, there are several variants to such programs, including pure credit and pure training and technical assistance programs. Some newer programs have combined direct assistance to clients with indirect efforts designed to expand the opportunities for profitable business development.

Project and Program Performance

1. Microenterprise development programs--irrespective of approach--can result in significant benefits for assisted firms. There is, however, considerable room to improve our understanding of the magnitude and sustainability of direct beneficiary impact. We do not know how significant the benefits are, to what extent these benefits are sustained, whether they represent net gains to the economy, or how impact varies among different approaches and assistance strategies.

Microenterprise assistance programs can make a difference for assisted enterprises. That sales, income, or employment increased in firms that received assistance has little meaning, however, unless this change is compared with the performance of firms not included in the program and with the progress that firms would have made without the program's assistance. Some types of microenterprises, particularly those in the informal sector, operate in environments in which demand is not growing

and entry is not constrained. In such situations, some benefits generated by assistance programs are not net gains to the economy but come at the expense of microenterprises that were not assisted. Concern with these types of impact issues goes well beyond adding decimal points to benefit calculations: it deals with impact issues at the foundation of microenterprise program strategy.

Enterprise formation programs must demonstrate that the enterprises they promote can endure the test of the market without the competitive advantages offered by cheap loans and technical assistance. Although positive beneficiary impact was reported for all of the programs reviewed, some doubts were expressed about the significance of the gains. Moreover, there was a relatively high failure rate--dropout, absence of impact, or business failure--among beneficiaries of these programs. This result is not unexpected, given the difficult business climate faced by a relatively inexperienced entrepreneurial group. Social benefits are considered important for formation programs, but the significance of these types of benefits has not been well documented.

Enterprise expansion programs must be able to show that the benefits accruing to assisted firms are net gains to the economy and do not arise from the decreased sales of competitors. Short-term loans have been shown to result in increases in income, reduced underemployment, and, in some cases, increased employment. However, such assistance by itself can help existing businesses grow only so far; eventually, other constraints will cap the expansion. One study (Berenbach 1988) found that providing additional working capital loans without addressing constraints of management capacity, fixed assets, or technology had a negative impact on enterprise performance.

Enterprise transformation programs need to establish that the long-term benefits resulting from their efforts are sufficient to justify the relatively high cost of the programs. The sample programs generally reported positive direct beneficiary impact on both incomes and employment. Two of the sample programs were reported to have influenced the policy environment. Both programs worked on an industry-specific basis and at several different stages in the industry, and both developed expertise that earned them a seat at the policy table.

2. The number of beneficiaries reached varies considerably across programs, but most of the programs targeting assistance to microenterprises are very small.

With few exceptions, enterprise formation and transformation programs focused their resources on a limited number of beneficiaries. The formation programs reviewed reached an average of 328 beneficiaries per year; the transformation programs directly reached an average of 264 firms. Although the enterprise expansion programs targeting microenterprises reached an average of 642 beneficiaries per year, they were dwarfed by the financial institutions whose beneficiaries number in the hundreds of thousands annually.

The differences in the number of beneficiaries reached by the financial institutions versus the other implementing organizations are due to several factors. Financial services are standardized products that can be mass-produced; tailored training and technical assistance cannot. Expansion of financial services programs requires strong management systems, but is less demanding in terms of line staff requirements; training and technical assistance programs require skilled staff members at the lowest levels of the organization, limiting coverage. The far-reaching financial institutions have, on average, been operating 3 1/2 years longer than the formation programs, 4 1/2 years longer than the expansion programs targeting microenterprises, and 5 years longer than the transformation programs.

3. Microenterprise programs are well suited to the goal of integrating women into the development process. In many programs reviewed, the proportion of women beneficiaries is high.

The proportion of women beneficiaries was highest in programs that (1) specifically targeted women and (2) targeted assistance to urban, commercial microentrepreneurs--sectors having proportionally high rates of female participation. A gender-specific focus caused no obvious performance trade-off. The majority of the enterprise formation programs reached a large proportion of women, both through explicit targeting and through focusing on the neediest groups in the program communities. Programs following the enterprise expansion approach, by virtue of their orientation toward commercial activities, tended to have a high proportion of women beneficiaries. Transformation programs, except when specifically targeted, did not reach a high proportion of women.

4. Microenterprise programs reach members of the poor majority in poor societies, who benefit both as entrepreneurs and as employees. However, the entrepreneurs assisted by these programs--regardless of approach--are not among the poorest of the poor.

Microenterprise programs do not, in general, directly assist those in the bottom 20 percent of the income distribution. The average loan size in the surveyed programs was often several multiples of what the very poorest receive as income each year. Even among the enterprise formation programs, selection is prudently biased in favor of those with entrepreneurial ability, who are not likely to be the poorest in their communities. Although the clients of these programs were indeed poor, they were not necessarily the poorest in the areas of project activity. This fact is not unique to the assistance strategy or donor; it is a characteristic of those involved in microenterprise.

5. Microenterprise programs decrease underemployment by the self-employed and create productive new employment opportunities. Programs that assist manufacturing firms generate the greatest number of new employment opportunities. There is no evidence in the reviewed programs that the jobs created are inferior in income, risk, or working conditions to self-employment. Microenterprise development has its greatest impact on the poorest of the poor by creating jobs.

Assistance provided to manufacturers generate the greatest number of new jobs, which are located within poor communities and generally do not require sophisticated skills. Programs that emphasize fixed-asset lending to manufacturers have a greater potential for reaching the poorer groups than do programs that place a greater emphasis on working capital loans to nonmanufacturing enterprises. Such job creation benefits those unable or unwilling to become entrepreneurs.

6. Successful microenterprise interventions can give A.I.D. a seat at the policy table, strengthen the political clout of businesses, attract the attention of policymakers, and result in important policy changes.

Program and project activities have shown an ability to gain the implementing organizations a seat at the policy table and to influence policies that have a critical bearing on enterprise development. Rather than attempting to earn credibility through research papers or conditionality, projects provide a vehicle for amassing hands-on information about the local business environment and for demonstrating the effect of constraints and the vision of what might be accomplished in the absence of those constraints.

7. Successful microenterprise development projects can exert a significant influence on the development of financial markets.

The best projects contributed to the development of financial markets of the countries in which they were located. These projects developed sustainable financing systems, created linkages, and increased the depth, integration, and efficiency of financial markets. The projects innovated financial arrangements that enabled microentrepreneurs to borrow more freely. The costs of financial transactions were reduced by risk-reducing innovations such as group guarantees, standardized feasibility analysis, and short-term working capital financing.

8. Cost per beneficiary is an indicator for comparing efficiency across programs and efficiency over time for an individual program. Cost per beneficiary varied widely across the programs--from $90 to $7,000.

The three approaches employ different technologies for assisting enterprises; some incur higher costs on the expectation of higher benefits. The cost per beneficiary was relatively high in the enterprise formation programs, but varied considerably. Higher costs were associated with the remoteness of the area being served and with the intensity of the training and technical assistance provided. Costs per beneficiary ranged from more than $2,600 in a research and development-intensive project to a reported low of $127 in a mature program. The cost per beneficiary can be extremely low in expansion programs because of the minimal technical assistance and training, and the use of low-cost screening methods. Average cost per beneficiary in the subsample was $575. Cost per beneficiary for the transformation programs was high--over $2,500 per beneficiary. The programs justify this high cost on the basis of the expectation of large long-run benefits.

9. Cost per dollar loaned is another indicator commonly used in evaluating microenterprise programs. This measure also suffers from the problem of program maturity and is often computed on the basis of different kinds of costs. The cost per dollar loaned in the sample varied from $0.19 for a minimalist credit program to $7.68 for a women-focused enterprise formation program.

Cost per dollar loaned is most useful for comparison when it is based only on the costs of delivering credit or when programs with similar mixes of services are compared. For the formation programs, cost per dollar loaned varies from a high of $7.68 for the experimental stage of a program in Honduras to a reported $0.42 in Egypt for a long-running project. The cost per dollar loaned for most enterprise expansion programs is low because of low overall operating costs combined with rapid portfolio turnover. The sample average was $0.46 per dollar loaned. Among the transformation programs, cost per dollar loaned was not available

for the pure credit programs, but for the mixed-services programs it ranged from a high of $3.90 to $0.20 for a mature program. The average cost per dollar loaned in this subsample was $1.08.

10. The information available is inadequate to judge the economic returns on investments in microenterprise programs relative to alternative uses of scarce foreign assistance resources. However, the indicators that do exist point to very high returns on investment in microenterprise development programs.

Although examination of beneficiary impact, cost-effectiveness, and institutional sustainability offers clues about the payoff of microenterprise interventions, these indicators do not provide the kind of comparative information that can inform policy-level decisions within A.I.D. The most recent thorough cost-benefit analyses of microenterprise projects found that the projects enjoy an undiscounted benefit-cost percent ratio greater than unity, with internal rates of return above 100 percent. These rates of return place microenterprise lending schemes among the most successful categories of foreign aid programs. Other studies also report favorable results. A 3-year study of an industry-specific technical assistance project concluded that the activity had a positive cost-benefit ratio (internal rate of returns), despite high costs attributable to its experimental status. A recent analysis of a high-cost enterprise formation program estimated the internal rate of return to be 6 percent. When the internal rate of return was recalculated to net out the effect of the research and development aspects of the program, however, it rose to 66 percent.

11. Financial self-sustainability of implementing institutions has been achieved in programs that limit their assistance to low-cost financial services. However, even in these cases, elements of subsidy to the institution are present. Long-term institutional survival and a sustained flow of services are often achieved through a combination of earnings, philanthropy, government budget appropriations, and donor assistance.

Enterprise formation and transformation programs cannot and do not set out to achieve financial self-sustainability. For these types of programs, the overall strength of the implementing institution and its capacity to raise funds from external sources are the keys to sustainability. Four of the minimalist credit enterprise expansion programs claimed to be financially self-sufficient. However, all of these programs relied on varying forms of subsidized inputs, including concessional sources of

loan funds, free technical assistance, and critical supervisory and control functions.

12. Financial self-sustainability of the implementing institution is not a necessary condition for successful, cost-beneficial enterprise development; however, for the assisted enterprises, financial sustainability is essential.

Economic rather than financial analysis is used to inform public sector expenditure decisions because of the need to add up the gains and losses that accrue to different groups affected by such decisions. From a cost-benefit standpoint, it may be justifiable to support the development of a microenterprise assistance institution that loses money if the benefits accruing to other groups are significant enough to more than offset the losses. The bias in favor of self-sustainability of service delivery is of recent vintage. It is predicated on the theory that markets offer the best possible test of the value of a service. In less developed economies, there are many reasons for the divergence of financial and economic returns. To judge the contribution of any particular project on the basis of the self-sustainability of its operations overlooks important developmental benefits not reflected in the profitability of the provider.

What We Know, What We Do Not Know, and What We Need To Learn

1. Direct assistance programs that aim to improve the performance of microenterprises by providing short-term credit without attempting to transform these firms into more complex businesses have a better record of achievement to date than do more ambitious transformational programs.

Enterprise expansion programs share a number of characteristics and are consistent with the so-called minimalist credit model. They provide small working capital loans with efficient screening, rapid disbursement, and a reasonable assurance of the availability of progressively larger loans upon successful repayment of previous debt. Interest rates are high and reflect the real cost of delivering the services. Limited amounts of training and technical assistance are sometimes provided, but with the primary purpose of educating the clients to become reliable customers. More extensive training and technical assistance are provided on a voluntary basis after the loan has been issued and, in the best programs, are not financially comingled with the credit activity.

Although the beneficiaries of the successful programs are poor, they are not the poorest of the poor. The vast majority of clients are in the commercial sector. As a result, these programs reach a very high proportion of women. Benefits are modest but widespread. Most of the benefit is in the form of increased income and reduced underemployment, although some employment is also created.

Without exception, organizations implementing these programs set out to establish financial self-sustaining credit systems. Self-sustainability is not an afterthought, but a primary organizational goal of organizations implementing enterprise expansion programs. As a result, implementing organizations exhibit a businesslike attention to cost, revenue, the market for the service, the technology of service delivery, staffing and staff development, and management information systems. The volume of lending is an essential ingredient of the financial performance of these organizations; thus they must operate in a market area large enough to achieve needed economies of size. This requirement is consistent with both the urban location of the Latin American programs and the decentralized structure of the programs in regions of high population density. These organizations reach smaller markets--secondary cities, for example--by branching out from a successful urban base.

In Latin America, the enterprise expansion approach has been most successfully undertaken by new institutions established for the express purpose of implementing such a program. These institutions have demonstrated an ability to deliver services annually to thousands of microenterprises. In Asia, the most successful programs have been implemented by government-linked financial institutions. The most successful projects have worked to strengthen the operations of existing institutions. These organizations are highly decentralized and have strong central supervisory structures and wide geographic reach, with operational units sometimes extending to the village level. As financial institutions, they do not specifically target microenterprises, and a significant portion of the lending is used for client investment rather than consumption. In Africa, loans are provided through the credit union system. Lending is also not targeted, and a much smaller proportion of loans is used by microenterprises--a function of the relatively lower density of economic activity.

These programs and the institutions involved in implementing them have discovered a service (small, short-term loans), a market, and an appropriate technology for delivering the service efficiently. The programs are start-up enterprises themselves--enterprises that justify initial subsidization as a result of their strong indirect benefits. To succeed, they must possess

the qualities of a successful business. The difficulties of establishing a successful enterprise expansion program should not be underestimated. Although there is a well-developed technology for implementing these programs, there are many hurdles to effective implementation--of which the most important is the choice of an implementing institution.

2. The services provided by nontransformational minimalist credit programs are sufficient to generate benefits for some microenterprises, in some areas, at some stages in the life cycle of the microenterprise. But the needs of the vast majority of microenterprises cannot be satisfied merely by providing small working capital loans.

The tremendous diversity among firms that fall within the definition of microenterprise also accounts for the constraints to growth faced by microenterprises. In most empirical surveys, respondents name lack of cash or credit as the most important problem facing the firm. This finding, however, must be treated cautiously. Cash-flow problems often are symptoms of other, more serious problems. Decisions to produce the wrong product for the wrong market at the wrong price are first felt as cash shortages. Furthermore, credit problems are often reported as "most pressing," but are first on a list of several constraints.

What stands out about the success of the minimalist programs is the potential self-sustainability of the implementing institutions and the associated perpetual flow of services. Moreover, efficient delivery of services corresponds to the needs of some microenterprises in some areas at some stages in their life cycle. But not all microenterprises can be caught in this net: for example, those requiring other inputs in addition to or as a substitute for working capital credit and those located in less densely populated areas. Programs that attempt to reach these firms are unlikely to be judged successful, when compared with the success of the minimalist model, unless evaluators explicitly take into account the very different developmental challenge such firms present. Few packages of development services can be delivered in a self-sustaining fashion. Delivery of a variety of services, however, while it may not be compatible with institutional self-sustainability, may result in the development of sustainable enterprises and generate more developmental benefits than costs.

3. The question of how to reach the enterprises whose needs cannot be satisfied by the minimalist strategy remains unanswered.

Direct assistance programs--credit, training, and technical assistance--aimed at integrating economically inactive and marginal groups have achieved their goals, but at a relatively high cost per beneficiary and on a limited scale. Direct assistance alone has not proved to be an effective or efficient means of inducing the developmental transformation of microenterprises. This fact is particularly disturbing given the potential productivity, income, and employment benefits of the business development approach. Assistance to firms not reached by the expansion programs may offer the greatest potential for reaching the poorest of the poor by creating jobs and for generating the greatest developmental impact by transforming marginal enterprises into sustainable businesses. A number of recently completed and ongoing projects and programs are explicitly directed toward testing innovative strategies for promoting business development. These include minimalist credit, training and technical assistance with and without credit, and industry- and subsector-specific interventions incorporating both direct and indirect assistance. Preliminary results from these experiments are promising.

Additional Findings and Factors Associated With Successful Performance

1. Clarity of the developmental approach, mission, and objective of the program is an essential ingredient to program success. Moreover, the donor--in the field and in Washington--and the implementing institution must share the same vision.

Microenterprise appeals to the concerns of a number of very different constituencies. Each group has its own view and understanding of the goals and purposes of microenterprise development. The three developmental approaches identified in this study attest to the range of perspectives on microenterprise. When pressure is placed on programs to be all things to all people, the effects are predictable: program focus is diluted, scarce management resources are spent resolving conflicting objectives, and incentives are distorted. Program managers cope with contradictions by trying to achieve a mixed bag of outputs well enough to ensure the next tranche of funding.

2. Successful microenterprise programs focus first and foremost on the development of profitable and sustainable businesses. Secondary targeting--directing resources to women or disadvantaged groups, for example--should be consistent with this primary focus.

The benefits of microenterprise development arise from the income earned by producing or selling goods and services. If the services provided to enterprises by assistance programs do not improve the performance of the businesses, there will be no benefits and the distribution question is moot. As obvious as this point seems, there are programs in the sample that have given priority to delivering resources to a particular target group at the expense of business development. Secondary targeting may mean that the businesses with the greatest potential profitability are sacrificed in favor of more modest ventures that are operated by women or other socially or economically disadvantaged groups. This targeting division is made on the basis of the value attached to the distribution of benefits.

3. A distinction can be made between the target beneficiary group and the targeting of assistance.

Most microenterprise assistance programs are a reaction to the failure of trickle-down economics and are based on the assumption that assistance must be provided directly to the beneficiary. Everyone must be his or her own entrepreneur. This perspective, however, presumes an answer to a question that is only beginning to be asked: trickle-down from what level? The previous discussion of employment impact pointed out that the poorest target groups may best be reached by assisting firms with the greatest potential for creating jobs accessible to the poor. A similar conclusion might be drawn for assisting firms in industries with high rates of female employment as a vehicle for distributing benefits to women. In the end, the issue is less one of who is assisted than of who receives the benefits from different types of assistance strategies.

4. Graduate programs, when possible, not enterprises.

Graduation is a double-edged sword for credit programs. Programs with progressive lending systems find that repeat customers who are eligible for longer term and larger loans restrict program expansion. If these reliable, low-cost clients graduate, however, the programs must assume greater risk and cost because they continually lose their best borrowers. The firms that are candidates for graduation are the best customers of the institutions. To lose established customers and replace them with new enterprises places real pressures on the financial position of the institution.

An alternative to graduating enterprises is the graduation of programs to commercial sources of funds. Microenterprise lending programs are well suited to retailing funds borrowed from commercial sources. The ability of microenterprise lending institutions to graduate will depend on the situation in local

financial markets. This type of graduation has attractive features. First, it imposes a discipline on the programs that goes beyond the stewardship of donor money. Second, it offers strong incentives for the adoption of interest rates that account for the opportunity cost of funds and inflation. Third, it encourages the adoption of accounting practices that separate lending activities from nonfinancial assistance and permit much more careful assessment of the costs of different types of service provision.

5. Average loan size varies with the developmental objective of particular programs.

The recommended average loan size for microenterprise lending programs supported by A.I.D. is $300. Out of the 41 loan portfolios of the 32 programs in the stocktaking sample, 13 met this criterion. Three of these were formation programs; 10 were expansion programs. The average size of the loans for programs following each of the three approaches is significantly above the $300 standard. Enterprise formation programs averaged just over $500; both types of expansion programs were in the $700 range; and the transformation programs averaged over $3,000 per loan.

6. The state of the art in understanding the role and value of training and technical assistance in microenterprise development is far less advanced than the understanding of credit.

A long legacy of failed public sector training and technical assistance programs has diverted attention away from training and technical assistance, thus retarding the development of the field. Only a handful of the evaluations and studies reviewed for this report included any real consideration of the content and quality of training materials, the appropriateness of delivery mechanisms, or the impact of these forms of nonfinancial assistance on the development of enterprises. The legacy of failure has had an equally important impact on prospective clients of training programs. In all three continents, the field assessments referred to entrepreneurs' skepticism about and reluctance to participate in training programs.

There are indications that training and technical assistance methods are improving over time. One program reported that only about 40 percent of borrowers were willing to attend postloan training courses, but, of those who did, less than 1 percent dropped out. Well-tested courses in business management are now being used in one project, and clients are paying to enroll (possibly induced by the hope of credit). Another organization is charging for technical assistance that is not linked to credit and, even at a very early stage in the program, is recovering 40

percent of costs. Some organizations have recently devoted considerable effort to developing business training techniques appropriate for the needs of particular disadvantaged groups.

7. There is no consistent relationship between the type of implementing institution and project or program performance--except that the institution be strong, mission oriented, competent, honest, and well directed.

If there is any single topic on which there was general consensus in the field assessments and secondary evaluations, it was the overwhelming importance of intangible, qualitative factors, particularly institutional leadership and commitment. Among the factors highlighted are the following:

-- A clear, unambiguous mission that is understood and accepted at all levels of the organization.

-- Strong and charismatic leadership. The most successful programs are led by an energetic national or dedicated foreign expert who has established strong linkages with local elites.

-- Well-trained and dedicated staff. Successful organizations cultivate organizational loyalty and encourage staff development through training, equitable personnel plans, and financial incentives for good performance.

-- Attention to organizational structure, commonly emphasizing horizontal functional relationships and delegated responsibility and authority.

-- Management information systems. The best programs are characterized by tight management information systems and forms of financial control, often computerized.

-- Flexibility, specifically the ability to learn from experience and to adapt to changing circumstances.

Where Do We Go From Here?

1. A.I.D. should accord high priority to continuing basic and applied research and development in the field of small-scale enterprise and microenterprise development.

Microenterprises have been around for a long time; microenterprise development has not. The rapid pace of recent developments must be viewed in the context of the limited base of

experience in microenterprise compared with many other areas of development assistance. The A.I.D. portfolio is evolving along with developments in the state of the art. Recently designed projects have drawn on the experience of earlier successes and, in some cases, are taking well-informed risks in an effort to continue to push back the frontier of knowledge about microenterprise.

The value of A.I.D.'s research and development program is clearly demonstrated in the field of microenterprise. It took many years to realize that agricultural development programs could not be effective without well-tested, appropriate packages of assistance. The same is true for microenterprise development. The most successful A.I.D.-sponsored enterprise development programs have been based on the technology developed and refined by studying the strengths and weaknesses of existing programs and then testing improved varieties under actual field conditions. The success of minimalist methodology can be traced to the extensive research and development effort supported by A.I.D. under the centrally funded Program for Investment in the Small Capital Enterprise Sector (PISCES) and other research on rural financial markets. These cases provide an excellent example of the value of applied research for program and project development.

Continuing basic and applied research is needed in several areas, including the following:

-- Qualitative research on the impact of direct and indirect forms of assistance on enterprises in combination with a limited number of thorough cost-benefit studies of microenterprise development programs

-- More careful analysis of the potential of different types of nonfinancial forms of assistance

-- Basic research to understand better the dynamics of enterprise growth and transformation

2. 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.

Business, regardless of its size, requires access to financial services. The financial institutions reviewed in the stocktaking provided necessary services to large numbers of beneficiaries, followed innovative screening and lending procedures, and performed well by commercial standards. The development of such financial institutions requires time, a favorable policy environment, and considerable developmental interest on the part

of concerned officials and bankers. However, these institutions do not appear overnight, and they expand slowly. A.I.D. may want to work closely with other donors, particularly the World Bank, whose comparative advantage is in the development of large-scale financial institutions.

3. When and where such financial services are unavailable, A.I.D. should encourage and support private organizations to extend the reach of the financial system by retailing financial services to microenterprises.

The programs of private organizations are a substitute for both financial institutions and moneylenders. The programs should be developed as if they will become financially self-sustaining and integrated into local financial markets. These private organizations will not achieve the economies of size associated with large-scale financial institutions and may require continued subsidization through granting of developmental terms on a portion of their asset structure and provision of technical assistance for management and operations.

4. The long-term financial needs of microenterprises will not be easily met through financial institutions. Here, there is stronger justification for experimenting with strategies that apply simplified appraisal systems and that base lending decisions on credit history and character.

Delivery of long-term fixed asset financing for microenterprises is not likely to be undertaken by banks or other financial institutions because of the high costs of appraisal and the effect of such lending on portfolio turnover. This type of lending is not a commercial proposition; it will require continuing external subsidization.

5. Training and technical assistance programs should be supported, but only when they respond to the identified business needs of microentrepreneurs. Some training is integral to the operation of effective lending programs, and it should be considered a cost of lending operations. Other types of training and technical assistance should be kept financially independent from lending operations.

Enterprise formation and transformation generally involve training and technical assistance. The particular strategies adopted should be responsive to the kinds of business opportunities available to entrepreneurs. Knowledge about the effectiveness and impact of different forms of nonfinancial assistance lags well behind our understanding of credit. Training and

technical assistance programs should be integrated into the applied research efforts mentioned earlier so that this imbalance can be overcome.

GLOSSARY

ACCION	ACCION International
ADEMI	Microenterprise Development Association (Asociación Para el Desarrollo de Microempresas)--Dominican Republic
ADOPEM	Dominican Association for Women's Development (Asociación Dominicano Para el Desarrollo de la Mujer)--Dominican Republic
A.I.D.	Agency for International Development
ATI	Appropriate Technology International
BKK	Badan Kredit Kecamatan--Indonesia
BMM	Women's World Banking (Banco Mundial de la Mujer)
BRI	Bank Rakyat Indonesia
CamCCUL	Cameroon Co-operative Credit Union League
CDIE	A.I.D. Center for Development Information and Evaluation
CEDP	Community Enterprise and Development Project--Senegal
CEOSS	Coptic Evangelical Organization for Social Service--Egypt
CHF	Cooperative Housing Foundation
CID	Council for International Development
CJEDP	Central Java Enterprise Development Project--Indonesia
CJEDP-R	CJEDP Rattan Export Development Activity--Indonesia
DAI	Development Alternatives, Inc.
DDF	Dominican Development Foundation
DEMATT	Development of Malawi Traders Trust

EUS	Aid to Urban Enterprises With a Solidarity Guarantee (Emprendamientos Urbanos con Garantía Solidaria)--Costa Rica
FAPE	Small Enterprise Assistance Foundation--Guatemala
FDM	Women's Development Foundation--Guatemala
FED	Ecuadorean Development Foundation (Fundación Ecuatoriana de Desarrollo)--Ecuador
FEE	Eugenio Espejo Foundation (Fundación Eugenio Espejo)--Ecuador
FID	Financial Institutions Development project--Indonesia
FONDESA	Development Fund (Fondo Para el Desarrollo)--Dominican Republic
FPCD	Paraguayan Cooperation and Development Foundation (Fundación Paraguaya de Cooperación y Desarrollo)--Paraguay
FUNADEH	National Development Foundation of Honduras (Fundación Nacional Para el Desarrollo de Honduras)
FUNDAP	Foundation for the Development of Socioeconomic Programs (Fundación Para el Desarrollo Integral de Programas Socioeconomicos)--Guatemala
GDP	gross domestic product
HIID	Harvard Institute for International Development
ICRW	International Center for Research on Women
IDEA	Instituto de Educación Administrativa
IIDI	Institute for International Development, Inc. (Opportunity International)
INCAE	Central American Business Administration Institute (Instituto Centroamericano de Administración de Empresas)--Costa Rica
INSOTEC	Institute for Socioeconomic and Technical Research--Ecuador
KUPEDES	General Village Credit Program of the Bank Rakyat Indonesia

MBM	Maha Bhoga Marga ("Way of Prosperity")--Indonesia
MUSCCO	Malawi Union of Savings and Credit Cooperatives
NCCK	National Council of Churches of Kenya
NCCK-SBS	Small Business Scheme of the NCCK, Kenya
NDF-B	National Development Foundation--Belize
NDF-J	National Development Foundation--Jamaica
NIMBA III	National Development Foundation--Liberia
NTF	New Transcentury Foundation
OEF/I	Overseas Education Fund International
OI	Opportunity International, Inc. (formerly IIDI)
PADF	Pan American Development Foundation
PfP	Partnership for Productivity
PISCES	Program for Investment in the Small Capital Enterprise Sector
PROAPE	Small Business Assistance Program (Programa de Asistencia a la Pequeña Empresa)--Dominican Republic
PRODEME	Program for the Development of Microenterprises--Dominican Republic
PROSEM	Business Promotion and Services (Promoción y Servicios Empresariales)--Guatemala
PVO	private voluntary organization
PWC	Puskowanjati Women's Cooperative--Indonesia
READI	Rural Enterprise and Agrobusiness Development Institution
REDP I	Rural Enterprise Development Project, Phase I--Burkina Faso
RRNA	Robert R. Nathan Associates, Inc.
SEDP	Small Enterprise Development Project--Ecuador

SELP	Small Enterprise Loan Program--Egypt
SIMME	Small Enterprise Loan Program--Guatemala
SSE	Small Enterprise Loan Program--Malawi
UDF	Urban Development Fund--Peru
UNDP	United Nations Development Programme
VITA	Volunteers in Technical Assistance
WEDP	Women's Entrepreneurship Development Program--Bangladesh
WIB	Women in Business Program (OEF/I)
WOCCU	World Council of Credit Unions
WWB	Women's World Banking

1. INTRODUCTION AND OVERVIEW

1.1 Background[1]

Tens of millions of the world's poor work as individuals or in small groups to collect, manufacture, or sell goods and services to earn a livelihood. A significant proportion of economic activity in developing countries is conducted, by choice or by necessity, in very small economic units--microenterprises. Some individuals are drawn into microenterprises by the incentive for profit signaled by the demand for goods and services; others are left no alternative but to struggle to subsist through self-employment alongside, and in competition with, others existing outside the "formal" economy. Firms employing 10 or fewer full-time workers account for between 40 and 90 percent of manufacturing employment in developing countries. In rural areas, microenterprises account for the majority of manufacturing employment; in urban areas they commonly account for the majority of employment in the commerce and service sectors.[2]

Microenterprises have, in one form or another, been on the agenda of the development community for many years. The recent growth in their popularity among donors, development agencies, and governments is the result of the convergence of political and developmental concerns. Employment issues dominate the political and economic agenda in almost every developing country. Problems of urban poverty, declining labor absorption in agriculture, and slow rates of job creation in nonagricultural sectors have intensified the need for creative strategies for employment and income generation. Efforts that foster the development of indigenous entrepreneurial talent and support the economic initiatives of the poor offer an attractive grassroots weapon for attacking the problems of poverty and unemployment.

Although few disagree with the goal of enterprise development defined in this way, considerable debate remains about what,

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[1]The first two chapters of this report summarize and draw liberally from the background and conceptual overview paper prepared for the stocktaking study (Boomgard et al. 1989).

[2]More detailed statistics on the importance of small enterprises and microenterprises in developing economies can be found in Liedholm and Mead (1987).

if anything, ought to be done to promote microenterprise.[3] Among the unresolved questions are the following:

-- Under what conditions can a growing microenterprise sector make a positive and sustainable contribution to development through its effect on broad-based growth, generation of productive employment opportunities, and more equitable distribution of income? Or is a growing microenterprise sector a pathology--a sector of the economy best absorbed into larger, more efficient and productive firms?

-- What approaches or types of interventions, if any, can effect a change in the pattern of development of the microenterprise sector? Is this change best accomplished by providing services directly to beneficiaries or through indirect means, such as policy, that influence the opportunities available for profitable business ventures?

-- Under what conditions are different approaches to microenterprise development able to generate high economic and developmental returns relative to competing uses of scarce public sector resources?

Embedded in these basic questions are numerous other questions that bear on what should and can be done to promote microenterprises. For example, what trade-offs, if any, are involved in targeting assistance to particular disadvantaged groups as compared with those best able to use project services productively? Are the poor best served by removing barriers to productive self-employment or by creating productive jobs in enterprises owned by others? The answers to these and other questions about the appropriate types and mixes of services, institutional delivery mechanisms, and sustainability of benefits

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[3]Also, there remains considerable debate on the role of microenterprises in the process of economic growth, a topic that is not addressed in this study. The controversy revolves around the relative dynamic efficiency of different sizes of firms and the effectiveness of supply-side interventions, as opposed to structural adjustment and policy change. Despite the theoretical and strategic importance of these concerns, the empirical technology required to resolve the debates does not exist. This report is predicated on the assumption that the program goals of the Agency for International Development are well served by continuing to support interventions that generate relatively more benefits than costs and that reach the Agency's chosen target populations.

and services are at the core of discussions on the way to best reach the poor through enterprise development.

1.2 Overview of the Stocktaking

This synthesis report is the final component of the Agency for International Development's (A.I.D.) Evaluation of the Effectiveness of Alternative Assistance Approaches in Microenterprise Development (also called "the stocktaking study"). The stocktaking study focuses on identifying projects and programs that have proved effective in generating and sustaining developmental benefits and on analyzing the factors responsible for their successful performance. The objectives of the stocktaking are to determine which approaches to microenterprise development are most consistent with A.I.D.'s program goal of broad-based economic growth and to understand the conditions that govern the choices among competing strategies.

The stocktaking is based on primary data collected from field assessments of active programs in 10 countries and on secondary information obtained from a review of available materials on a sample of A.I.D-sponsored microenterprise projects. The primary and secondary data constitute a sample of 32 projects and programs. In addition to this synthesis report, the stocktaking includes a background and conceptual overview paper (A.I.D. Evaluation Special Study No. 63), a statistical overview, and 10 separate reports presenting the results of the country field assessments. The evaluation was conducted by Development Alternatives, Inc. (DAI) and Robert R. Nathan Associates, Inc. (RRNA) under the direction of the A.I.D. Center for Development Information and Evaluation (CDIE).

1.3 The Sample of Projects and Programs Reviewed

The findings of the stocktaking are based largely on the analysis of the 32 cases included in the sample. Although the stocktaking team endeavored to draw information from projects and programs that were representative of the entire A.I.D. portfolio, the sample is by no means free of bias. The universe of A.I.D. projects and programs designed to assist microenterprises is large, diverse, and scattered throughout the Agency. According to a recent study (Lieberson and Doyle 1989), at least 87 active A.I.D. field projects or programs in 35 countries, including projects designed solely to assist microenterprises, private sector development projects, and microenterprise components of larger projects, will spend $290 million over their total project

life. Field projects accounted for approximately 90 percent of the $57 million spent on microenterprise projects in FY 1988. The remaining 10 percent was accounted for by centrally funded projects sponsored by four Washington-based bureaus. Many microenterprise programs are supported both directly and indirectly through centrally funded matching grants to private voluntary organizations (PVOs). Organizations supported through these grants often receive additional Mission funds for specific projects in the field, making it difficult to count individual activities.

1.3.1 Sample Selection for the Stocktaking

A.I.D. selected the field projects in the 10 countries on the basis of whether the projects had been operating long enough to have an established track record, whether they employed interesting and innovative approaches to microenterprise assistance, and whether useful lessons could be learned from the individual projects and programs. When possible, field teams also evaluated programs and projects included in the secondary sample. Altogether, 24 projects or programs were reviewed in the field, of which 13 overlapped with the secondary sample.

The selection of projects to be included in the secondary sample, the document review, presented conceptual and practical challenges. The universe of candidate cases was largely specified by the scope of the stocktaking and included A.I.D-funded projects that, to a greater or lesser extent, targeted assistance to microenterprises and for which some analysis of beneficiary impact was available.

The stocktaking focused on factors associated with successful project performance. This focus required identifying reference material that not only contained complete project descriptions, but also addressed the issue of beneficiary impact in some detail. This proved to be a more limiting criterion than was originally anticipated. Although many evaluations discuss beneficiary impact, few treat the issue in a sound methodological manner. Evaluations serve specific purposes in the A.I.D. system, and, with the exception of a few directed studies, the in-depth assessment of impact is not among the most common objectives.

The emphasis of the stocktaking on beneficiary impact resulted in a focus on field projects, rather than on A.I.D./Washington-supported research or more general institutional support efforts that have a far less direct link with the beneficiary group. Excluded on this basis were the important

centrally funded PVO matching grants program and much of the portfolio of the Bureau for Science and Technology. However, a number of the projects that were included in the stocktaking have been indirectly supported through these mechanisms.

In several cases, it proved difficult to distinguish A.I.D. projects from the programs and institutions supported. Many microenterprise service-delivery institutions draw on an array of external funding sources or have been assisted only in relatively limited ways through A.I.D. projects. For example, the Badan Kredit Kecamatan (BKK) credit program in Indonesia has been the subject of a detailed A.I.D.-sponsored impact evaluation. Because A.I.D. assistance was only a part of a much larger effort, it is impossible to measure the portion of the BKK's reported beneficiary impact that can be attributed to the A.I.D. inputs. In such situations, comparability requires that the overall program be the subject of the analysis. Thus, due caution must be used in attributing results exclusively to A.I.D. intervention.

From the set of projects meeting the evaluation criteria, an effort was made to cover a range of approaches to microenterprise promotion and as many geographic regions and countries as possible. The decision was strongly influenced by the timely availability of key documents that could serve as raw material for the study. In the end, 21 projects were included in the secondary sample. Thus the total sample includes 32 cases.

The sample of 32 cases must be considered a purposive rather than a random sample, and the results must be interpreted accordingly. Nevertheless, we believe that the findings are robust enough to have general applicability.

1.3.2 Composition and Characteristics of the Sample

Table 1 presents the projects and programs included in the evaluation. The table describes the salient features of each case, including the country, the date when A.I.D.'s involvement began, the dollar value of A.I.D.'s contribution to the program or project, the type of implementing institution, the source of technical assistance, the developmental approach of the program, and the service orientation of the project. Summary descriptions of each project are included as an appendix to the background conceptual overview paper (Boomgard et al. 1989).

Table 1. Projects/Programs Reviewed in the Evaluation--Summary Characteristics

Country	Project/Program Name	Beginning of A.I.D. Involvement	A.I.D. Funding ($1,000)	Implementing Institution Type	Source of External TA	Developmental Approach	Services to Enterprise	Desk/Field Review
Asia and Near East								
Bangladesh	Women's Entrepreneurship Development Project	1982	877	Govt	None	F	Credit/TAT	D F
Indonesia	Fin. Inst. Dev. Project	1986	13,745	---	---	---	---	---
	FID/Badan Kredit Kecamatan	1986	ND	Govt	DAI	E	Credit	D F
	FID/KUPEDES	1986	ND	G-Bank	HIID	E	Credit	D F
Indonesia	CJEDP - Rattan Export Development Program	1985	1,400	G-Project	DAI	T	TAT,Policy	D
Indonesia	Puskowanjati Women's Cooperative	1984	505	Coop	None	E	Credit/TAT	F
Indonesia	Maha Bhoga Marga Foundation	1987	179	I-PVO	OI	E	Credit	F
Egypt	CEOSS Income and Employment Generation Project	1983	313	I-PVO	None	F	Credit/TAT	F
Egypt	Helwan Project Small Enterprise Loan Program	1982	181	G-Project	CHF	E	Credit	F
Africa								
Burkina Faso	PfP Rural Enterprise Development Project	1977	2,467	US-PVO	PfP/CID	F	Credit/TAT	D
Cameroon	Cameroon Co-operative Credit Union League	1975	4,800	C-Union	WOCCU	E	Credit	F
Chad	Chad Private Enterprise Project I & II	1984	2,051	US-PVO	VITA	T	Credit/TAT	D
Kenya	Nat. Council of Churches Kenya - Small Bus. Scheme	1981	275	I-PVO	None	F	Credit/TAT	D
Liberia	Nimba County Rural Technology Project	1980	4,264	US-PVO	PfP	E	Credit/TAT	D
Malawi	Rural Enterprise & Agribus. Dev. Institutions	1984	---	---	---	---	---	---
	READI-Malawi Union of Savings and Credit Coop.	1984	1,388	C-Union	WOCCU	E	Credit	F
	READI-Development of Malawian Traders Trust	1987	760	Govt	PfP/Africare	T	TAT	F
Senegal	Community and Enterprise Development Project	1985	9,000	G-Project	---	---	---	---
	Small-Scale Enterprise Component	1985	ND	G-Project	NTF	T	Credit	D F
	Village Organization Component	1985	ND	G-Project	NTF		Credit/TAT	D F
Latin America								
Belize	National Development Foundation of Belize	1983	336	I-PVO	PADF	T	Credit/TAT	D
Colombia	Banco Mundial de la Mujer	1982	ND	A-PVO	WWB	E	Credit/TAT	D
Costa Rica	Aid to Urban Ent. Through a Solidarity Guarantee	1982	65	G-Bank	PISCES	E	Credit	D
Costa Rica	Women In Business Program	1985	ND	US-PVO	OEF	F	TAT/Credit	D
Dom. Rep.	Asociación Para el Desarrollo de Microempresas	1982	1,085	I-PVO	Accion	E	Credit/TAT	D F
Dom. Rep.	Asoc. Dom. Para el Desarrollo de la Mujer	1982	ND	A-PVO	WWB	E	Credit	D
Dom. Rep.	Dominican Development Foundation - PRODEME	1980	500	I-PVO	PISCES	E	Credit/TAT	D
Dom. Rep.	Pro de Asist Peq Empre/Fondo Para el Desarrollo	1985	ND	I-PVO	None	E	Credit/TAT	F
Ecuador	Small Enterprise Development Project	1987	4,500	---	---	---	---	F
	SEDP - Inst. of Socioeconomic & Tech. Research	1987	1,900	I-PVO	None	T	TAT	F
	SEDP - FEE and FED Component	1987	ND	US-PVO	Accion	E	Credit/TAT	F
	SEDP - Carvajal Foundation Component	1988	ND	L-PVO	Carvajal	T	TAT/Credit	F
Guatemala	Small Enterprise Assistance Foundation	1984	ND	I-PVO	OI	E	Credit/TAT	F
Guatemala	Women's Development Foundation	1981	305	I-PVO	None	T	Credit/TAT	F
Guatemala	Found. for the Dev. of Socioeconomic Programs	1985	---	I-PVO	---	---	---	---
	FUNDAP - Momostenango Project	1985	637	I-PVO	ATI	T	TAT	F
	FUNDAP - Nahula Project	1988	195	I-PVO	None	T	TAT	F
	FUNDAP - Prog. for the Support of Microent.	1988	200	I-PVO	Accion	E	Credit	F
Honduras	National Development Foundation of Honduras	1985	1,000	I-PVO	PADF	T	Credit/TAT	D
Honduras	Women in Business Program	1985	ND	US-PVO	OEF	F	TAT/Credit	D
Jamaica	National Development Foundation of Jamaica	1982	500	I-PVO	PADF	T	TAT/Credit	D
Paraguay	Fundación Paraguaya de Cooperación y Desarrollo	1985	370	I-PVO	Accion	E	Credit/TAT	F
Peru	Urban Development Fund	1982	13,000	G-Bank	None	T	Credit	D

Notes: ND = No data
--- = Not relevant
I-PVO = Indigenous Private Voluntary Organization
A-PVO = Affiliated Private Voluntary Organization
US-PVO = U.S. Private Voluntary Organization
L-PVO = Latin American Private Voluntary Organization
TA = Technical Assistance
T = Enterprise Transformation Approach
E = Enterprise Expansion Approach
F = Enterprise Formation Approach
TAT = Technical Assistance and Training
D = Desk Study Review
F = Field Review
G-Bank = Government Bank
G-Project = Government Project
C-Union = Credit Union
Other acronyms are listed in the Glossary.

1.4 The Approach and Organization of the Report

Our review of the sample indicates that it reflects different approaches to enterprise development. This diversity is a response to the heterogeneous character of microenterprises and the differing developmental goals of the programs. Section 2 presents an overview of the characteristics of microenterprises and the implications for development programs. It identifies three distinct approaches to enterprise development that have emerged in response to the diverse needs of beneficiaries, as perceived by A.I.D. and implementing organizations. The approaches are referred to throughout the report as (1) the enterprise formation approach, (2) the enterprise expansion approach, and (3) the enterprise transformation approach.

These approaches are treated in detail in Sections 3, 4, and 5, respectively. The sections examine the principal variants of each approach and describe the salient features and performance of the sample cases. Preliminary observations, findings, and lessons learned are presented for each approach. Section 6 draws together the conclusions of the previous analyses and presents the findings and lessons learned from the evaluation. Section 7 then reflects on the findings, with a focus on future research and information activities needed in the microenterprise field.

2. DEVELOPING MICROENTERPRISES: CHALLENGES, APPROACHES, AND PERFORMANCE

> The microenterprise subsector includes the whole spectrum of labor-intensive productive activities ranging from rural-based agribusiness and handicraft production to urban-based trading, service, and manufacturing enterprises....As a working definition, subject to the following exceptions, microenterprises should have no more than approximately 10 employees. Special emphasis should be placed on small-sized and individually owned productive activities....An attempt to define or limit the size of a microenterprise to approximately 10 employees, for example, would exclude from the program some enterprises that Congress desired to receive the benefits of the program, i.e., enterprises made up of poor people, such as rural, community-based firms owned and operated by 20 women, or certain cooperatives. Furthermore, the objective of gradually advancing an enterprise to access formal sources of financing could be undermined with too severe a limit on the firms' employees. (A.I.D. 1988a,1-2)

2.1 The Nature and Characteristics of Microenterprises

This section offers an overview of the nature and characteristics of the microenterprise sector with the objective of better understanding the challenges faced in microenterprise development. Initially, the boundaries of the sector are explored--in terms both of activities that are somehow more complex than microenterprises and of activities that are unable to gain access to even the microeconomy. This discussion is followed by examination of the diversity within the sector and a brief summary of the implications of the discussion for microenterprise development.

The term "microenterprise" naturally directs attention towards firm size as its primary distinguishing feature. While from a practical point of view, firm size is a useful way of classifying enterprises, it tends to obscure important differences that have a direct bearing on the process and challenges of enterprise development. Microenterprise can be viewed as one stage on a continuum reflecting the relative complexity and sophistication of economic activity. Along this continuum, the microenterprise sector lies between the survival-oriented activities of those on the fringes of the economy and the more complex and sophisticated small-scale enterprises.

2.1.1 Microenterprise Versus the Survival Activities of the Poorest of the Poor

Large numbers of people in developing countries are for a variety of reasons unable to surmount the relatively low entry barriers into the microenterprise sector. This group includes those struggling to eke out a living through whatever means possible. Their activities are marginal and are motivated by the drive to survive rather than by an urge to prosper. The income they earn from their activities is insufficient to allow for the accumulation of resources, human or financial. The underemployed, the vast number of hawkers and street vendors found in many countries, the collectors of cigarette butts and discarded plastic bags, subsistence agriculturists, and many women engaged in traditional household activities fit into this category.

These individuals are denied access to more profitable enterprises by social and cultural barriers or because they lack education, skill, experience or opportunity to gain experience, financial resources, and access to markets. In addition to those with no access to resources or markets, there are those whom Malcolm Harper (1988) has aptly characterized as "submarginal,"

including "refugees, the disabled, ex-offenders, women in some societies, and minority or occasionally majority communities who have for some reason been excluded from the economic mainstream."

2.1.2 Microenterprise Versus Small-Scale Enterprise

Microenterprise is bounded on the upper end by small-scale enterprise. Table 2 describes a number of dimensions on which microenterprises can be differentiated from larger firms. If there is a single most critical distinction between the two, it results from relative ease of starting a microenterprise compared with a larger scale enterprise: skills required, both in a technical and business sense, are simple; initial investment is low; products or services are familiar and require little quality control; and markets and marketing systems are not complex.[4] However, ease of entry results in intense competition, which forces earnings down to very low levels. Relatively slow rates of income growth for the poor urban and rural consumers who make up the majority of the market for microenterprises reinforce competitive pressures on prices and returns. Microenterprises ordinarily have neither the financial means nor the capacity to assume the risks associated with growth.

As firm size grows, so does the complexity of the tasks facing the enterprise. With this complexity comes increased risk. A greater volume of sales must be made on a regular basis, necessitating active efforts to minimize disruptions in material supply or product sales caused by logistical or cash flow problems. A larger labor force--which must be paid--requires training, direction, and coordination. The skill and innovation needed to manage such an effort, in and of itself, erects a barrier to potential competitors that will support somewhat higher earnings. Since the goods and services produced and sold by small enterprises serve a wider range of consumers, there may be market niches that offer solid opportunities for enterprise growth.

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[4]The "barriers to entry" framework is adapted from the work of Peter Kilby, particularly his 1982 report on small-scale industry in Kenya. While Kilby focuses on the distinction between traditional and modern small-scale enterprise, much of his argument can be easily adapted to microenterprise.

Table 2. Distinguishing Characteristics of Microenterprises

Characteristic	Microenterprise	Small Enterprise
Number of Workers	Roughly 10 or fewer full-time workers.	Roughly 10 to 50 full-time workers.
Work Force	Primarily family labor.	Largely hired workers.
Sources of Finance	Rely almost entirely on cash transactions, informal credit markets, and supplier credit. Start-up commonly funded by family savings.	Limited access to formal financial markets; commonly rely on informal financial markets, supplier credit, and reinvested earnings.
Management	Little management specialization.	Some specialization in management functions.
Technology	Traditional--based on widely existing technical knowledge, existing labor skills, and existing raw materials supplies.	Less traditional--innovation required in some aspect of the transformation process.
Products	Products and services are generally simple and unsophisticated; prices are low; cater to basic needs of low-income consumers.	Products and services range from simple to more complex; span a relatively broad range of consumer types.
Markets	Typically serve highly localized markets through simple marketing channels.	Marketing patterns somewhat more complex reflecting innovation in raw material procurement or in output sales.
Competition	Competition intense as a result of ease of entry and localized market area.	Competition somewhat less intense because of barriers to entry.
Earnings	Returns to owners/entrepreneurs generally very low.	Returns higher but subject to greater variation and risk.

2.1.3 Heterogeneity Within the Microenterprise Sector

There is no generally agreed-upon way to carve up the microenterprise sector. What can be agreed upon is that there is tremendous diversity among firms falling within the microenterprise definition. Firms differ in size, type of enterprise (manufacturing, service, commerce), the industry (subsector) in which they compete, location (urban, small town, rural), type of technology (traditional, less traditional), linkage to the economy (product markets, labor and capital markets, material suppliers), entrepreneurial motivation (subsistence, growth), organization of production (household, factory), and so on.

These differences correspond to differences in the constraints to growth faced by microenterprises. In most empirical surveys, respondents name lack of cash or credit as the most important problem facing the firm (Liedholm and Mead 1987, 103). This finding, however, must be treated with caution. Cash-flow problems often are symptoms of other, more serious problems, rather than of the disease itself. Decisions to produce the wrong product for the wrong market at the wrong price are first felt as cash shortages. Furthermore, credit problems are often reported as "most pressing," but they are first on a list of several constraints.

The stocktaking background and conceptual overview paper examined several examples of different types of developmental constraints facing microenterprises (Boomgard et al. 1989). The conclusions drawn from that analysis were that enterprises vary in their potential for growth and that enterprises face fundamentally different types of constraints.

2.1.4 The Challenges of Microenterprise Development

From the standpoint of enterprise development, the preceding discussion has at least three important implications.

-- The transformation of a microenterprise into a small enterprise is not trivial. It is likely that only a select few microentrepreneurs have the capability or interest to make the change. The risks associated with the transformation are probably larger than most poor people or financial institutions are willing to run in the absence of risk-reducing assistance.

-- The relative ease of entry into the microenterprise sector creates the possibility that clients of

assistance programs may achieve improvements at the expense of others in the sector. In the absence of productivity increases, successful provision of assistance may represent a transfer of benefits from nonassisted firms to assisted firms rather than a net gain for the economy.

-- The heterogeneity of microenterprises implies that the opportunities for growth or increased earnings for microenterprises, the constraints on the firms, and the type of assistance required vary considerably from one situation to another. While there is little concrete evidence on the subject, it is probably true that many attempts to promote enterprises have failed through the projects' inability to cope adequately with the diverse needs of the clientele. And, in cases where assistance has been appropriately tailored, the costs per unit of benefit may become prohibitive or the reach of the intervention may be extremely limited.

2.2 Approaches to Microenterprise Development

In light of the diversity inherent in the sector, it is not surprising that development institutions have approached microenterprise development from different perspectives. The various approaches share roughly similar goals but differ in their target populations, the types of services provided, the institutional structure and organization of the programs, and tactical details.

Microenterprise projects are unique responses to particular opportunities and constraints in varied environments. Individually, each project represents an attempt to attain particular goals and to meet the needs of various constituencies within the constraints--human, financial, and environmental--found in their respective contexts. Nevertheless, important similarities across projects permit the identification and specification of three broad approaches to microenterprise development. The three approaches, which are differentiated by their developmental goals and target population, are: (1) the enterprise formation approach, (2) the enterprise expansion approach, and (3) the enterprise transformation approach.

The enterprise formation approach aims to integrate highly disadvantaged groups or individuals from the survival economy into the microeconomy. These programs are sometimes referred to as community development programs because their enterprise development work is frequently embodied in a broader social development program. These programs often serve a relatively large

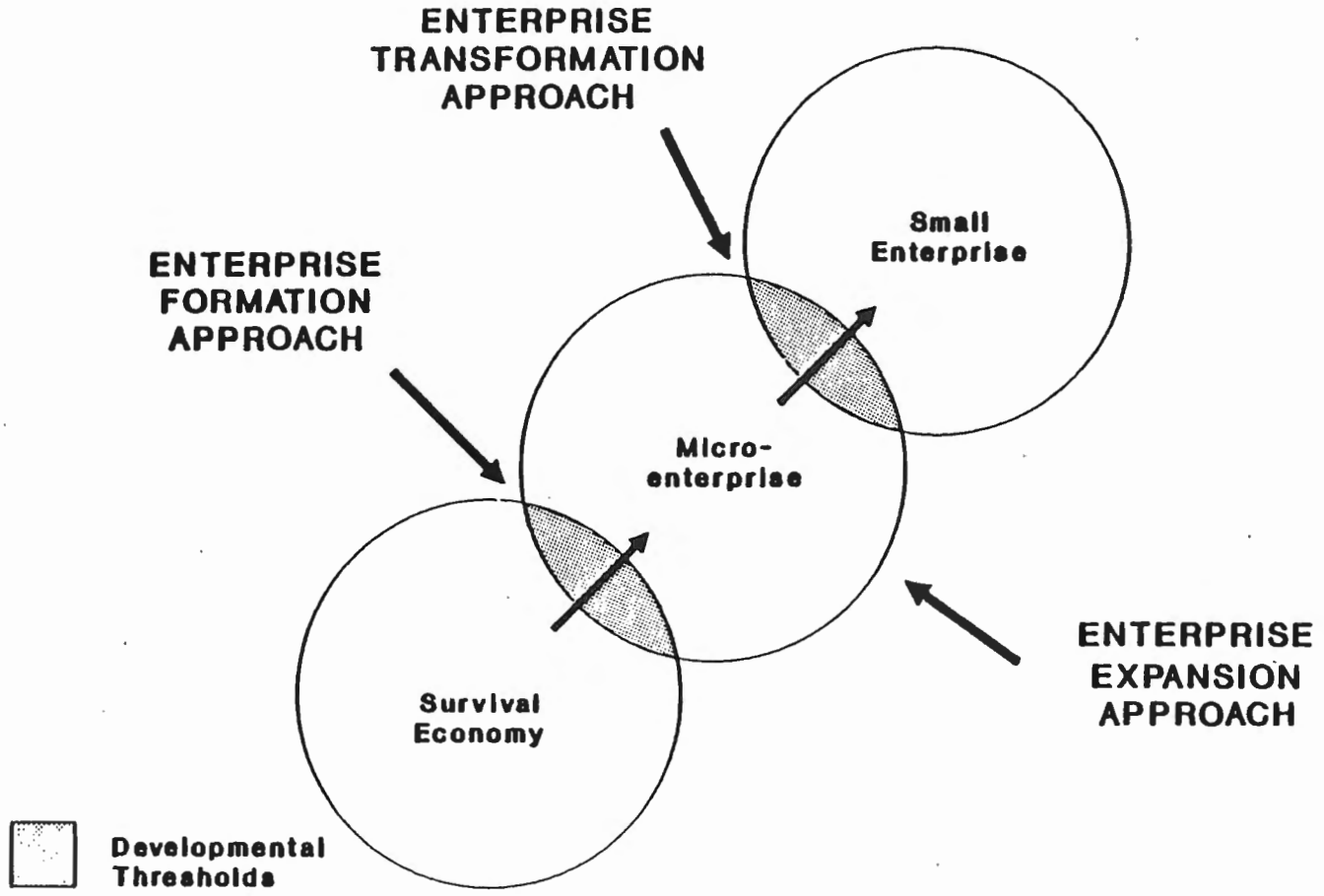
proportion of new entrepreneurs and offer a comprehensive range of services focused on creating rudimentary business skills. Credit is almost always tied closely to training and technical assistance, and loans are relatively small and may be subsidized. The relatively high per-beneficiary costs typically incurred by these efforts are justified by the expectation of high social returns in terms of poverty alleviation and community growth. Generally speaking, much of the direct benefit of the enterprise formation approach is in the form of income generation rather than of employment.

The goal of the enterprise expansion approach is to improve the performance of microenterprises. This approach is essentially marginalist, in an economic sense, because of its implicit emphasis on small, achievable improvements across a relatively large number of firms. Under programs following this approach, some firms may graduate to small-enterprise status, but the dynamic is governed more by natural selection than by project effort. These programs commonly focus on providing credit with or without general business training, and many of these programs have evolved toward a minimalist credit-only orientation in an effort to reduce operational costs. Loans are typically for short-term working capital needs, and interest rates may be relatively high. Loan size is usually small, and screening is often based on some form of character reference and repayment history. Benefits in the marginalist approach often are associated with both income growth and decreased underemployment.

The third approach explicitly strives to graduate its clients from the microenterprise sector. Programs following the enterprise transformation approach most often provide an integrated mix of credit, training, and technical assistance to a select group of clients. Loans are larger and are used to fund fixed capital as well as working capital needs. Interest rates are often subsidized. Screening is generally based on project feasibility and participation in the training program. Per-beneficiary operational cost is high and is justified in terms of a larger expected benefit. Since firms assisted through this approach are typically somewhat larger than those assisted through the other approaches, employment generation plays a relatively larger role in the composition of project benefits.

Figure 1 illustrates the differences among these three approaches. The three circles of the diagram represent the survival groups, microenterprises, and small-scale enterprises. While there is some overlap between the groups, movement from one circle to the next requires a transformation in order to overcome the barriers to entry into the higher level form of enterprise. The relative size of the circles does not necessarily correspond to the size of the population group, nor is there an expectation

FIGURE 1
APPROACHES TO MICROENTERPRISE DEVELOPMENT



that enterprises will necessarily graduate from one group to the other. There is likely to be exit from the microenterprise sector, particularly as some individuals graduate from self-employment to employment in other firms.[5]

In terms of the diagram, both the enterprise formation and enterprise transformation approaches are transformation oriented --an orientiation that accounts for their relatively heavy emphasis on technical assistance and training and for their inherent paternalism. However, the microenterprise expansion approach seeks improved performance within the microenterprise circle and can support and enable rather than guide, thus reflecting the credit orientation of the marginalist approach.

There is, needless to say, considerable variation within each of the approaches outlined above, and not all programs fit neatly within one approach. Programs are implemented by different types of institutions, and programs and projects are structured along different lines. Most programs provide services directly to target firms, but some focus on improving the environment in which the enterprises operate. Many of the organizations active in microenterprise development have well-defined models: ACCION's solidarity groups, Technoserve's community-based enterprises, Overseas Education Fund International's (OEF/I) focus on rural women, the Pan American Development Foundation's (PADF) national development foundations, and so on. Nevertheless, much of the variation can be understood in terms of the three broad approaches outlined above.

Differences in constraints, developmental challenges, and approaches to microenterprise were recently summed up by Shari Berenbach (1988) in a way that deserves to be quoted at length.

> OEF's experience points to the need for basic business training and confidence building for a "pre-entrepreneurial" population. This prepares them to become the existing businesses serviced by others. ACCION's experience demonstrates that microcredit can be highly effective with vendors and can stimulate certain levels of enterprise growth with microenterprises. However, enterprises encounter a growth ceiling when receiving working capital credit alone. The celebrated ADEMI [Microenterprise Development Association] program of the Dominican Republic has recently opened credit lines for fixed asset borrowing to

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[5]Some would argue that this change to formal employment may represent the most desirable form of transformation for most economically inactive microenterprises.

> overcome such constraints. Increased scale and production capacity will require additional management training and technical services to be utilized fully. The Carvajal Foundation PRODEME [Program for the Development of Microenterprises] program concentrates on management training for those microenterprises which are emerging from the ACCION level. With greater levels of managerial capability, firms completing the Carvajal training program are now ready to make use of subsidized small enterprise credit lines typically channeled through development banks. Beyond this stage of enterprise growth, firms begin to acquire specialized management. Training programs such as IDEA [Instituto de Educación Administrativa] in Bolivia... are then intended to provide the professional formation for these managers.... Firms growing beyond this level now turn to the development finance corporations or commercial banks to meet their capital requirements. Management training requirements of established firms are then filled by the graduates of university business studies of programs such as INCAE [Central American Business Administration Institute] or ESAN [Escuela Superior de Administración] (p. 69).

2.3 Assessing the Performance of Microenterprise Assistance Programs

The performance of microenterprise assistance programs can be judged against three primary criteria: beneficiary impact, cost-effectiveness, and institutional sustainability.

2.3.1 Beneficiary Impact

Beneficiary impact is the cornerstone of program performance. For a program to be successful, the services provided by the implementing organization must have a demonstrable impact on the performance of beneficiaries. Six considerations are relevant to assessing the beneficiary impact of microenterprise development programs: direct beneficiary impact, the distribution

of benefits, indirect benefits, losses due to displacement, social benefits, and other, nonquantifiable benefits.[6]

Direct Beneficiary Impact: Direct beneficiary impact measures the improvement in the performance of assisted enterprises resulting from the application of program-supplied inputs or the influence of program-induced environmental changes. It is a function of the magnitude of the impact, the sustainability of the improved performance over the long term, and the number of beneficiaries. The preferred measure of enterprise performance is enterprise income. Other commonly used statistics--changes in production, sales, or profitability--serve as proxies for enterprise income.

Distribution of Benefits: The distribution of benefits refers to the relative value placed on benefits that accrue to priority target groups. Microenterprise development has attracted the attention of the Congress and the donor community as an effective means of generating income and productive employment for those with the greatest need--the absolute poor and women.

The employment impact of microenterprise development is a second type of distributional issue. Employment is often discussed along with income in the context of direct beneficiary impact, but it is more appropriately treated in terms of the distribution of enterprise income. Employment benefits result from wages paid out from enterprise income.

Indirect Benefits: Indirect benefits are gains for other economic actors precipitated by increased beneficiary income. The most important indirect benefits for microenterprise projects

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[6]The discussion of beneficiary impact focuses, for practical reasons, on enterprises rather than on households or individuals. It would have been preferable, however, to consider any particular enterprise as one of several activities undertaken by a family or household. The typical household allocates its scarce resources across a range of commercial and noncommercial enterprises. Assisting a given type of enterprise will elicit adjustments in the household's allocation of resources among different activities, with a direct impact on total household income and welfare. This disaggregated perspective highlights the importance of the intrahousehold economic and decision-making roles and the differential welfare implications of these decisions. By focusing on the enterprise, the stocktaking sacrifices some depth of analysis and precision in its treatment of gender issues. The general findings of the study, however, are probably not affected by this abstraction.

are benefits to suppliers that result from increased demand on the part of assisted enterprises (backward linkages); benefits realized by the firms that meet the increased demand for goods; and services generated by increased income (consumption effects or income multipliers, leveraged benefits). Both backward and consumption linkages are directly related to the size of the direct benefit flow. Except in cases where the program actively seeks to create benefits through indirect linkages, the effects of indirect benefits can be set aside for most evaluations since they merely serve to inflate the final benefit total.

Displacement: Of greater concern are indirect losses due to displacement--losses incurred by other enterprises as a result of the increased sales of assisted beneficiaries. Displacement, if it results from increased productivity on the part of assisted firms, is a necessary part of economic development. Presumably, firms capable of producing at a lower cost will increase their sales at the expense of other less efficient enterprises. Without productivity gains, however, increased earnings will result from embodied subsidies or nonsustainable improvements. In such cases, displacement losses to other nonassisted firms or potential entrants can potentially cancel the direct gains to beneficiaries.

Social Benefits: Some authorities consider social benefits to be a significant output of microenterprise programs, but such benefits are notoriously difficult to classify and quantify. Maria Otero (1987b) has suggested that social impacts be organized under four categories: participation, attitudinal change, solidarity, and family well-being. These benefits are likely to be most important for projects that are oriented toward community development or that serve the poorest entrepreneurs. There is some agreement that this type of benefit is generally greatest when the projects achieve economic success. Like indirect benefits, therefore, social benefits tend to magnify the impact of successful interventions.

Other Types of Benefits: Microenterprise projects can also result in several other types of benefits that may be important but that are exceedingly difficult to quantify.

-- Projects can contribute to the success of policy dialogue by generating information and by providing access to key policymakers or policy discussions.

-- Projects may create dynamic economic benefits--that is, they can introduce entrepreneurial impulses and skills that will impart a higher level of skill and efficiency to the economy. By their very nature, these benefits will take time to manifest themselves.

-- Microenterprise projects are valued by some for their political benefits in integrating poor urban entrepreneurs of the informal sector into the body politic, especially in Latin America.

-- A single project may develop a replicable intervention approach or model that can be implemented elsewhere at a far lower project development cost.

Much like the indirect and social benefits discussed above, however, these types of outputs generally depend on successful economic performance and are more likely to magnify the benefits of an already successful intervention.

Despite the critical importance of beneficiary impact in making informed judgments about the success of microenterprise projects, there is little concrete evidence on the subject. The evaluations reviewed in this study were selected largely because they place relatively more emphasis on beneficiary impact than others. But for the most part even these evaluations focus primarily on the performance of intermediary institutions and pay little attention to the questions of beneficiary impact.

There are reasons for this neglect, some of which are quite legitimate. Evaluations are ordinarily conducted during the life cycle of a project to fulfill specific procedural requirements rather than to test the fundamental assumptions of a project's design. Many of the most challenging issues faced during project implementation are institutional. If the intermediary organization fails to develop the capacity to deliver the requisite services effectively, the question of beneficiary impact is irrelevant. At the same time, it is far simpler and cheaper to evaluate the performance of a single organization that presumably maintains auditable financial records than a large collection of microenterprises that do not. This fact is particularly relevant, given the awkwardness of committing sizable amounts of money to evaluate what are usually micro-sized microenterprise projects.

Although impact has rarely been adequately measured, most evaluators have had a sense that the various projects have made a positive difference. Evidence is often presented of the strong demand for credit or other inputs, suggesting that the input does indeed have value to the beneficiary. This is particularly true, it is argued, in the case of credit accompanied by high repayment rates (suggesting productive use) and relatively high interest rates (suggesting value). It should be noted, however, that the test is valid only in a limited range of cases--those in which the rate of interest reflects not only the opportunity cost of capital but also the full administrative and "risk" costs of

lending. None of the projects reviewed, with the possible exception of ADEMI in the Dominican Republic, had achieved this objective. Almost all of the programs reviewed involved some degree of subsidization and provided loans at subsidized (often highly subsidized) rates.

In the absence of reliable and consistent impact measures across projects, it is not possible to accurately discriminate among the differential sources of successful performance. This does not mean, however, that there are not interesting and important conclusions to be drawn from the kinds of information that do exist. Some findings, particularly those on the direction, composition, and gross magnitude of changes for some indicators, are consistent and probably reliable. Assistance to manufacturing enterprises, for example, is consistently reported to create more jobs than assistance to commercial activities. The problems arise in trying to understand what types and forms of assistance, under what conditions, most effectively promote employment-generating manufacturing enterprises.

2.3.2 The Costs and Cost-Effectiveness of Microenterprise Programs

The ratio of the present value of benefits to costs provides the ideal comparative measure of program performance. However, in the absence of reliable measures of program benefits, the ratio of various intermediate indicators of performance and costs may be compared across programs to assess the relative cost-effectiveness of different approaches. Two different measures of cost-effectiveness are examined in the stocktaking: cost per program beneficiary and the cost per dollar loaned.

Cost per beneficiary is expected to vary widely across programs. Such differences are primarily the result of the different approaches or "technologies" of the programs. Transformational approaches spend more per beneficiary in the expectation of greater benefits per beneficiary. These benefits may not show up immediately and can take several years to materialize. This is particularly true for fixed capital investments and many types of training and technical assistance. Nontransformational approaches are expected to generate fewer benefits per beneficiary and thus are far more conservative on the expenditure side. In the case of working capital finance, for example, benefits generally materialize rapidly with the infusion of capital, taper off, and then rise again in response to new loans. The firm grows gradually over time, eventually reaching a limit determined by the existing level of fixed assets.

In the sample cases, the cost per dollar loaned generally reflects total program costs and is therefore larger for programs with relatively high training and technical assistance expenditures. Some programs--for example, the Maha Bhoga Marga Program in Indonesia--draw a clear distinction between their lending activities and nonloan-related training and technical assistance. Other programs do not enforce this financial "transparency," thereby muddying the waters of their management information systems and making cross-program comparisons of lending efficiency more difficult.

Cost per beneficiary and cost per dollar loaned are also influenced by the maturity of the programs. During the early phase of a program, costs are higher because of start-up expenses, learning-curve inefficiencies, external technical assistance, and the relatively small number of beneficiaries or volume of loans disbursed. As a program matures, costs are expected to decline to a long-run equilibrium level.

2.3.3 Impact on Institutional Performance: Sustaining the Flow of Services

A.I.D. projects typically invest in creating or improving the capacity of an institution to deliver benefit-creating services. Except in extreme cases, the period of time needed to recover sufficient benefits to justify a project extends beyond the period of investment. Moreover, unless the absorptive capacity of the target group is reached, the more permanent the flow of services the larger the eventual flow of benefits. The sustainability of the service flow, therefore, is instrumental in determining the course of the stream of future benefits.

Three factors determine the sustainability of a service flow: financial sustainability, the financial capacity of the institution to continue program activities; organizational sustainability, the capacity of the organization to plan, manage, and perform the functions needed to continue the program; and external sustainability, the capacity of the institution to continue to operate and deliver services within its external environment.

Financial Sustainability: Financial sustainability depends on the capacity of the implementing organization to secure resources to operate the program. These costs may be met through funds secured from external sources (donors, the host government, or philanthropic donations) or through internal sources (earnings generated from provision of program services or earnings from other commercial ventures that cross-subsidize the program).

Program self-sustainability is achieved when earnings from the provision of services are sufficient to cover all of the costs incurred in service delivery. Self-sustainability is desirable for several reasons: it enhances the independence of the implementing organization, it may force the program to be more responsive to its clients, and it implies that services are priced at market values undistorted by subsidy and inefficiency. It is worth noting that self-sustainability does not necessarily reduce the financial risk faced by the program. Earnings are just as risky (perhaps more so in the short run) than funds provided by external sources.

Organizational Sustainability: Microenterprise development projects need to be more than financially sustainable--they also need to be organizationally sustainable. Organizational sustainability is the capacity of an organization to manage its operations independently, make strategic decisions, and solve problems. Even organizations that are profitable must have leadership, accounting and management information systems, and qualified, trained staff to carry out necessary operations.

External Sustainability: Finally, to achieve sustainability, microenterprise development projects must also be externally sustainable--that is, able to survive in the external environment in which they operate. For the most part, external sustainability hinges on the political acceptability of the implementing organization and its program, which can be influenced by the structure of the institution or by the compatibility of its political and economic agenda with that of the government.

3. INTEGRATIVE PROGRAMS: THE ENTERPRISE FORMATION APPROACH

3.1 Introduction

The common goal of enterprise formation programs is to integrate highly disadvantaged groups or individuals into the economy. The challenge confronting these programs is to develop viable businesses, owned and operated by relatively inexperienced entrepreneurs, generally in economically isolated areas. Despite the odds and the attendant risk of failure, the cases reviewed for the stocktaking demonstrated that under the right conditions, it is possible to design and implement programs that succeed in meeting these goals.

Six of the 32 cases in the total sample for the stocktaking evaluation incorporated variants of the enterprise formation

approach. Proportionately, however, such programs are almost certainly underrepresented in the sample. By their very nature, many are small, highly focused, and poorly documented. The sample selection process yielded cases that are probably somewhat larger and more successful than the average and that have a higher profile. The enterprise formation subsample includes the Coptic Evangelical Organization for Social Service (CEOSS) Income and Employment Generation program in Egypt; the National Council of Churches of Kenya (NCCK) Small Business Scheme (NCCK-SBS); OEF/Women in Business (OEF/I-WIB) programs in Costa Rica and Honduras; the Women's Entrepreneurship Development Program (WEDP) in Bangladesh; and the first phase of the Rural Enterprise Development Project (REDP I) in Burkina Faso. The main features of the six programs are portrayed in Table 3.

3.2 Characteristics of the Sample Programs

3.2.1 Program Orientation and Strategy

Enterprise formation programs target the poorest of the self-employed and the unemployed in the communities where they operate. These programs often work in economically remote areas or marginal urban areas, and with highly disadvantaged groups, such as illiterate women. Project services are extended for both new and existing enterprises.

-- The Kenya National Council of Churches project does not seek out local entrepreneurs to support, nor does it attempt to turn its individual and group clients into prosperous, expanding businesses. Its goal is less ambitious but more difficult: it seeks to help poor, usually illiterate, sometimes disabled, principally female, and at times totally inexperienced business operators to increase and then stabilize their incomes and improve the quality of their family life.

-- Phase I of the REDP in Burkina Faso set out to identify and test ways of fostering the development of rural enterprises in an economically isolated, poor agricultural area with an extremely low population density (8 persons per square kilometer, contrasted with 720 persons per square kilometer in Central Java, the home of the BKK).

-- Driven by the OEF/I's goal of assisting highly disadvantaged rural women, the WIB was established in 1985 to apply and refine an approach to enterprise development

Table 3. Enterprise Formation Programs: Selected Characteristics

Country	Program	Latest Ref. Year	Years of Operation	Beneficiaries		Average Loan Size ($)	Characteristics								
				Total	Per Year		A (%)	B (%)	C (%)	D (%)	E (%)	F	G (%)	H ($)	I ($)
Bangladesh	WEDP	1988	6	8,919	1,321	60	87	50	25	35	5	0.4	50	133	1.40
Egypt	CEOSS	1988	5	786	157	132	ND	20	ND	14	2	0.2	23	127	0.42
Burkina Faso	REDP I	1982	4	313	78	670	33	25	50	23	19	4.5	10	2,646	1.40
Kenya	NCCK-SBS	1984	3	673	224	150	ND	3	50	38	-2	-0.4	70	454	3.00
Costa Rica	OEF/I-WIB	1988	2	161	81	721	47	ND	45	22	-14	0.6	100	1,164	5.53
Honduras	OEF/I-WIB	1988	2	217	109	1,316	47	ND	45	13	11	1.8	100	1,164	7.68
Average Enterprise Formation Approach			3.7	1,845	328	508	54	25	43	24	3	1.3	59	948	3.24

Note: A = Percentage of loans (by number) to manufacturing enterprises
B = Percentage of loans used for fixed capital investment
C = New enterprises as percentage of total beneficiaries
D = Percentage of loan fund in arrears
E = Real interest rate = nominal rate minus average rate of inflation (1980-1986)
F = Average loan size/GDP per capita (1985)
G = Percentage of women beneficiaries
H = Life-of-project cost per beneficiary
I = Latest cost per dollar loaned
ND = No data
Acronyms defined in the Glossary.

involving organizational, training, credit, and technical support that could reach those not covered by the solidarity group programs of urban-based PVOs. Similarly, in Bangladesh the WEDP was established as a pilot effort to assist in the establishment or expansion of microbusinesses owned and operated by women--a group without an entrepreneurial tradition, in a country whose institutions are heavily biased against women's participation in business.

With the notable exception of the WEDP in Bangladesh, enterprise formation programs focused their resources on a limited number of beneficiaries. In 5 years, CEOSS provided 786 loans (157 per year); over 3 years, NCCK-SBS reached 673 beneficiaries (224 per year); REDP I served 78 clients per year; and OEF/I-WIB served no more than 109 beneficiaries per year. The largest, WEDP, reached a total of 8,919 beneficiaries or 1,321 per year.

3.2.2 Services Offered

Direct training and technical assistance were integrally linked with, and often preceded, the provision of credit. Preloan counselling, training, and advisory services were common.

-- Characteristically, these programs relied on careful screening of prospective clients based on need, character, and family background. Final lending decisions were based on the feasibility of the proposed investment. Cosigners, group guarantees, and character references were used in place of collateral. Because of the screening procedures, the time that elapsed between first contact and loan disbursement was generally long (an average of 6 months in the NCCK-SBS case).

-- Average loan sizes varied substantially, depending on local conditions and the specific objectives of the program. In this subsample, average loan sizes were $60 for the WEDP, $132 for CEOSS, $150 for the NCCK-SBS, $670 for REDP I, $721 for the OEF/I-WIB in Costa Rica, and $1,316 for the OEF/I-WIB in Honduras.

-- Loans were given for both working capital (97 percent in NCCK, 80 percent in CEOSS) and fixed asset investments. Average loan terms ranged from 12 months to 2 years, with longer grace periods than were observed for either of the other approaches (see Sections 4, 5, and 6).

-- Arrearages and defaults tended to be high, reflecting a bias in favor of disbursement rather than collection. For example, in NCCK in 1983, 38 percent of all loans were in arrears more than 90 days.

-- Interest rates were below formal lending rates, reflecting a community development orientation and emphasis on disadvantaged beneficiary groups. Real interest rates averaged approximately 3 percent for the subsample.

3.2.3 Technical Assistance and Training

Training and technical assistance were generally intensive, lasting from 16 weeks for OEF/I-WIB (82 hours) to as long as 8 months for the vocational training component of CEOSS. Training programs focused on credit management, general business skills, improving self-esteem, and consciousness-raising. Counselling by social workers was considered very important in helping the NCCK clients to overcome business problems. WEDP was an exception, however. Only 10 percent of its borrowers received training, although loan supervision required frequent contact between project staff and the clients.

3.2.4 Institutional Characteristics

Two of the programs, CEOSS and NCCK-SBS, had evolved from an income-generation component of an existing, indigenous community development program. The WIB Program of OEF/I differed from the CEOSS and NCCK programs in that it did not piggyback its services onto an existing local community development infrastructure. The REDP was experimental and operated outside of a legitimizing institutional structure. The WEDP was implemented as a pilot project of a larger public sector enterprise development organization.

-- In all cases, enterprise development was a new activity for an existing institution.

-- Each of these projects maintained close links within the community in which it worked and with the beneficiaries it served.

-- The implementing institutions were often torn between business development and social welfare objectives. A.I.D. has frequently exacerbated this kind of division by pressing for a business development agenda with

organizations that are more concerned with community welfare.

3.3 Project and Program Performance

3.3.1 Beneficiary Impact

-- The projects in the enterprise formation subsample demonstrated that it is possible to deliver services--training, credit, and technical assistance--to highly disadvantaged people in remote, low-income areas. All of the programs reviewed reported positive beneficiary impact, although some doubts were expressed about the significance of the gains. For example, only 10 percent of the WEDP beneficiaries in Bangladesh received training; in the review of the program, evaluators expressed doubts that the small amounts of credit were sufficient to foster significant improvements in the beneficiary firms. While there was some reported employment impact, much of the economic gain was in the form of increased income.

-- The beneficiaries of these programs were indeed poor, but they were not necessarily the poorest people in the areas of project activity. In the case of OEF, for example, an evaluator observed: "The OEF experience does indicate that there is a minimum threshold of household resources necessary for the success of microenterprise activities. However, that threshold is much lower than many would have anticipated" (Berenbach 1988, 22).

-- Despite rather selective screening, not all program clients were able to benefit from the assistance. There was a relatively high failure rate--dropout, absence of impact, or business failure--among firms participating in these programs. Fifty-three percent in the OEF/I-WIB Program experienced serious difficulties, halted production, or never got started; and among REDP's clients, fewer than 50 percent improved their net worth, and 30 percent of those abandoned their businesses. This result is not unexpected, given 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 enterprise but were used to meet consumption needs.

-- Five of the six enterprise formation programs reached a large proportion of women, both through explicit targeting (OEF, WEDP) and by focusing on the neediest groups in the program communities (NCCK-SBS, CEOSS).

-- Broader social and family benefits are a stated objective of many formation programs. The manager of one project noted, "Less tangible benefits are important to many clients, like having borrowed money and successfully repaid a loan for the first time or gaining some new insight into management. The novelty of attempting something new, even if it does not work out as expected, can be a very significant experience" (Schiller 1982). The OEF/I-WIB programs were reported to have enhanced both the self-image and influence of their clients through the increased role they play in household decision making and through growing levels of family support for the women's enterprises. Moreover, benefits to the firm translated into benefits for the entire family because of the manner in which the women entrepreneurs spent their income.

3.3.2 Cost-Effectiveness

-- In the enterprise formation programs, the cost per beneficiary was relatively high, but it varied considerably across programs. Higher costs were associated with service to remoter areas and provision of more intense training and technical assistance. Costs were reduced when the program could work within an existing program infrastructure (CEOSS, NCCK-SBS). Dollar costs per beneficiary ranged from over $2,600 in the research and development-intensive REDP I project to a reported low of $127 in the mature CEOSS Program. By comparison, a life-of-project level of $500 per beneficiary is considered a reasonable standard in the Latin American context (Lassen 1988).

-- Costs per dollar loaned averaged $7.68 for the experimental stage of the OEF/I-WIB Program in Honduras; $3.00 in NCCK; $1.40 in REDP I; $1.40 in WEDP; and a reported $0.42 in CEOSS over the life of the project (a figure that compares favorably with the most efficient high-volume minimalist lending programs).

-- In the microenterprise context, economies of scale are difficult to achieve because the programs must be highly adapted to the needs of the target population. This

fact reduces the potential for developing widely replicable assistance packages. The scale of the programs was generally small, except for the WEDP in densely populated Bangladesh. Nevertheless, even the WEDP was pressured by funding agencies to reduce program costs by moving some of its activities to less remote areas.

3.3.3 Institutional Sustainability

-- Enterprise formation programs cannot and do not set out to achieve financial self-sustainability. For these types of programs, the overall strength of the implementing institution and its capacity to raise funds from external sources is the key to sustainability.

3.4 Observations, Findings, and Lessons Learned

First, the benefits of enterprise formation programs depend on the development of sustainable businesses. The potential value of social and family benefits should not be discounted, but there is no evidence that these types of gains are important in the absence of successful enterprise development. Formation programs that are staffed and managed by professionals with a social welfare orientation can lose sight of the need to develop profitable businesses when emphasizing integration or poverty alleviation. The most successful programs have emphasized the development of strong business skills on the part of program staff and have sought outside support for provision of needed technical services.

Second, the training and technical assistance provided by enterprise formation programs must be of high quality, specifically geared to the target population (often illiterate, and containing a high proportion of women), and relevant to the development of requisite business or technical skills. Over the past few years, much effort has been devoted to developing specialized training materials appropriate to this challenge.

Third, the best programs serve clients who have some prior experience in the activity to be assisted, and who have been carefully screened. Programs can do a major disservice to their clients if they promote a particular line of business, lend money, and then watch the business fail. Given the high-risk nature of such programs, this problem is very serious. Entrepreneurship is not for everyone, and good programs need to know when to quit.

To summarize, all six of the enterprise formation programs reviewed have proven to be highly sustainable and are still in operation. However, their sustainability is based on continued external support and not on earnings. The REDP in Burkina Faso is reported to have undergone substantial change toward a minimalist credit program based on the Grameen Bank model. Funding is now being provided by the French Government. OEF/I continues working to improve the quality of its training materials and to increase the cost-effectiveness of its WIB Program. It is reported that OEF/I has managed to reduce costs from over $1,000 to about $500 per beneficiary, although this could not be verified. The NCCK program is still operating and continues to receive A.I.D. grants to support the SBS. The CEOSS Program was examined in one of the stocktaking field assessments, and it is reported to be on the verge of receiving additional A.I.D funding. Continued A.I.D. support for WEDP is also under consideration.

The enterprise formation programs are a means of transferring resources to the poor in the form of intensive training, technical assistance, and subsidized credit. The credit components of these programs can be expensive to operate, particularly when the depreciation of the loan fund through default and inflation is counted. Unless the discipline of borrowing and repayment can be demonstrated to have some intrinsic value, these programs may prove more efficient and effective by providing "enterprise formation grants" rather than loans to the beneficiaries. Such a change would have the further benefit of eliminating the potentially disastrous debt burden that accompanies borrowing for uncertain ventures, under difficult conditions--borrowing that may be directed by less than astute business advice.

4. MINIMALIST PROGRAMS: THE ENTERPRISE EXPANSION APPROACH

4.1 Introduction

Programs classified under the enterprise expansion approach do not seek to transform their clients into more complex businesses. Rather, these programs offer services--primarily credit--that enable microentrepreneurs to increase their sales and income and, in some cases, to generate jobs through incremental improvements in performance. The proponents of this approach have made a series of remarkable and influential discoveries: small, working capital loans generate benefits in assisted firms; beneficiaries are willing to pay for these services; and with

efficient operations and correct pricing of its services, an institution can become financially self-sustaining.

The stocktaking sample included 22 programs incorporating variants of this approach. While most of these programs explicitly targeted microenterprises, several offered nontargeted financial services. Pure financial services are provided to consumers (including microenterprises) through rural banks supported by the Financial Institutions Development (FID) project in Indonesia;[7] the Aid to Urban Entrepreneurs With a Solidarity Guarantee (EUS) Program in Costa Rica; and the credit unions in Malawi (MUSCCO [Malawi Union of Savings and Credit Cooperatives]) and Cameroon (CamCCUL [Cameroon Co-operative Credit Union League]). The Puskowanjati Women's Cooperative (PWC) in East Java, Indonesia, illustrates a cooperative model that provides credit, organizational assistance, and some training to its members.

The so-called "minimalist credit" model with explicit targeting provides a limited amount of training to complement the financial services delivered to microenterprises. It is most commonly used in Latin America and is best exemplified by the credit program run by indigenous PVOs assisted by ACCION. There are six programs based on the minimalist credit model in the sample, including ADEMI in the Dominican Republic; the Paraguayan Cooperation and Development Foundation (FPCD) in Paraguay; the Business Promotion and Services (PROSEM) Program of the Foundation for the Development of Socioeconomic Programs (FUNDAP) in Guatemala; the Eugenio Espejo Foundation (FEE) and Ecuadorean Development Foundation (FED) programs in Ecuador; the Women's World Banking (BMM) Program in Colombia; and the Small Enterprise Loan Program (SELP) project in Egypt. Finally, several other mixed-services programs fit this category, emphasizing expansion of existing microenterprises. These include the PRODEME (Program for the Development of Microenterprises) program of the Dominican

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[7]These include the Badan Kredit Kecamatan (BKK) in Central Java, similar village financial institutions in three other provinces, and the general village credit program (KUPEDES) of the government bank, Bank Rakyat Indonesia (BRI).

Development Foundation;[8] the Small Business Assistance Program/ Development Fund (PROAPE/FONDESA) program in the Dominican Republic; the Opportunity International (OI)-affiliated Maha Bhoga Marga Program in Indonesia; the Small Enterprise Assistance Foundation (FAPE) in Guatemala; and the Partnership for Productivity (PfP) Nimba County project in Liberia. The main features of the cases are summarized in Table 4.

4.2 Characteristics of Sample Programs

4.2.1 Program Orientation and Strategy

-- The immediate objective of the projects following this approach is most commonly to develop an institutional capacity to deliver financial services to the poor, with the longer term goal of increasing incomes and employment for those who lack access to formal sources of credit.

-- Nontargeted financial services programs in the enterprise expansion subsample served broad geographic regions; programs that explicitly targeted microenterprises worked primarily in the informal sector of large metropolitan centers.[9]

-- These programs were oriented toward a balance of "poverty alleviation" and "business development," although many practitioners would argue that this is a false

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[8]It is notable that the minimalist methodology of the ADEMI program in the Dominican Republic evolved from ACCION's experience with the PRODEME Program of the Dominican Development Foundation (DDF) under the A.I.D. PISCES project. The PRODEME Program was characterized by complicated and long loan-processing systems and an institutional bias that was not consistent with achieving financial self-sufficiency. ADEMI was an experiment with a new institution that had a commitment to develop a self-sustaining program from the start.

[9]The focus of these targeted programs on the urban informal sector is, in part, a reflection of the particular characteristics of the stocktaking sample. Other programs not included in the study operate in rural areas, and usually in regions with high population densities.

Table 4. Enterprise Expansion Programs: Selected Characteristics

Country	Program	Latest Ref. Year	Years of Operation	Beneficiaries		Average Loan Size ($)	Characteristics								
				Total	Per Year		A (%)	B (%)	C (%)	D (%)	E (%)	F	G (%)	H ($)	I ($)
Indonesia	FID/BKK[a]	1982	10	2,700,000	270,000	70	11	3	2	19	81	0.1	60	ND	0.11
Indonesia	FID/KUPEDES[a]	1988	3	ND	1,300,000	320	ND	4	ND	ND	24	0.6	ND	ND	0.18
Indonesia	PWC	1988	4	16,000	ND	150	ND	ND	ND	ND	27	0.3	100	ND	ND
Indonesia	MBM	1988	7	4,075	582	174	16	ND	ND	17	15	0.3	59	ND	0.17
Egypt	SELP	1988	3	317	106	2,194	12	40	0	19	-2	3.6	28	ND	High
Cameroon	CamCCUL[a]	1988	20	ND	2,240	2,264	ND	ND	ND	24	-5	1.6	25	ND	0.59
Liberia	Nimba III	1987	2	479	319	839	27	ND	ND	10	12	1.8	ND	413	0.51
Malawi	MUSCCO[a]	1988	9	ND	ND	ND	ND	ND	ND	ND	6	ND	ND	ND	1.16
Malawi	MUSCCO-SSE[a]	1988	1	ND	ND	1,480	ND	ND	ND	ND	4	8.7	ND	ND	ND
Colombia	WWB-BMM	1985	3	406	162	229	ND	0	0	12	15	0.2	75	ND	ND
Costa Rica	EUS[a]	1983	1	447	447	247	34	20	0	ND	-11	0.2	37	ND	ND
Dom. Rep.	ADEMI	1988	7	19,428	3,428	510	89	ND	0	10	74	0.6	36	ND	0.30
Dom. Rep.	ADOPEM	1985	3	154	51	902	ND	ND	6	15	18	1.1	100	ND	ND
Dom. Rep.	DDF-PRODEME(micro)	1983	2	101	51	1,564	100	ND	0	42	-4	2.0	20	917	0.59
Dom. Rep.	DDF-PRODEME (group)	1983	2	978	587	191	0	83	0	33	8	0.2	17	70	0.28
Dom. Rep.	PROAPE/FONDESA	1988	1	416	83	700	69	34	0	15	8	0.9	18	ND	ND
Ecuador	SEDP-FEE	1987	2	ND	ND	250	ND	ND	ND	27	51	0.2	ND	ND	1.22
Ecuador	SEDP-FED	1986	2	2,765	1,383	205	0	ND	ND	5	31	0.2	ND	ND	0.21
Guatemala	FUNDAP-PROSEM	1988	0	198	660	257	ND	ND	0	2	19	0.2	24	ND	ND
Guatemala	FAPE	1988	3	155	52	1,935	80	ND	0	20	9	1.5	9	ND	ND
Guatemala	FAPE-SIMME	1988	1	545	545	1,220	ND	ND	0	5	5	1.0	9	ND	ND
Paraguay	FPCD	1988	3	2,938	980	100	45	0	0	12	113	0.1	60	900	0.19
Average Expansion Approach			4.0	161,730	87,871	705	40	20	1	17	23	1.2	42	575	0.46
Average Nonfinancial Institutions			2.7	3,264	642	714	44	26	1	16	25	0.9	43	ND	0.43
Average Financial Institutions			7.3	1,350,224	393,172	676	23	9	1	22	17	2.2	41	575	0.51

Note: A = Percentage of loans (by number) to manufacturing enterprises
B = Percentage of loans used for fixed capital investment
C = New enterprises as percentage of total beneficiaries
D = Percentage of loan fund in arrears
E = Real interest rate = nominal rate minus average rate of inflation (1980-1986)
F = Average loan size/GDP per capita (1985)
G = Percentage of women beneficiaries
H = Life-of-project cost per beneficiary
I = Latest cost per dollar loaned
ND = No data
Acronyms defined in the Glossary

[a]Financial Institutions

dichotomy, since they consider that business development is a means to alleviate poverty.

-- The majority of programs targeted existing enterprises with far fewer than 10 employees. There was minimal targeting by sector, although commercial activities received the bulk of program services. Some programs limited their services to manufacturers. Women received a significant proportion of program resources.

-- Graduation of the beneficiaries to formal channels of credit was often an objective of these programs, but was rarely achieved in the cases reviewed.

-- The nontargeted pure financial services programs reached large numbers of beneficiaries, a portion of whom were microentrepreneurs. The KUPEDES program in Indonesia had 1.3 million loans outstanding from its network of 2,500 branches in January 1988; the village financial institutions programs (BKK) in the same country had over 3 million loans outstanding. The CamCCUL credit union made 28,000 loans in 1987, but it is estimated that only 8 percent of these (2,240) were used in productive enterprises.

-- Targeted programs can also reach relatively large numbers of beneficiaries, but not on the same scale as the large financial institutions. ADEMI, the largest of the Latin American minimalist programs, reached about 3,500 beneficiaries per year. Most of the other targeted programs served fewer than 1,000.

4.2.2 Services Offered

Programs under the enterprise expansion approach generally focused on provision of credit services; training and technical assistance, when included, were oriented to improving the reliability of the clients as borrowers. Some programs were focused much more heavily on training and technical assistance, but these were exceptions among the enterprise expansion programs.

-- Short-term loans were extended in small amounts, initially for working capital purposes. Loan sizes and terms were increased according to repayment of previous loans. The most common risk-reduction and loan-guarantee mechanisms were group guarantees and character references, rather than collateral. Group guarantees were

common only in the Latin America programs in the subsample.

-- Average loan size varied from approximately $70 in the BKK program to over $2,000 in the SELP program in Egypt. Half of the programs had an average loan size under $300. The average loan size in the sample was $705. Average loan terms ranged from 2 to 33 months, with the majority maturing in less than 4 months.

-- Projects following the microenterprise expansion approach charged interest rates that, in general, were higher than local bank lending rates and lower than informal market rates. Annual real percentage rates varied from -11 percent to more than 113 percent. The average real interest rate in the sample was 23 percent.

-- Several projects were able to minimize loan transaction costs for both the beneficiaries and the institution by installing simple, direct, and decentralized procedures for quick loan disbursement and repayment. Initial loan disbursement could take anywhere from a few days in the most streamlined programs to over 9 months for others.

-- Arrearages and defaults averaged between 10 and 20 percent. Wide variation in reporting methods across programs, however, makes comparative analysis very difficult. The sample average was 17 percent.

4.2.3 Technical Assistance and Training

-- Training and technical assistance were not provided to borrowers in the pure financial services programs. The targeted microenterprise programs, however, ordinarily required potential borrowers to participate in preloan credit education sessions. Solidarity group programs often involved a somewhat more extensive group development program before loans were made.

-- Some programs conducted general or specialized training and technical assistance on a volunteer basis, apart from the lending process. In addition, some programs provided follow-on technical assistance for those having difficulties with repayment.

-- A few programs required extensive preloan training as a condition for borrowing. These programs were generally

based on older "technology" or had loosely defined program objectives.

4.2.4 Institutional Characteristics

-- The pure financial services programs were implemented by government institutions (including banks) and credit unions; in contrast, the vast majority of targeted microenterprise programs were implemented by local PVOs with technical or financial assistance from U.S. PVOs.

-- The majority of the projects were located close to the location of the intended beneficiaries and had geographically dispersed branch offices.

-- Several projects had developed streamlined, standardized, and systematized operating and accounting procedures.

-- The quality of the staff was generally reported to be adequate for the tasks to be performed, but there were inadequate numbers of qualified personnel. In most cases, project staff were relatively young and inexperienced as compared with those observed in programs using the other two approaches. Several projects hired university graduates. In some examples (ADEMI, KUPEDES), innovative staff incentive systems based on performance were in place.

4.3 Project and Program Performance

4.3.1 Beneficiary Impact

-- The microenterprise lending programs have evolved on the basis of the finding that for many informal sector enterprises, the provision of financial services--targeted or nontargeted--can be just as effective in generating benefits as mixed-services programs. While the data in the cases reviewed were not sufficiently precise to prove or disprove this presumption, a large body of evidence indicates that working capital loans lead to increases in income and decreases in underemployment, and, in some cases, to increased employment.

-- Working capital finance, by itself, can help existing businesses grow only so far; eventually, other constraints will cap the expansion. One study found that additional working capital loans, without addressing constraints of management capacity, fixed assets, or technology, had a negative impact on enterprise performance (Berenbach 1988).

-- The enterprise expansion approach, by virtue of its orientation towards commercial activities, tended to have a high proportion of women beneficiaries. This is the result of the disproportionately high rates of female participation in informal sector commercial enterprises.

4.3.2 Cost-Effectiveness

-- The cost per beneficiary of delivering program services can be extremely low in microenterprise lending programs. Overall costs are kept low by providing minimal technical assistance and training and by using low-cost screening methods. Average cost per beneficiary in the subsample was $575.

-- The cost per dollar loaned for most enterprise expansion programs is low. This is the result of low overall operating costs combined with rapid portfolio turnover. The subsample average was $0.46 per dollar loaned.

4.3.3 Institutional Sustainability

-- Four of the programs in this subsample have claimed to be financially self-sufficient. These are the BKK and KUPEDES financial institutions in Indonesia, the CamCCUL credit union in Cameroon, and the ADEMI microenterprise program in the Dominican Republic. Others, such as the FPCD in Paraguay, were reported to be moving toward eventual financial self-sufficiency. All of these programs, however, benefit from some form of external subsidy. Moreover, maintenance of the real value of the loan fund in the face of inflation and bad debt are generally not accounted for in these assessments.

-- Achievement of self-sustainability depends on the ability to employ efficient risk-reducing screening tech-

niques, to charge market-level interest rates, and to maintain high repayment rates.

4.4 Observations, Findings, and Lessons Learned

First, microentrepreneurs were able and willing to finance their businesses (operations and expansion) at positive, real interest rates. Microenterprise credit programs provided an alternative to the extremely high interest rates charged by informal lenders. Presumably, by increasing the volume of lending, avoiding monopolistic pricing strategies, and lowering portfolio costs, microenterprise lending programs offered the borrowers a potentially viable and lower cost alternative to the moneylender.

Second, it is important to remember that there is a direct inverse relationship between the level of interest rates and the benefits that borrowers retain. As programs raise real interest rates to increase earnings, benefits are transferred from borrowers to lenders. It is easy to overlook the need to balance institutional self-sustainability and beneficiary impact. The Dominican Republic field assessment noted that ADEMI's recent increase of effective interest rates improved short-term earnings, but the report also warned of the need for careful portfolio monitoring to detect distress on the part of its borrowers.

Third, several factors were consistently associated with program success:

-- A large potential market for program services within the geographic reach of the program. This is consistent with both the urban location of the Latin America programs and the decentralized structure of the programs in regions of high population density. Smaller markets--secondary cities, for example--are reached by branching out from a successful urban base.

-- A service that appeals to the buyers and that is characterized by simple and quick application and disbursement, limited preloan training, repayment terms that correspond to the cash flow of the enterprises, and possibly, assurances of additional loans on repayment. Program clients are less concerned with the level of interest rates than with the simplicity and ease of application, timely approval, and simple repayment.

-- Strong, competent organizations with capable leadership are essential ingredients in program success. The best programs have a clear, straightforward mission, well-

developed management information systems, dedicated staff, and high-quality management. A strongly held institutional goal of self-sustainability reinforces the efficiency of the program and management of operations. Successful programs strive to be self-sustaining and integrate this goal into the design of the program from the very beginning. For example, the early success of the FPCD program in Paraguay is attributed to the fact that no A.I.D. support was available for the loan fund; thus, the program relied on permanent commercial sources of finance from the start.

-- The difficulties of establishing a successful enterprise expansion program should not be underestimated. There is a well-developed technology for these programs, but they face many hurdles to effective implementation. Most important is the choice of an implementing institution. The stocktaking examined programs that were considered successes. For each successful program there are many that have accomplished far less.

Fourth, the development of the large financial institutions in the sample required relatively intensive, long-term technical assistance. A.I.D. has been assisting the BKK Program in various ways since 1980. The CamCCUL credit unions took 15 years to become sustainable; MUSCCO, after 9 years, is still trying. These large organizations place heavy demands on management, organization, and staffing. The development of smaller, potentially self-sustaining PVO-based microenterprise programs is not easy, but, given the proper circumstances, it can be accomplished in a few years and with a limited amount of outside technical assistance.

Fifth, the more successful programs drew a clear distinction between credit activities and nonloan-related training and technical assistance. This permitted more careful management of financial systems, clarified the pricing and cross-subsidization issues, and promoted clear operational objectives. Such "financial transparency" also facilitated evaluation of program success.

Sixth, the refinement and spread of the minimalist methodology can be traced to the extensive research and development effort supported by A.I.D. under the centrally funded PISCES project and other research on rural financial markets. These cases provide an excellent example of the value of applied research for program and project development.

Finally, the financial services orientation of the enterprise expansion approach raises a number of questions about the

long-term developmental impact of these programs. The segments of the economy that benefit most from these programs are those that are expected to disappear during the process of development. Moreover, the relative ease of entry into the informal sector raises questions about the total benefits generated after displacement of nonassisted enterprise and potential entrants is counted.

5. DEVELOPING BUSINESSES: THE ENTERPRISE TRANSFORMATION APPROACH

5.1 Introduction

Enterprise transformation programs seek to accelerate the development of microenterprises into more productive, better managed, dynamic businesses. Successful business development can result in increases in income and employment in the short term, but more important, it sets in motion a sustainable, long-term process of enterprise growth. Transformation programs assist microentrepreneurs to surmount barriers to entry at the small enterprise level, thus positioning them on the road to graduation out of the informal sector.

Fourteen enterprise transformation programs were included in the stocktaking sample. Two were pure credit programs: the Urban Development Fund (UDF) in Peru and the Community Enterprise and Development Project's (CEDP) Small Enterprise component in Senegal. Six were PVO-based mixed credit and training and technical assistance programs: the three National Development Foundations in Belize (NDF-B), Jamaica (NDF-J), and Honduras (FUNADEH); the Volunteers in Technical Assistance (VITA) Private Enterprise Project in Chad; the Carvajal component of the Small Enterprise Development Project (SEDP) in Ecuador; and the Women's Development Foundation (FDM) program in Guatemala. The remaining four programs were oriented almost exclusively toward technical assistance: Development of Malawi Traders Trust (DEMATT) in Malawi; the Central Java Enterprise Development Project (CJEDP) in Indonesia; much of the FUNDAP program in Guatemala; and the Institute for Socioeconomic and Technical Research (INSOTEC) component of the SEDP in Ecuador. Principal features of the 14 cases in the enterprise transformation sample are presented in Table 5.

Table 5. Enterprise Transformation Programs: Selected Characteristics

Country	Program	Latest Ref. Year	Years of Operation	Beneficiaries		Average Loan Size ($)	Characteristics								
				Total	Per Year		A (%)	B (%)	C (%)	D (%)	E (%)	F	G (%)	H ($)	I ($)
Belize	NDF/B	1985	2	111	95	1,618	75	50	ND	5	23	4.4	Low	2,922	0.48
Chad	VITA I	1986	2	95	41	4,722	24	ND	0	ND	3	8.9	6	4,386	1.60
Chad	VITA II	1988	1	69	55	4,914	ND	ND	0	66	3	41.0	1	6,942	3.90
Ecuador	SEDP - Carvajal	1988	1	ND	ND	1,360	ND	ND	ND	NA	-30	1.1	40	ND	ND
Ecuador	SEDP-INSOTEC	1988	1	ND	ND	NA	100	NA	ND	NA	NA	NA	ND	ND	NA
Guatemala	FDM	1988	7	180	26	3,112	61	67	50	11	5	2.5	100	423	0.20
Guatemala	FUNDAP-Momostenango	1988	2	2,175	1,088	NA	100	NA	ND	NA	NA	NA	ND	293	NA
Guatemala	FUNDAP-Nahula	1988	1	ND	ND	NA	ND	NA	ND	NA	NA	NA	ND	ND	ND
Honduras	FUNADEH	1985	2	258	172	3,858	ND	ND	100	7	12	3.1	35	1,275	0.75
Indonesia	CJEDP-R	1987	3	96	96	NA	ND	NA	10	NA	NA	NA	0	2,604	NA
Jamaica	NDF-J	1987	5	1,202	240	2,181	44	ND	20	15	0	3.0	35	960	0.44
Malawi	DEMATT	1988	2	546	276	NA	54	ND	ND	NA	NA	NA	5	ND	NA
Peru	UDF	1985	2	1,664	740	3,550	68	41	18	14	-20	3.8	40	3,133	0.18
Senegal	CEDP-SSE	1988	3	241	80	4,032	11	20	ND	9	4	23.7	8	ND	NA
Average Transformation Approach			2.3	603	264	3,261	63	45	28	18	0	10.2	27	2,549	1.08

Note:
A = Percentage of loans (by number) to manufacturing enterprises
B = Percentage of loans used for fixed capital investment
C = New enterprises as percentage of total beneficiaries
D = Percent of loan fund in arrears
E = Real interest rate = nominal rate minus average rate of inflation (1980-1986)
F = Average loan size/GDP per capita (1985)
G = Percentage of women beneficiaries
H = Life-of-project cost per beneficiary
I = Latest cost per dollar loaned
NA = Not applicable
ND = No data
Acronyms defined in the Glossary

5.2 Characteristics of the Sample Programs

5.2.1 Program Orientation and Strategy

-- Programs in all three variants of the business development approach (credit, mixed services, and technical assistance) aim to promote the sustainable ability of client enterprises to generate jobs and to increase incomes. Strengthening the role of the private sector is also frequently claimed as an objective of the programs.

-- The clients of business development programs are only slightly larger, on average, than those assisted by the enterprise expansion approach. The programs reviewed assist firms that fall well within A.I.D.'s 10-employee working definition of microenterprise.

-- Assistance is most commonly targeted to firms in the manufacturing sector that have demonstrated growth potential. Surprisingly, several of the direct assistance programs provided assistance to a relatively large proportion of new enterprises (although the individual entrepreneurs involved may have had previous business experience).

-- Several newer programs have combined direct assistance to clients with indirect efforts designed to expand the opportunities for profitable business development. These programs have worked to ease supply constraints by assisting suppliers of raw materials to microenterprises (FUNDAP, CJEDP); to increase demand by breaking down barriers to the penetration of new markets (i.e., subcontracting, export intermediation); and to influence policy and regulations constraining enterprise development. In these cases, a distinction may be made between the targeted client and the program beneficiary.

5.2.2 Services Offered

The typical business development program provides clients with an intensive, sometimes tailored mix of training, credit, and technical assistance. The diversity within the subsample is at least partly due to ongoing experimentation with different mixes of service and different assistance strategies.

-- In the mixed-services programs, credit and technical assistance and training were closely linked: project beneficiaries usually were required to accept technical assistance and training prior to qualifying for a loan.

-- In all cases, loans were extended on the basis of extensive feasibility analyses (of highly variable quality) of the proposed investment projects. Loan application procedures can be complicated and the time from application to disbursement can be lengthy.

-- Average loan size was significantly larger than for either the formation or expansion approaches. Average loans ranged from about $1,360 in Ecuador to over $4,900 in Chad, with a mean size of $3,261.

-- A relatively large proportion of loans was made for acquisition of fixed capital, although some programs attempted to increase loan fund turnover by maintaining a substantial proportion of shorter term working capital loans.

-- Loans were made almost exclusively to individual enterprises.

-- Arrearages and defaults were generally below 15 percent, although a few programs encountered serious repayment problems (VITA-Chad and UDF-Peru).

-- Interest rates were quite low in most cases. Rates in the UDF-Peru Program were nominally 80 percent per year, but negative in real terms. No other program charged more than a nominal 24-percent rate. Many real interest rates were negative. The average real interest rate charged in the transformation programs was 0.0 percent.

5.2.3 Technical Assistance and Training

-- Technical assistance and training in the mixed-services model focused on basic business skills, with an emphasis on financial planning, financial controls, accounting, and marketing and production technology. One-on-one technical assistance was a common feature of these programs.

-- Programs rarely charged fees to recover the costs of technical assistance and training. The Carvajal Foundation component of the SEDP in Ecuador was an exception.

In this case, fees were expected to recover 40 percent of program costs. The evaluation of the NDF program in Jamaica found that beneficiaries were willing to pay for training, although no charges were levied (Trevor Hamilton 1987). Some programs (e.g., DEMATT) strongly resisted the concept of charging fees.

-- Several interesting variations were found. The Carvajal Foundation, best known for its strong, well-tested business training program, focused on general business skill development with credit available to successful graduates (SEDP Ecuador). The DEMATT Program in Malawi has recently revised its training approach to be responsive to the needs of entrepreneurs. Training is provided to groups of firms facing similar constraints. In Indonesia, CJEDP provided training and technical assistance on an industry-specific basis, but only in response to the requirements--technical and business--of specific, demonstrated business opportunities. Training was organized around specific products that were purchased by the project and resold at a discount to buyers to facilitate the start-up business relationships. Technical assistance in the CJEDP case was also provided to a larger scale export company to facilitate the development of an export market for microenterprises.

5.2.4 Institutional Characteristics

The programs reviewed were implemented by several different types of institutions:

-- The pure credit programs were administered by a government bank and a government-sponsored project management unit.

-- Four of the mixed services programs were implemented by indigenous PVOs; one was implemented directly by a U.S. PVO; and one was implemented jointly by indigenous PVOs in cooperation with a Latin American PVO. All involved cooperation between indigenous and nonindigenous organizations.

-- Two of the training and technical assistance projects were implemented by indigenous PVOs, one by a government organization, and one by a semiautonomous project management unit staffed by a U.S. consulting firm and an indigenous PVO.

-- Compared with programs utilizing either of the other two approaches, enterprise transformation programs characteristically require a higher level of business and technical experience and skill on the part of program management and staff.

5.3 Project and Program Performance

5.3.1 Beneficiary Impact

-- The subsample programs generally reported positive direct beneficiary impact on both incomes and employment. There was little clear evidence, however, on the independent impacts of credit and of training and technical assistance.

-- Direct assistance programs typically reach a small number of beneficiaries. None of the programs reviewed reached more than about 1,000 beneficiaries yearly, and the mean was closer to 250.

-- Transformation programs, except when specifically targeted, do not reach a high proportion of women.

-- Two of the sample programs were reported to have influenced government policymaking. Both programs worked on an industry-specific basis, worked at several different stages in the industry, and had developed expertise that earned them a seat at the policy table.

5.3.2 Cost-Effectiveness

-- Cost per beneficiary for this subsample of programs was high--over $2,500 per beneficiary. The programs justify this high cost on the basis of the expectation of large long-run benefits.

-- Cost per dollar loaned was not available for the pure credit programs, but for the mixed services programs it ranged from a high of $3.90 for Chad VITA II, down to much lower amounts in the following programs: $0.75 for FUNADEH, $0.48 for the NDF-B, $0.44 for the NDF-J, and $0.20 for the mature FDM. The average cost per dollar loaned in the subsample was $1.08.

-- A 3-year study of the rattan export development activity of the CJEDP concluded that the activity had a positive cost-benefit ratio, despite high costs attributable to its experimental status.

5.3.3 Institutional Sustainability

-- The two credit-oriented programs explicitly sought to become financially self-sustainable. One, Peru's UDF, which is based within a government banking system, did not succeed because of a structural inability to charge positive real interest rates in a highly inflationary environment. The second, Senegal's CEDP, still organized as a project, claimed to be moving toward self-sustainability.

-- The mixed-services NDF programs explicitly sought to become sustainable through a combination of earnings and external support.

-- The industry-specific programs did not seek sustainability, but sought to promote self-sustaining business relationships and worked to assist private firms and institutions that could continue to provide services on demand to microbusinesses. CJEDP explicitly measured the success of its individual programs by its ability to terminate assistance efforts in each particular area and to move on to new activities.

5.4 Observations, Findings, and Lessons Learned

First, economic conditions, the business climate, and the policy and regulatory environment exert a greater influence on the success of programs using the enterprise transformation approach than on the success of programs using the other approaches. In Peru, high inflation rates combined with interest rate ceilings undermined the UDF, and in Chad, the VITA projects were thwarted by economic chaos brought about by civil war. By contrast, in Senegal, 3 years of strong agricultural sector performance created buoyant local business conditions. The evaluation of the NDF program (Trevor Hamilton 1987) in Jamaica argued that the program's success could be attributed to a favorable business climate and a political mood supportive of private sector activity. Moreover, as businesses grow they encounter specific regulatory and policy constraints that often are not apparent from a macro-level viewpoint.

Second, direct training and technical assistance to micro-enterprises are expensive, particularly if the assistance is specifically tailored to the needs and constraints faced by individual firms. Transformation programs face a difficult dilemma--the diverse needs of growing businesses limit the value of general training and technical assistance. However tailoring assistance to the needs of individual firms raises the costs per unit of benefit to prohibitive levels and limits the reach of the intervention to a few select beneficiaries.

Third, there is a long legacy of failure among direct assistance business development programs supported by governments and donors. The programs reviewed have fared better than the comprehensive public sector programs in many countries. A.I.D. has avoided the worst mistakes of the 1970s but has only begun to test alternative approaches. Programs using the business development approach have the potential to provide the most substantial developmental impact of all the programs; however, far less research and development has been supported in this area than in the minimalist enterprise expansion model.

To summarize, the bright spots on the horizon are the minimalist credit program in Senegal, the work of FUNDAP in Guatemala, the recently started INSOTEC component of the SEDP in Ecuador, and the CJEDP project in Indonesia.

-- The Senegal project is unique because it appears to violate the conditions for sustainability found in the Latin America microenterprise development programs: loan size is large and interest rates are relatively low. Can such a program be financially viable? Can it be viable through weather-induced downturns in the local economy?

-- CJEDP, FUNDAP, and INSOTEC are distinguished by their industry focus and varying degrees of emphasis on indirect assistance. They recognize that business development is constrained by factors external to firms, as well as by internal factors. Can these programs induce sustainable changes in the structure of industries to provide greater opportunities for microenterprises and small-scale firms? Can the hands-on experience of these programs earn them a place at the policy table? Do these programs generate the long-term benefits needed to justify their relatively high cost?

6. EVALUATION FINDINGS AND LESSONS LEARNED

6.1 Introduction

This section presents the findings of the stocktaking evaluation and lays out lessons learned that have relevance for program implementers, donors, and others interested in the field of microenterprise development. The discussion is divided into four parts. Section 6.2 examines the performance record of A.I.D.'s microenterprise portfolio to answer the question: Can microenterprise programs make a difference? Section 6.3 looks at the state of the art--what we know how to do--and relates the existing technology to performance. Section 6.4 addresses several issues bearing on the design and implementation of successful microenterprise programs. Finally, Section 6.5 explores an alternative way of thinking about microenterprise development that is beginning to influence the design and implementation of projects and offers interesting prospects for future programs.

6.2 Can Microenterprise Programs Make a Difference?

When judged against the criteria of direct beneficiary impact, cost-effectiveness, and institutional sustainability, A.I.D.-supported microenterprise programs have a solid record of achievement. A significant proportion of the money spent in this area reaches the intended beneficiaries. The institutions involved in microenterprise development are generally small, development oriented, and close to their clients. Microenterprise programs are not prone to the excesses of top-heavy bureaucratic public sector institutions, which often place their own organizational maintenance ahead of their mandated developmental mission. Microenterprise programs rarely become "white elephants" unable to adapt to changing circumstances; at their very worst, they become "white mice" scurrying to find a new niche or another small infusion of donor funds to continue in their development mission.[10]

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[10]The "white mice" analogy is borrowed from a talk given by Thomas Dichter Via, President of Technoserve, at the International Development Conference, sponsored by Society for International Development, Washington, D.C., February 20-22, 1989.

6.2.1 Who Benefits, and How Much?--Impact Issues

> Microenterprise programs deliver services that can significantly influence the performance of assisted enterprises. The magnitude of the impact for any given client may appear modest, but even small increases in income can dramatically improve the lives of poor people.

Despite data and methodological limitations, all of the evaluations that addressed the impact issues found positive results. In a large proportion of assisted firms, sales, income, profit, and employment were all positively influenced. Almost without exception, reviewers were impressed with the beneficiary impact of these programs. Few doubts were expressed about the ability of project inputs--credit, training, or technical assistance--to generate positive changes in enterprise performance. Of the studies reviewed, two systematically compared the progress of assisted firms with that of unassisted firms. Both studies found significant positive income and employment effects resulting from the interventions. One project provided primarily credit; the other provided technical assistance and training only.

Thus there is little question about the potential of these programs, irrespective of approach, to generate positive direct benefits. There is, however, considerable room to improve our understanding of the magnitude and sustainability of direct beneficiary impact across different enterprise types in different settings. Most of what is known about impact is drawn from one-time interviews with beneficiaries. This evaluation methodology does not address critical questions about the sustainability of changes in performance of client enterprises or about what is happening to nonbeneficiaries.

The enterprise formation programs need to demonstrate that the enterprises they promote can endure the test of the market without the competitive advantages offered by cheap loans and technical assistance. The expansion programs must be able to show that the benefits accruing to assisted firms are net gains to the economy and do not occur at the expense of competitors. The transformation programs need to establish that the long-term benefits resulting from their efforts are sufficient to justify the relatively high cost of the programs. None of these issues has been satisfactorily addressed in the literature on microenterprises.

> The number of beneficiaries reached varies considerably across programs, but most of the programs targeting assistance to microenterprises are very small.

The reach of microenterprise programs is related to the services provided, the strength of the implementing institutions, the resources devoted to the program, and the size of the market (for services) in the areas where the programs operate. While the village financial institutions in Indonesia serviced millions of borrowers each year, the largest targeted microenterprise programs reached a few thousand. The ADEMI program in the Dominican Republic served nearly 4,000 firms in one year, and the WEDP in Bangladesh can reach just over 2,000. None of the remaining cases reached more than 750 enterprises per year during the time the evaluations were conducted. It is notable that these programs generally reach no more than a very small proportion of the potential beneficiaries in the areas they serve.

Table 6 summarizes the information from the stocktaking sample on the number of beneficiary enterprises reached annually by programs using each of the developmental approaches. Because the pure financial institutions reach very large numbers of borrowers, they have been separated out from the other microenterprise-oriented expansion programs in the table. The results are striking. The typical formation program reaches 328 beneficiary enterprises per year, and a transformation program directly reaches an average of 264. The microenterprise expansion programs reach an average of 642 beneficiaries per year, but they are dwarfed by the financial institutions, which reach nearly 400,000 borrowers annually.

Financial services are standardized products that can be "mass produced"; tailored training and technical assistance cannot. Expansion of financial services programs requires strong management systems, but it is less demanding in terms of line staff requirements. Training and technical assistance programs require skilled staff members at the lowest levels of the organization. This, in part, explains why the minimalist credit microenterprise programs can grow faster than the mixed-service or technical assistance programs.

Another factor that plays a role in the size of these programs is their age. Table 7 reports the average years in operation for programs using each of the approaches. The far-reaching financial institutions have, on average, been operating 3 1/2 years longer than the formation programs, 4 1/2 years longer than the microenterprise programs, and 5 years longer than the transformation programs. Moreover, a closer look at the age of the financial institutions (see Table 4) reveals that the average would be considerably higher if the year-old experimental small-enterprise "window" of the Malawian MUSCCO credit union were excluded and if a more recent window had been adopted for the Indonesian BKK Program.

Table 6. Average Number of Annual Beneficiaries

Program Approach	Average Annual Beneficiaries
Enterprise Formation	328
Enterprise Expansion	87,871
Financial Institutions	(393,172)
Microenterprise Programs	(642)
Enterprise Transformation	264
Statistically significant variation:[a]	Yes

[a]Differences in the averages across the various approaches are interesting in and of themselves, but their use must be tempered by an understanding of the variability in the data used to calculate the means. The reported "statistically significant variation" means that there is a 95-percent probability that the differences in the averages reflect real differences among the approaches as opposed to random variation due to the peculiar characteristics of the sample. In more precise terms, a one-way analysis of variance was performed for each indicator comparing the variance within each approach to the variance between approaches. The null hypothesis tests the equality of means for all approaches. A positive result indicates, based on the F-statistic, that the null hypothesis could be rejected at the .95 confidence level.

The prospects for expanding existing programs have only recently been placed on the agenda. Accion, for example, now has the issue of "massification" at the top of its list of priorities for its affiliated programs. Programs with credit components cannot grow without protecting and expanding their supply of loanable funds. Because of inflation, arrearages, and defaults, the prospect for many programs is contraction unless there is a continuing infusion of funds. Direct borrowing from development banks, borrowing from commercial banks, and savings mobilization are all potentially important sources of funds for growth.

Microenterprise programs are well suited to the goal of integrating women into the development process. The proportion of women beneficiaries is high in many of the programs reviewed.

Table 7. Average Years in Operation

Program Approach	Average Years in Operation
Enterprise Formation	3.7
Enterprise Expansion	4.0
Financial Institutions	(7.3)
Microenterprise Programs	(2.7)
Enterprise Transformation	2.3
Statistically significant variation:	Yes

Table 8 illustrates that the share of women beneficiaries in microenterprise development programs is significant. However, the proportion of women beneficiaries is considerably lower in programs using the enterprise transformation approach than in programs using either the formation or expansion approaches, primarily because of the relatively low female participation rates in the manufacturing sectors targeted by these projects. It should be noted that there is a large amount of variation within each of the approaches in comparison with the variation between them. This accounts for the inconclusive statistical analysis.

The proportion of women beneficiaries was highest in programs that (1) specifically targeted women and (2) targeted assistance to urban, commercial microentrepreneurs--a sector with proportionally high rates of female participation. The gender-specific focus caused no obvious performance trade-off. To the extent that some of the women's programs exhibited problems, the problems were due to factors apart from gender. None of the studies reviewed, however, probed to the household level, the locus of a number of important gender issues. This level is particularly relevant for the formation programs, which work with new or newly commercialized women's enterprises. As was noted

earlier, this type of assistance can have a significant impact on the economics of the household, which can influence the welfare gains associated with changes in the composition of household earnings.

Table 8. Average Percentage of Women Beneficiaries

Program Approach	Average Percentage of Women Beneficiaries
Enterprise Formation	59
Enterprise Expansion	42
Financial Institutions	(43)
Microenterprise Institutions	(43)
Enterprise Transformation	27
Statistically significant variation:	No

One study (Reichmann 1984) of the ADEMI Program in the Dominican Republic suggested that despite a female participation rate of 36 percent, it would be possible to expand the program's impact on women. A barrier to expansion, the study pointed out, was that the largely male staff of the program tends to orient promotion efforts toward male entrepreneurs. This presumption also lies behind the all-female staffing of the WEDP in Bangladesh. However, there is no evidence that the gender composition of the staff is associated with measurable program biases. For example, the ADEMI Program is gradually shifting its focus away from commerce toward relatively larger firms in the manufacturing sector. Although this shift in focus should lead to lower female participation rates, the proportion of women beneficiaries has risen. The WEDP, even with a female staff, continues to lend to a large number of women who play a minor role in the male-dominated enterprises that ultimately benefit from the funds.

> Microenterprise programs reach members of the poor majority in poor societies, people who benefit as entrepreneurs and as employees. However, the entrepreneurs assisted by these programs--regardless of the approach used--are not among the poorest of the poor.

In general, microenterprise programs do not directly assist those in the bottom 20 percent of the income distribution. The average loan size in the surveyed programs was often several multiples of what the very poorest receive as income each year. When average loan size is compared with per capita gross domestic product (GDP), the "distance" between the loans and the poorest of the poor is apparent (see Table 9).

Table 9. Average Loan Size to GDP per Capita

Program Approach	Average Loan Size to GDP/Capita
Enterprise Formation	1.2
Enterprise Expansion	
Financial Institutions	(2.2)
Microenterprise Programs	(0.9)
Enterprise Transformation	10.2
Statistically significant variation:	Yes

Even among the enterprise formation programs, selection may be biased in favor of those with entrepreneurial ability, who are not likely to be the poorest in their communities. This tendency does not represent any particular bias in the A.I.D. portfolio, but is rather a consequence of the characteristics of microenterprises. As a point of comparison, even the well-documented Grameen Bank program reports that, before borrowing, its clients are more prosperous than nonclients (Hossain 1988). However poor microentrepreneurs may be by U.S. standards, or in relation to local elites, the possession of the small amount of capital they have typically lifts them above the very poorest in their societies.

> Microenterprise programs decrease underemployment by the self-employed and create productive new employment opportunities. Programs that assist manufacturing firms generate the greatest number of new employment opportunities. There is no evidence in the reviewed programs that the jobs created are inferior in income, risk, or working conditions to

self-employment. Microenterprise development has its greatest impact on the poorest of the poor by creating jobs.

Most projects assisted enterprises engaged in manufacturing, services, and commerce. That there are methodological problems inherent in measuring employment changes is recognized; however, it was consistently reported that assistance provided to manufacturers generated the greatest number of new jobs. It is not clear whether this fact is due to the nature of manufacturing compared with that of services and commerce or to the larger proportion of fixed asset loans made by programs that target manufacturing. Microenterprises are highly labor intensive. Some increase in production and sales can be accommodated by reducing excess capacity, but sustained increases in output generate new, productive jobs.

Tables 10 and 11 report the stocktaking findings on the proportion of manufacturing beneficiaries and fixed asset loans by approach. The results are as might be expected. Enterprise formation and transformation programs devote more of their resources to manufacturing firms than do expansion programs. The pure financial services expansion programs serve the fewest manufacturers. However, there is significant variation within each of the approaches, which, combined with the limited number of cases reporting this information, explains the negative statistical result.

Table 10. Average Percentage of Beneficiaries in Manufacturing

Program Approach	Average Percent Mfg. Beneficiaries
Enterprise Formation	54
Enterprise Expansion	40
Financial Institutions	(23)
Microenterprise Institutions	(44)
Enterprise Transformation	60
Statistically significant variation:	No

Similar results are found for fixed asset lending. The proportion of lending for the purchase of tools, machinery, and equipment is far larger for transformation programs than for expansion or formation programs. Financial institutions, at this level of the economy, do not generally provide loans for fixed asset purchases.[11] Again, significant variation within each approach diminishes the statistical validity of the findings.

Jobs created in microenterprises are located within poor communities and generally do not require sophisticated skills. This fact suggests that programs that emphasize fixed asset lending to manufacturers have a greater potential for reaching the poorer groups than programs that place a greater emphasis on working capital loans to nonmanufacturing enterprises. Such job creation benefits those unable or unwilling to become entrepreneurs.

Table 11. Average Percentage of Fixed Asset Loans

Program Approach	Average Percent Fixed Asset Loans
Enterprise Formation	25
Enterprise Expansion	20
Financial Institutions	(9)
Microenterprise Institutions	(26)
Enterprise Transformation	45
Statistically significant variation: No	

[11]It is more expensive for financial institutions to make loans for fixed as opposed to working capital. Appraisal costs are higher, the period to maturity is longer (reducing potential portfolio turnover), the risks of default are greater, and the approved collateral offered by the borrower may not be foreclosable. Appraisal raises costs significantly, making small fixed asset loans unattractive for commercial lenders.

6.2.2 At What Price?--Cost-Effectiveness Issues

> Cost per beneficiary is a reasonable indicator for comparing efficiency across programs, and efficiency over time for an individual program. Cost per beneficiary varied greatly across the programs--ranging from $90 to $7,000. Much of the variation, however, is explained by the maturity of the programs, their experimental content, and the expected level of benefit.

The VITA Private Enterprise project in Chad provides a useful example of both the problems and usefulness of using cost per beneficiary as a performance indicator. At the end of the first phase of the project, reviewers were highly impressed with its results. In an impoverished and war-torn area that was practically devoid of enterprise activity, VITA demonstrated over a 2-year period that, through provision of credit and technical assistance, business activity could be revived. The cost of the project was considered high by some--over $4,000 per beneficiary (excluding the loan fund, bad debt, and decapitalization); yet others argued that the cost was reasonable because the program was resulting in the rebirth of a business economy, something that could not be measured in costs per beneficiary. Moreover, costs were projected to decline dramatically during the second phase of the project because the start-up cost had been paid and the operating costs could be spread among a larger number of beneficiaries as demand for loans continued to grow. However, war intervened, demand for loans declined, defaults increased, and cost per beneficiary rose to nearly $7,000 during the second phase, providing a clear clue that things were not moving in the expected direction.

Although the VITA Private Enterprise project in Chad is an extreme example, it highlights the strengths and weaknesses of cost per beneficiary as a performance indicator. The comparison of Phase I and Phase II of the Chad project on the basis of cost per beneficiary clearly indicated that performance was weakening. However, to argue that the Chad project was unsuccessful because of a high cost per beneficiary ignores differences in benefits per beneficiary across different programs. The three program approaches employ different technologies for assisting enterprises--some incur higher costs in the expectation of higher benefits. Table 12 shows that the average cost per beneficiary varies considerably across the approaches.

While it would be convenient to adopt a cost-per-beneficiary standard for the different approaches, there is too much variation within the approaches to make this a meaningful exercise. However, by reversing the problem, it is possible to estimate the

size of the benefit stream required to justify any given cost. If the discount rate is assumed to be 10 percent, manufacturing value added is 40 percent of sales, and benefits are counted 5 years into the future, production and sales must grow by approximately $1,500 (and be sustained for 5 years at the new level) to justify a $2,500 cost per beneficiary. If the time horizon is reduced to 3 years, the sustained increase must be $2,300 per year. For a commercial enterprise the amounts are larger because of the lower proportion of value added in sales. The results of this analysis are presented in Table 13.

Table 12. Average Program Cost per Beneficiary

Program Approach	Average Program Cost per Beneficiary (dollars)
Enterprise Formation	948
Enterprise Expansion	575
Financial Institutions	(ND)
Microenterprise Programs	(575)
Enterprise Transformation	2,549
Statistically significant variation: No	

Note: ND = no data

Can these levels of benefits be generated? Data from ADEMI in the Dominican Republic, a strong-performing program using the expansion approach, indicate that gross sales of its manufacturing clients for the 3-year period from 1984 to 1987 increased by $1,163 in real terms. This amount represents an undiscounted sustained annual figure of approximately $575, which, after discounting, becomes about $520. Since ADEMI's costs are probably closer to $200 per beneficiary than the average $575 for all of

the expansion programs, the program meets the test.[12] These general orders of magnitude are within the realm of the achievable.

Table 13. Annual Sustained Increase in Production or Sales To Justify Average Program Cost per Beneficiary (in dollars)

Program Approach	Manufacturing		Commerce	
	3 Years	5 Years	3 Years	5 Years
Enterprise Formation	875	580	3,500	2,300
Enterprise Expansion	530	350	2,100	1,400
Enterprise Transformation	2,300	1,500	9,200	6,100

Note: Assumptions: Discount rate is 10 percent; average value added as percentage of sales is 40 percent for manufacturing, 10 percent for commerce.

Cost per dollar loaned (unit of service delivered) is another indicator commonly used in evaluating microenterprise programs. This measure also suffers from the problem related to program maturity, and is often computed on the basis of different kinds of costs. The cost per dollar loaned in the sample varied from $0.19 for a minimalist credit program to $7.68 for a women-focused enterprise formation program.

Cost per dollar loaned is most useful in a comparative sense when it is based only on the costs of delivering credit or when programs with similar mixes of services are compared. Costs per dollar loaned for the three mixed-service NDF projects reviewed were $0.44, $0.48, and $0.75. One might conclude that the third program is operating less efficiently than the first two, which are quite similar. A more careful look, however, reveals that the clients of the relatively high-cost program were

[12]This conclusion, however, assumes that all of the change in sales is due to the program-supplied inputs and that all other indirect effects and displacement are neutral. It also arbitrarily stops counting benefits after 3 years, thus underestimating the total.

almost exclusively start-up businesses requiring intensive assistance and screening, and that clients of the first two were mostly established firms.

Table 14 compares the average cost per dollar loaned for programs using all three approaches.

The most serious problem with the cost-per-dollar-loaned measure is that different programs count different kinds of costs. This problem is particularly troublesome in programs that provide a mix of training, technical assistance, and credit. The cost per dollar loaned in programs using the formation and transformation approaches include the costs of a significant amount of nonloan activity.

Table 14. Average Program Cost per Dollar Loaned

Program Approach	Average Cost per Dollar Loaned (dollars)
Enterprise Formation	3.24
Enterprise Expansion	0.42
Financial Institutions	(0.51)
Nonfinancial Institutions	(0.43)
Enterprise Transformation	1.08
Statistically significant variation: Yes	

The information available is inadequate to judge fairly the economic returns on investments in microenterprise programs relative to alternative uses of scarce foreign assistance resources. The indicators that do exist point to very high returns on microenterprise development programs.

Despite A.I.D.'s own efforts to develop and disseminate evaluation strategies specifically tailored for small-enterprise and microenterprise development projects, no methodologically sound applications of these tools have been found. While examination of beneficiary impact, cost-effectiveness, and institutional sustainability offers clues on the payoff of

microenterprise interventions, these indicators do not provide the kind of comparative information that can inform policy-level decisions within the Agency. The most recent thorough cost-benefit analyses of microenterprise projects (Kilby and D'Zmura 1985) are based on data from programs in 1982--programs that are now virtual dinosaurs given the developments that have taken place in the field since that time.

Cost-benefit assessments have been made for a number of projects of different types and for some activities within certain projects. In the cost-benefit study referred to above, Peter Kilby and David D'Zmura (1985) reviewed data from five programs and concluded that "All of the projects enjoy an undiscounted benefit-cost percent ratio greater than unity, with four out of five internal rates of return above 100 percent. These rates of return place microenterprise lending schemes among the most successful categories of foreign aid programs" (p. xi).

More recently, Stephen Davies (1988, 61; Boomgard 1988) estimated that the rattan products export development activity of the Central Java Enterprise Development Project (CJEDP) had an internal rate of return of between 20 and 25 percent. Considering that this was an experimental project and that Davies's estimates included costs that can be allocated to other subproject activities, the finding is impressive.

Finally, in a recent analysis of the OEF/I-WIB Program, by all accounts a high-cost integrative enterprise formation program, Shari Berenbach (1988) estimated the internal rate of return to be 6 percent. However, when the figure was recalculated to net out the effect of the research and development aspects of the program, the internal rate of return rose to 66 percent.

6.2.3 Can the Institution Survive?--Sustainability Issues

> Financial self-sustainability of implementing institutions has been achieved in the best managed programs that limit their assistance to low-cost financial services. However, even in these cases, elements of subsidy to the institution are present.

Financial sustainability is defined as the capacity to cover operating expenses and reasonable allowances for bad debt with earnings from interest and other charges. Four programs in the sample were generally regarded as financially self-sustaining according to this definition: ADEMI in the Dominican Republic, the BKK and KUPEDES programs in Indonesia, and the CamCCUL credit union system in Cameroon. Several other programs were reported to be moving toward self-sustainability. But some caution must

be used in interpreting these findings, because all of these programs relied on varying forms of subsidized inputs. While operating budgets in ADEMI, KUPEDES, and CamCCUL could be funded from earnings, the programs relied on concessional sources of loan funds and received free technical assistance; in the case of BKK, the expense of critical supervisory and control functions was not charged to the program.

An examination of real interest rates charged to borrowers reveals the limited potential of self-sustainability from earnings for both formation and transformation programs.

Table 15 presents the findings on real interest rates across the three approaches. Both the formation and transformation programs charged interest rates far below what would be required to achieve self-sustainability. These rates are relatively close to or slightly below the rates charged by commercial banks. However, the enterprise expansion programs charged high real interest rates in order to achieve self-sustainability. Borrowers from these programs are relatively insensitive to the level of interest rates because the alternative is ordinarily the much higher interest rates charged by moneylenders. Nonetheless, the high rate required to attain self-sustainability transfers benefits from the borrower to the lending institution. Furthermore, there is little evidence to suggest that entrepreneurs are willing or able to pay similar rates on longer term fixed asset loans. This issue requires more detailed investigation.

Table 15. Average Real Interest Rates

Program Approach	Average Real Interest Rates (percent)
Enterprise Formation	3
Enterprise Expansion	
Financial Institutions	17
Microenterprise Programs	25
All Expansion Programs	23
Enterprise Transformation	0
Statistically significant variation:	No

> Long-term institutional survival and a sustained flow of services are often achieved through a combination of earnings, philanthropy, government budget appropriations, and donor assistance.

A number of programs qualify as sustainable, but remain dependent on external sources of funding or subsidy for operations. The Dominican Association for Women's Development (ADOPEM), the Women's World Banking project in the Dominican Republic, was reported to be sustainable, but it did not pay for the salaries of its staff. The NDF projects in Jamaica, Belize, and Honduras expected to rely on the philanthropy of the local private sector to fund costs not covered by interest earnings.

> Credit programs that strive to become self-sustaining, even when the goal is unattainable, generally perform better than programs that are managed with the expectation of continuing external support.

Microenterprise lending programs are businesses. They are businesses that sell a product (the use of money) that can generate benefits for its consumers (which is why donors support their start-up). If these organizations think of themselves as businesses that live or die on the basis of earnings, they will behave differently than if they are not subject to such a market test. This direction reflects both the personal characteristics of the organizations' leaders and an organizational and institutional mentality that must be built in at the time the program is designed. Adding on the requirement of self-sustainability to existing organizations can dramatically change their goals and directions, weakening their clarity of mission and disrupting performance.

> Financial self-sustainability of the implementing institution is not a necessary condition for successful cost-beneficial enterprise development; but for the assisted enterprises, financial sustainability is essential.

Some programs, particularly those with a strong credit orientation, place high value on moving toward full cost recovery through earnings. Other programs, especially those oriented toward training and technical assistance, emphasize the sustainability of the enterprises that receive assistance rather than that of the service delivery institution. These differences reflect differences in the intermediation of services. In both types of programs a public subsidy is applied to generate a stream of benefits. In programs with strong credit orientation, the subsidy starts up a potentially sustainable flow of services

(credit) that creates a flow of benefits (improved enterprise performance). In programs with a technical assistance orientation, the subsidy directly funds a flow of services of limited duration that create a similar flow of benefits. The choice of one or the other depends on the comparison of benefits with costs, including the subsidy.

Economic rather than financial analysis is used to inform public sector expenditure decisions because of the need to add up the gains and losses that accrue to different groups affected by such decisions. From a cost-benefit standpoint, it may be justifiable to support the development of a credit institution that loses money if the benefits accruing to other groups are sufficiently large to more than offset the losses.

The bias in favor of self-sustainability of service delivery is of recent vintage and is predicated on the theory that markets offer the best possible test of the value of a service. In less developed economies there are many reasons for the divergence of financial and economic returns. To judge the contribution of any particular project on the basis of the self-sustainability of its operations can ignore important developmental benefits that are not reflected in the profitability of the provider. Similarly, there may be cases in which A.I.D. is justified in providing continuing grants to support voluntary organizations or research institutions. In all of these cases, the decisions hinge on a careful counting of the benefits derived from subsidization.

6.3 What Have We Learned About What Works?

6.3.1 What Do We Know How To Do?

> Direct assistance programs that aim to improve the performance of microenterprises without attempting to transform these firms into more complex businesses have a better record of achievement to date than do more ambitious transformational programs.

These programs share a number of characteristics and are consistent with the so-called minimalist credit model. They provide small working capital loans with efficient screening, rapid disbursement, and a reasonable assurance of the availability of progressively larger loans upon successful repayment of previous debt. Interest rates are high and reflect the real cost of delivering the services. Limited amounts of training and

technical assistance are sometimes provided, but with the primary purpose of educating the clients to become reliable borrowers. When more extensive training and technical assistance are offered, they are provided on a voluntary basis, after the loan has been issued. In the best programs, training and technical assistance are not financially commingled with the credit activity.

Although the beneficiaries of the successful programs are poor, they are not the poorest of the poor. The vast majority of clients are in the commercial sector. As a result, these programs reach a very high proportion of women. Benefits are modest, but widespread. Most of the benefit is in the form of increased income and reduced underemployment, although some employment is also created.

Without exception, the organizations implementing these programs set out to establish financially self-sustaining credit systems. Self-sustainability is not an afterthought, but a primary organizational goal. As a result, the programs exhibit a businesslike attention to cost, revenue, the market for the service, the technology of service delivery, staffing and staff development, and management information systems. The volume of lending is an essential ingredient of the financial performance of these organizations, and they must operate in a market area large enough to achieve needed economies of size.

In Latin America, the minimalist approach has been most successfully undertaken by new institutions established for the express purpose of implementing a program. These institutions have demonstrated an ability to deliver services annually to thousands of microenterprises. Programs are based in large urban areas and have occasionally expanded successfully to secondary urban centers. In Asia, the most successful programs have been implemented by government-linked financial institutions. The most successful projects have worked to strengthen the operations of existing institutions. These organizations are highly decentralized, and they have strong central supervisory structures. They have wide geographic reach, with operational units sometimes extending to the village level. As financial institutions, they do not specifically target microenterprises, but a significant portion of the lending is used for investment rather than consumption. In densely populated Indonesia, these organizations reach millions of borrowers annually. In Africa, borrowers are reached through the credit union system. Lending is again not targeted, and because of the relatively lower density of economic activity, a much smaller proportion of loans is used by microenterprises.

These programs and the institutions involved have discovered a service (small, short-term loans), a market, and an appropriate technology for delivering the service efficiently. The programs are perhaps best viewed as start-up enterprises themselves--enterprises that justify initial subsidization because of their strong indirect benefits. To succeed they must possess the same qualities as a successful business.

6.3.2 The Limits of What We Know

> The services provided by nontransformational minimalist credit programs are sufficient to generate benefits for some microenterprises, in some areas, at some stages in their life cycle. But the needs of the vast majority of microenterprises cannot be satisfied merely by providing small working capital loans.

The minimalist strategy works (when properly implemented) in large market areas, because from a large potential group of program clients, there will be a sizable number of firms that can use the loans productively enough to justify the high price of the service. However, even among the successful clients of successful programs a point is reached when progressively larger inputs of working capital may, in fact, exert a negative impact on enterprise performance.

What stands out about the minimalist successes is the potential self-sustainability of the implementing institutions and the associated perpetual flow of services. Moreover, there is a cor-respondence between the service that can be efficiently delivered and the needs of some microenterprises in some areas at some stages in their life cycle. But other firms may not be caught in this net--for example, enterprises that require other inputs in addition to or as a substitute for working capital credit and those located in less densely populated areas. Programs that attempt to reach these firms are unlikely to be judged successful in terms of the minimalist model, unless the very different developmental challenge is explicitly taken into account. There are few packages of development services that can be delivered in a self-sustaining fashion. There may, however, be a variety of services that, while they are not compatible with institutional self-sustainability, may result in the development of sustainable enterprises and thus generate more developmental benefits than costs.

6.3.3 What We Do Not Know

The question of how to reach the enterprises whose needs cannot be satisfied by the minimalist strategy remains unanswered.

Direct assistance programs--credit, training, and technical assistance--aimed at integrating economically inactive and marginal groups have achieved their goals, but at a relatively high cost per beneficiary and on a limited scale. These programs can achieve important social and political objectives. The operations of the best implementing institutions are not and do not seek to become dependent on funding from A.I.D. and other major international donors. Nevertheless, A.I.D. can play an important role by supporting continuing program development and experimentation by these groups, and by facilitating the exchange of information and experiences among organizations committed to the goals of economic integration and community development.

Direct assistance alone has not proven to be an effective or efficient means of inducing the developmental transformation of microenterprises. This is particularly disturbing given the potential productivity, income, and employment benefits of the transformation approach. A number of recently completed and ongoing projects and programs are explicitly directed toward testing innovative strategies for promoting business development. They include minimalist credit, training and technical assistance with and without credit, and industry- and subsector-specific interventions incorporating both direct and indirect assistance. Preliminary results from these experiments are promising.

6.4 Additional Findings and Considerations

6.4.1 Projects and Policy Reform

Successful microenterprise interventions can give A.I.D. a seat at the policy table, strengthen the political clout of the private sector, attract the attention of policymakers, and result in important policy changes.

The economic policy environment has a strong influence on the opportunities available for profitable business ventures: it influences the opportunities available to different sizes of firms, and it can undermine the effectiveness of development

projects. Program and project activities have helped implementing organizations gain a seat at the policy table and influence policies that have a critical bearing on different aspects of enterprise development. Rather than attempting to earn credibility through research papers or conditionality, projects provide a vehicle for amassing hands-on information about the local business environment and for demonstrating the impact of constraints and the vision of what might be accomplished in their absence. They can sway policy debate by offering an answer to resistance to change among policymakers.

In Indonesia, the success of CJEDP's rattan export activity influenced national policy on rattan materials, significantly influenced the Government's use of private exporters as a vehicle to assist small-industry clusters throughout the country, and resulted in a request from the Director General of Small Industry for an A.I.D.-sponsored adviser to assist in formulating input into the next 5-year plan. The FID project in Indonesia resulted in a change in financial market regulations that had constrained the development of rural banks. The industry-specific FUNDAP programs in Guatemala attracted renewed Government attention to the economic problems in the highlands area. In Latin America, the project-implementing institutions were typically important political constituencies, and their leaders were often influential politicians. These institutions have been important agents in the discussions of how to deregulate the economy to permit the private sector to realize its full potential.

The success of projects also has a demonstration effect. In several Latin American countries, the success of microenterprise projects has led to the development of nationwide policies to encourage enterprise development, often using the institution whose pilot projects precipitated the national programs.

> Successful microenterprise development projects can exert a significant influence on the development of financial markets.

The best projects in the sample contributed to the development of financial markets of the countries in which they were located. They developed sustainable financing systems, created linkages, and increased the depth, integration, and efficiency of financial markets. The projects innovated financial arrangements that enabled microentrepreneurs to borrow more freely. The costs of financial transactions were reduced by risk-reducing innovations such as group guarantees, standardized feasibility analysis, and short-term working capital financing.

Some officials would prefer to achieve these same economies by having these new financial arrangements handled by existing financial institutions. Yet this has often proven impossible. It is the high transaction costs rather than the perceived risk that dissuade formal financial institutions from servicing the microenterprise sector.

6.4.2 Developmental Approach and Objectives

> Clarity of the developmental approach, mission, and objective of the program is an essential ingredient to program success. Moreover, the donor--in the field and in Washington--and the implementing institution must share the same vision.

The Administrator of A.I.D. recently drew attention to the complex political environment in which the U.S. foreign assistance program operates. This environment has resulted in a program that is caught in a dizzying web of conflicting objectives so that "no one seems to be really sure of exactly what the program is supposed to do" (A.I.D. 1989, 24). Microenterprise development is not immune to these same forces. Microenterprise appeals to the concerns of a number of very different constituencies. Each of these groups has its own view and understanding of the goals and purposes of microenterprise development. The three developmental approaches identified in this study attest to the range of perspectives on microenterprise.

When programs are pressured to be all things to all people, the effects are predictable: program focus is diluted, scarce management resources are spent resolving conflicting objectives, and incentives are distorted. Program managers cope with contradictions by trying to achieve a mixed bag of outputs well enough to ensure the next tranche of funding. This issue was identified in both positive and negative ways in the stocktaking assess-ments of programs in Indonesia, Egypt, Malawi, Bangladesh, and Paraguay.

Implementing institutions are often prone to confusion about program goals even without pressures from outside. These organizations must build constituent support in order to be sustainable. As reliance on a greater diversity of funding sources increases, outside pressures will intensify. Some donors are making funds available to microenterprise programs in Latin America with the requirement that interest rates reflect those in the formal financial markets. For programs such as the FPCD in Paraguay, which charges interest 10 times higher than bank rates,

acceptance of funding on such terms could significantly disrupt the program's movement toward self-sustainability.

The problems arising from confusion over goals can be corrected over time. As programs progress they may change their approach to concentrate more fully on their central goal. For example, ADEMI dropped its solidarity groups despite the fact that they served a poorer clientele, because it judged that they cost more and had less productive impact than its larger microenterprise clients.

6.4.3 Reaching Priority Target Groups

> Successful microenterprise programs focus first and foremost on the development of profitable and sustainable businesses. Secondary targeting decisions--for example, directing resources to women or disadvantaged groups--should be consistent with this primary focus.

The benefits of microenterprise development arise from the income earned by producing or selling goods and services. If the services provided to enterprises by assistance programs do not improve the performance of the businesses, there will be no benefits and the distribution question is moot. As obvious as this point seems, there are programs in the sample that have given priority to delivering resources to a particular target group at the expense of business development. Secondary targeting may mean that the businesses with the greatest potential profitability are sacrificed in favor of more modest ventures that are more compatible with the target group. This choice is made on the basis of the value attached to the distribution of benefits.

> A distinction can be made between the target beneficiary group and the targeting of assistance.

The reaction against the "trickle-down" development theories of the 1950s and 1960s was strong and well deserved. Investments in heavy industry protected by tariff walls were expected to fuel a process of development that would be widely shared throughout societies. This did not occur. Benefits were concentrated at the top, fueling a pattern of development that progressively widened the distance between the rich and poor.

Most microenterprise assistance programs are a reaction to the failure of "trickle-down" economics and are based on the assumption that assistance must be provided directly to the beneficiary. Everyone must be his or her own entrepreneur. This

perspective, however, presumes an answer to a question that is only beginning to be asked: trickle-down from what level? The previous discussion of employment impact pointed out that the poorest target groups may be best reached by assisting firms with the greatest potential for creating jobs accessible to the poor. A similar conclusion might be drawn for assisting firms in industries with high shares of female employment as a vehicle for distributing benefits to women. In the end, the issue is less one of targeting assistance than of understanding the magnitude and distribution of benefits of different types of assistance strategies. This issue is explored further in the discussion of leverage in Section 6.5.

6.4.4 Graduation

Graduation of firms from microenterprise lending programs to commercial sources of finance rarely occurs.

The graduation of enterprises from microenterprise development programs to formal financial institutions is a stated objective of many programs, and an explicit goal of A.I.D.'s "Microenterprise Guidelines." Despite sporadic success, examples of graduation are rare. Access to financial services is commonly cited as a problem for small-scale enterprises that are far more sophisticated than the typical microenterprises. Banks are reluctant to lend to small firms, not because of the risks associated with lending, but because of the high transaction costs of dealing with this segment of the economy. Moreover, given the structure of financial markets in many countries and the counter-productive effects of many efforts to direct credit to small firms, the gulf between the financial services offered by most microenterprise programs and those of the formal financial sector remains wide.

Apart from these supply-side considerations, many of the clients of microenterprise programs are a long way from being bankable firms in the formal sense. The transition from microenterprise to small-scale enterprise is not trivial and involves fundamental transformations in the business. Only the smallest minority of the petty traders and vendors who constitute the majority of microenterprise program clients are ever likely to gain access to formal credit sources. The ADEMI program in the Dominican Republic reported examples of approaching commercial banks with its very best clients, only to be told that the banks would prefer not to bother with them. Other constraints, such as strict collateral requirements and cultural barriers, can reinforce the problems of bank access.

Even though graduation of microenterprises is unlikely, programs should be designed to encourage firms to shift to formal financial markets whenever possible.

Client firms should be encouraged to graduate to formal institutions when they are able to do so. Some programs go to great lengths to prepare clients for the rigors of commercial banking. Bank windows are often used for disbursement and repayment. Training and technical assistance emphasize financial control, business planning, and bookkeeping to enable firms to deal with the requirements of the banks. Bankers have been brought onto the boards of implementing institutions to be educated about the "bankability" of the client group. Also, some programs try to avoid creating incentives that encourage clients to continue program borrowing when it is no longer needed. For, example, they charge higher interest rates than do commercial banks (although such rates must be higher than the real cost of borrowing) and have ceilings on loan size.

Graduate programs, when possible, not enterprises.

Graduation is a two-edged sword for credit programs. Programs with progressive lending systems find that repeat customers who are eligible for longer term and larger loans restrict program expansion. Programs that are lending from a fund that is being eaten away by inflation and by turnover slowed by arrearages can find that their resources are being tied up by a shrinking number of clients. However, programs must assume greater risk and cost when their reliable, low-cost clients graduate, because these clients are their best borrowers: they probably borrow money in the largest amounts and constitute the lowest risk. To lose established customers and replace them with new enterprises places real pressures on the financial position of the institution.

An alternative to graduating enterprises is graduation of programs to commercial sources of funds. Microenterprise lending programs are well suited to retailing funds borrowed from commercial sources. A banker who refused to lend to the ADEMI customer was willing to lend the organization funds to reloan to the clients. In Paraguay, the FPCD was not eligible for A.I.D. loan funds and therefore was forced from the very beginning to capitalize its fund from commercial sources. The ability of microenterprise lending institutions to graduate will depend on the situation in local financial markets.

Graduating enterprises to commercial sources of funds has a number of attractive features. First, it imposes a discipline

on the programs that goes beyond the stewardship of donor money. Second, it offers strong incentives for adoption of an interest rate structure that accounts for the opportunity cost of funds and inflation. Third, it encourages the adoption of accounting practices that separate lending activities from nonfinancial assistance and permit much more careful assessment of the costs of different types of service provision.

6.4.5 Average Loan Size

Average loan size varies with the developmental objective of particular programs. A $300 loan standard is well below the average for all approaches and limits financial assistance to short-term working capital loans.

A.I.D. has recommended $300 as the average loan size for microenterprise lending programs that it supports. Out of the 41 loan portfolios of the 32 programs in the stocktaking sample, 13 met this criterion. Three of these were formation programs; 10 were expansion programs. The average loan size for each of the three approaches (Table 16) is significantly above the $300 standard. Enterprise formation programs averaged just over $500; both types of expansion programs were in the $700 range; and the transformation programs averaged over $3,000 per loan.

Although not included as a separate category in the table, the programs characterized by the smallest loans were minimalist credit microenterprise expansion programs. The majority of these loans are for working capital, and a high percentage are used in commercial establishments.

Table 16. Average Loan Size

Program Approach	Average Loan Size (dollars)
Enterprise Formation	508
Enterprise Expansion	705
Financial Institutions	(676)
Microenterprise Programs	(714)
Enterprise Transformation	3,261
Statistically significant variation:	Yes

6.4.6 Training and Technical Assistance

The state of the art in understanding the role and value of training and technical assistance in microenterprise development is far less advanced than in the case of credit.

There is a long legacy of failed public sector training and technical assistance programs. At worst, government field extension officers have been known to roam the countryside and city streets (until the money for gasoline and per diem runs out) looking for one more "recipient" to add to the list of "numbers trained" or "numbers assisted." However, in many cases, it is the entrepreneurs who train the extension agents, who later leave their low-paying jobs to test their newfound skills in business. Classroom training programs frequently bear no resemblance to the needs of the trainees. Practical training is centered on machines that the microentrepreneur will never use (even in the training program because there is no fuel to power the generator) or is based on products for which there is no demand. Business training derived from accounting and management texts bears little relevance to the marks on the wall indicating how much was sold this month. There are undoubtedly many exceptions to this pattern. Nevertheless, the history of training- and technical assistance-oriented enterprise development is largely a story of failures.

This legacy of failure has had the effect of diverting attention away from training and technical assistance and retarding the development of the field. Only a few of the evaluations and studies reviewed for the stocktaking gave any real consideration to the content and quality of training materials, the appropriateness of delivery mechanisms, and the impact of these forms of nonfinancial assistance on the development of enterprises.

This legacy of failure has also had an impact on prospective clients of training programs. In all three continents, the field assessments made reference to enterpreneurs' skepticism about and reluctance to participate in training programs. In several programs, the clearest example being PROAPE/FONDESA in the Dominican Republic, credit was offered not for its own sake, but as an inducement to participation in a training program.

There are indications that training and technical assistance methods are getting better over time. One program in Honduras reported that only about 40 percent of borrowers were willing to attend postloan training courses, but, of those who did, less than 1 percent dropped out. The Carvajal Foundation courses in business management are now being used in one component of the

Ecuador SEDP, and clients are paying to enroll (possibly induced by the hope of credit). Another organization involved in the Ecuador project was charging for technical assistance that was not linked to credit and, even at a very early stage in the program, was recovering 40 percent of costs. This project, however, served a clientele of relatively large-scale enterprises, only a portion of which fell under A.I.D.'s microenterprise definition. OEF/I has recently devoted considerable effort to developing business training techniques that are appropriate for illiterate women.

> The evidence in the sample neither rejects nor supports the "single missing ingredient" hypothesis about technical assistance. However, successful technical assistance programs point to the need to accurately identify the essential missing ingredients and to address them effectively and efficiently.

Proponents of the single missing ingredient hypothesis argue that technical assistance is most likely to be successful in cases where enterprise growth is held back by a single constraining factor.[13] This novel view, which has gained widespread support, was first put forward by Peter Kilby (1979) on the basis of his review of 11 United Nations Development Programme (UNDP) technical cooperation projects. It is notable, however, that Kilby also points to the importance of other factors, including the quality of the technical advisers, the autonomy of the implementing unit, and the timely provision of inputs. Given these types of constraints, it is hardly surprising to find that success hinged on there being but a single missing ingredient. The public sector assistance agencies reviewed could not reasonably have been expected to accomplish more.

The weakness of the single missing ingredient hypothesis as a guideline for action is that it fails to account for the capacity of the implementing institution. The CJEDP addressed several constraints in several industries with some success (Boomgard 1988). Had the project been deterred by a need to first find potential interventions that fit the single missing ingredient model, few, if any, of the subprojects would have been effective. The same also appears to be true for the FUNDAP wool industry program in Guatemala. Thus what governs the success of technical assistance programs is their ability to identify constraints and

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[13]This hypothesis has been extended to include financial as well as nonfinancial assistance. It is suggested, for example, that minimalist lending programs are effective because they allow firms to overcome financial constraints through provision of a "single missing ingredient"--working capital. See Kilby and D'Zmura 1985.

to address them in a timely and effective manner. By relying on more autonomous, better managed, private sector implementing institutions, projects can turn their attention to providing the essential missing ingredients rather than focusing on the more limited number of cases constrained by a single factor.

6.4.7 Institutional Considerations

There is no consistent relationship between the type of implementing institution and project or program performance--except that the institution be strong, mission-oriented, competent, honest, and well directed.

If there was a topic on which there was general consensus in the field assessments and secondary evaluations, it was the overwhelming importance of intangible, qualitative factors determining project or program performance, particularly institutional leadership and commitment. Among the factors highlighted are the following:

-- A clear, unambiguous mission that was understood and accepted at all levels of the organization.

-- Strong and charismatic leadership. The most successful programs were led by an energetic national or dedicated foreign expert who had established good linkages with local elites.

-- Well-trained and dedicated staff. Successful organizations cultivated organizational loyalty and encouraged staff development through training, equitable personnel plans, and financial incentives for good performance.

-- Attention to organizational structure. Successful organizations commonly emphasized horizontal functional relationships and delegated responsibility and authority.

-- Management information systems. The best programs were characterized by tight management information systems and forms of financial control, often computerized.

-- Flexibility, specifically the ability to learn from experience and adapt to changing circumstances.

6.5 Subsectors, Leverage, and Microenterprise Development

Three fundamental propositions about enterprise development stand out above others.

-- Business is not easy. The term microenterprise immediately distracts from the fact that we are talking about businesses. Those claiming expertise in microenterprise development rarely have had the opportunity to experience at first hand the difficulty of succeeding in a commercial endeavor. The failure rates among new businesses or businesses attempting to graduate to the next level of size or complexity are extraordinarily high in developed, as well as developing, economies. With very few exceptions, the easier it is to succeed in a line of business, the lower the return. The demands placed on entrepreneurial and managerial talent rise along with the prospect of larger size or higher earnings.

-- The needs of microenterprises are diverse. The term microenterprise captures a tremendous amount of heterogeneity in terms of both products sold and industry functions performed. Opportunities and constraints, whether internal or external to the firm, vary along with this diversity.

-- Enterprise development is costly. Because large numbers of microenterprises are geographically dispersed throughout rural and urban areas, the direct delivery of any type of service to a target group of beneficiaries poses high logistical and administrative costs.

One successful response to the challenges posed by the problems described above has been to focus on providing a well-defined service (short-term credit) directly to enterprises in relatively large market areas. Another possible response is to seek out opportunities for enterprise development in which focused interventions influence relatively large numbers of firms. The development of self-sustaining microenterprise lending institutions is, in fact, one way of achieving this result. The "principle of leverage" can guide the search for cost-effective means of developing microenterprises.

Leverage can be achieved through a variety of mechanisms. The mechanisms used or discussed in the evaluations of the stocktaking sample can be grouped into the following categories:

-- Leverage through the development of self-sustaining service programs. Projects supporting the development

of these programs provide focused technical assistance, training, and financial resources to an institution with the expectation that its efforts will benefit a large number of enterprises.

-- Leverage through market-led linkages. Market-led linkages are closely related to the familiar concepts of backward and forward linkages and of vertical integration/disintegration. Opportunities can be created for microenterprises to be suppliers of intermediate products to other firms or to be users/sellers/transformers of the products of other firms. Subcontracting is one example of this type of linkage. Generation of these linkages often requires intervention at multiple levels of a transaction and may include subsidies for transaction costs, technical assistance and training, and other specific types of assistance. Once these linkages are successfully established, they are sustained commercially and can expand by demonstration and emulation.

-- Leverage through pump-priming. Pump-priming is defined as the temporary assumption of an industry function in order to facilitate the development of commercial relationships. For example, CJEDP assumed the role of an export trading service on its rattan export subproject, thereby reducing the high transaction costs constraining export sales. FUNDAP's wool industry marketing outlet in Guatemala is another example of pump-priming. This kind of activity can be an intermediary step in the generation of market-led leverage, or it can serve as a point of leverage in and of itself.

-- Leverage through demonstration and leadership. Demonstration and industry leadership can have strong positive externalities. "Follow-the-leader" entrepreneurship characterizes many industries in both developing and developed economies. An effective demonstration effort can, when properly targeted, influence large numbers of intermediaries and beneficiaries.

-- Leverage through research and development. The development or adaptation of technology, new products, and information can, in selected cases, leverage major benefits.

-- Leverage through policy change. By definition, policy affects broad groups of firms and is, therefore, a particularly potent leverage point and is also among the most difficult to influence. However, as the CJEDP rat-

tan program demonstrated, a project can earn a seat at the "policy table"--an important spin-off of projects that is often overlooked. Moreover, effective enterprise development can strengthen the position of groups of entrepreneurs sufficiently to get their interests noted in political debates.

In many situations, levers are industry-specific and involve considerations that go beyond the microenterprise target group. Levers involve the relationships between microenterprises and larger firms, between firms specialized in different functional areas within an industry, and between the "environment for enterprise development" and enterprises. Identification of leverage points requires a thorough understanding of the context in which firms operate.

In recent years, some experts have advocated a "subsector" approach to enterprise development. The subsector approach adopts a systems view of the economic universe, emphasizing the interdependence of economic actors, particularly those involved in the production and distribution process. Subsectors are meaningful collections of actors bound together by their participation in the production-distribution system for similar (i.e., competitive) products.[14]

Programs can be influenced by the subsector approach in two ways. First, projects can approach enterprise development on an industry-specific problem-solving basis rather than on the cross-sectoral policy or credit basis more commonly employed in donor-assisted efforts. The subsector approach would suggest that such cross-industry programs be based on induction from the analysis of a variety of industries and be tailored to their varying needs. Second, potential interventions can be identified within subsectors by looking up and down the production-distribution systems, from raw materials to final consumers, for constraints and opportunities for microenterprise development. But this approach admits the legitimacy of distinguishing between target clients and beneficiaries, currently unpopular in certain circles. Not every businessman or businesswoman needs to be an entrepreneur, and the functional disaggregation of the subsector approach can indicate a workable "distribution of entrepreneurship" as a guide to program design.

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[14]The most complete discussion of the subsector approach as it relates to enterprise development can be found in Boomgard et al. (1986).

7. IMPLICATIONS FOR THE FUTURE

More than 32 projects and programs in 21 countries have been reviewed for this evaluation. Section 7 steps back from the details of the individual cases, approaches, and issues to summarize the findings that bear most significantly on A.I.D.'s role in promoting microenterprise development.

7.1 General Observations on the State of the Art

Microenterprises have been around for a long time; microenterprise development has not.

The earliest careful empirical studies of small-scale enterprise were begun in the late 1970s, and the earliest A.I.D projects assisting small-scale enterprise and microenterprises were begun around the same time; but the first serious examination of these efforts began in the early 1980s. The first minimalist credit microenterprise project was initiated in 1982. The projects reviewed in the stocktaking study had been in operation an average of just over 3 years. The rapid pace of recent developments must be viewed in the context of the limited base of experience in microenterprise development compared with that in many other areas of development assistance.

The A.I.D. microenterprise portfolio is evolving in accordance with developments in the state-of-the-art knowledge about microenterprise development.

Recently designed projects have drawn on the experience of earlier successes and, in some cases, are taking well-informed risks in an effort to continue to push outward the frontier of knowledge about microenterprise development. There is clearly room to improve the quality and distribution of information on what is being learned at the field level.

The value of A.I.D.'s ongoing research and development program is clearly demonstrated in the field of microenterprise.

It took A.I.D. many years to realize that agricultural development programs could not be effective without well-tested, appropriate packages of assistance. The same is true for microenterprise development. The most successful A.I.D.-sponsored enterprise development programs have been based on the technology developed and refined by studying the strengths and weaknesses of existing programs and then testing improved varieties under

actual field conditions. This approach is equally valid for assistance to entrepreneurs and for assistance to implementing institutions.

7.2 What We Know and What We Do Not Know

> We know that there are significant differences in the developmental goals and approaches of microenterprise development programs and that these differences are a reflection of the breadth and heterogeneity of the microenterprise sector and of the divergent interests of the institutions promoting microenterprise development.

Three broadly defined approaches to microenterprise development have been identified in this study: the enterprise formation approach, the enterprise expansion approach, and the enterprise transformation approach. Each of the approaches faces a very different development challenge and operates with different developmental goals. Programs within each approach strive to attain objectives--to induce changes--that will benefit the poor and otherwise disadvantaged persons in low-income parts of the world. The means for achieving those objectives vary significantly. The strongest case for microenterprise promotion can be made by drawing bits and pieces of the argument from each approach: job creation and growth from the transformation programs; institutional sustainability, cost-effectiveness, small loans, high interest rates, and impact on women from the expansion programs; and impact on socially and economically disadvantaged groups from the formation programs. It is time to begin sorting out our evidence by approach rather than by the far less meaningful aggregate called microenterprise.

> We know that microenterprise development programs--irrespective of approach--can result in significant benefits for assisted firms. We do not know how significant the benefits are, to what extent these benefits are sustained, whether they represent net gains to the economy, or how impact varies among different approaches and assistance strategies.

Microenterprise assistance programs can make a difference for assisted enterprises. But this statement does not provide the whole picture. The fact that sales or income increased in firms that received assistance does not have much meaning unless this performance is compared with the performance of firms that did not receive help and with the progress that firms would have made without the program's assistance. Some types of

microenterprises, particularly those in the informal sector, operate in environments where demand is not growing and where entry is not constrained. In such situations, some of the benefits generated by assistance programs are not net gains to the economy but come at the expense of other firms that were not assisted. Concern with these types of impact issues goes well beyond adding decimal points to benefit calculations--it deals with impact issues at the foundation of microenterprise program strategy.

> We know that under the right circumstances and with the right institutions, it is possible to establish lending institutions that efficiently meet the short-term working capital requirements of some microenterprises. These institutions can become self-sustaining from earnings.

As these institutions thrive, incomes rise and underemployment falls. Moreover, the poor and women share significantly in these direct benefits. We know little about the dynamic developmental impact of these changes and the potential contradictions between the high interest rates required for sustainability and the level of benefits enjoyed by the beneficiaries.

> We know that there are vast numbers of microenterprises whose needs cannot be met by provision of working capital alone. We do not yet know how best to support firms facing other internal and external nonfinancial constraints.

We think that assistance to the firms that have not yet been reached may offer the greatest potential for reaching the poorest of the poor by creating jobs, and for generating the greatest dynamic developmental impact by transforming marginal enterprises into sustainable businesses.

7.3 Where Do We Go From Here?

> A.I.D. should accord high priority to continuing basic and applied research and development in the field of small-scale enterprise and microenterprise development.

Continuing basic and applied research is needed in several areas, including the following:

-- Qualitative research on the impact of direct and indirect forms of assistance on enterprises in combination

with a limited number of thorough cost-benefit studies of microenterprise development programs

-- More careful analysis of the potential of different types of nonfinancial forms of assistance

-- Basic research to better understand the dynamics of enterprise growth and transformation

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.

Business, regardless of its size, requires access to financial services. The financial institutions reviewed in the stock-taking provided necessary services to large numbers of beneficiaries, followed innovative screening and lending procedures that facilitated access to the system, and performed well by commercial standards. The development of such financial institutions requires time, a favorable policy environment, and considerable developmental interest on the part of concerned officials and bankers. These institutions will not appear overnight and will expand quite slowly. A.I.D. will want to work closely with other donors, particularly the World Bank, whose comparative advantage is in the development of large-scale financial institutions.

When and where such financial services are unavailable, A.I.D. should encourage and support private organizations to extend the reach of the financial system by retailing financial services to microenterprises.

The programs of private organizations are a substitute for both financial institutions and moneylenders. They should be developed as if they will become financially self-sustaining and integrated into local financial markets. These organizations will not be able to achieve the economies of size associated with large-scale financial institutions and may require continuing subsidization through granting of developmental terms on a portion of their asset structure and of technical assistance for management and operations.

The longer term financial needs of microenterprises will not easily be met through financial institutions. Here, there is stronger justification for experimenting with strategies that apply simplified appraisal systems and that base lending decisions on credit history and character.

Delivery of longer term fixed asset financing for microenterprises is not likely to be undertaken by banks or other financial institutions because of the high costs of appraisal and the effect of such lending on portfolio turnover. We know that this type of lending is not commercially viable, and it will require continuing external subsidization.

> Training and technical assistance programs should be supported, but only when they respond to the identified business needs of microentrepreneurs. Some training is integral to the operation of effective lending programs, and it should be considered a cost of lending operations. Other types of training and technical assistance should be kept financially independent from lending operations.

Enterprise formation and transformation generally involve training and technical assistance. The particular strategies adopted should be responsive to the kinds of business opportunities available to entrepreneurs. Some of the more promising advances in this area were discussed in Section 6. Our knowledge of the effectiveness and impact of different forms of nonfinancial assistance lags well behind our understanding of credit. Training and technical assistance programs should be integrated into the applied research efforts mentioned earlier so that this imbalance can be overcome.

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Microenterprise Stocktaking: A Statistical Look at A.I.D.'s Microenterprise Portfolio, September 1989, A.I.D. Evaluation Special Study No. 63 (PN-AAX-222).

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