



Microenterprise Development Programs in the United States and in the Developing World

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Summary. — Sparked by examples from Bangladesh, Bolivia, Indonesia, and other developing countries, hundreds of microenterprise programs have been started in the United States. Will these US efforts be successful? This paper reviews the evidence and concludes that microenterprise development is much more difficult in the United States than in the developing world. The paper suggests some ways to address the challenges of US microenterprise development.
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1. INTRODUCTION

Microenterprises are tiny businesses; most have one employee, the owner. Microenterprise development programs make loans and/or give classes to poor people to help them to start or to strengthen their businesses. In the past 15 years in the United States, the number of microenterprise programs has grown to more than 340 (Langer, Orwick, & Kays, 1999). Growth has also been rapid in the United Kingdom (Rogaly, Fisher, & Mayo, 1999; Rogaly & Roche, 1998).

Some scholars see microenterprise as a promising way to help the working poor, the unemployed, and those who receive public assistance (Balkin, 1989; Clinton, 1997; Friedman, 1988; Raheim & Alter, 1998; Soloman, 1992). This view stems from a few programs in the developing world that serve massive numbers of people efficiently. The best-known examples are Grameen Bank in Bangladesh (Hashemi, Schuler, & Riley, 1996; Jain, 1996), BancoSol in Bolivia (Gonzalez-Vega, Schreiner, Meyer, Rodriguez-Meza, & Navajas, 1997; Hulme & Mosley, 1996), and Bank

Rakyat Indonesia (Chaves & Gonzalez-Vega, 1996; Patten, Rosengard, & Johnson, 2001).

The success of the transfer of microenterprise promotion depends on the context (Bhatt & Tang, 1998; Hulme, 1990; Taub, 1998). Can microenterprise programs work as well in the United States as in the developing world? This paper reviews evidence of the effects of the context. It argues that microenterprise for the US poor is more difficult than in the developing world. Microenterprise is a good choice for a few extraordinary poor people, but wage jobs, additional education, and job training are still the most common paths out of poverty (Bates, 1997; Bendick & Egan, 1987; Bhatt, Tang, & Painter, 2001; Dennis, 1998; Mokry, 1988; Novogratz, 1992; Servon, 1999).

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Two large-scale tests of US microenterprise development programs suggest that impacts may be small. In a randomized experiment (Benus, Johnson, Wood, Grover, & Shen, 1995), access to microenterprise programs about doubled the rate of movement from unemployment to self-employment, but the absolute increase in the number people who moved was only about one per 100 (Schreiner, 1999a). Likewise, take-up rates in a nationwide demonstration of microenterprise programs aimed at recipients of public assistance (Friedman, Grossman, & Sahay, 1995) suggest that access would move, at most, about one person per 1,000 from public assistance to microenterprise (Schreiner, 1999b). It seems that few poor people in the United States will use self-employment to escape working poverty (Servon, 1996; Sherraden, Sanders, & Sherraden, 1998).

In the United States, abundant wage jobs and an effective public safety net decrease the push to self-employment. Most microenterprise programs in the developing world make loans to the poor through groups, but groups in the United States tend to fall apart because of lack of social capital and because individuals with a good credit record can get loans on their own. The two most important constraints on self-employment in the United States are a lack of savings and/or a lack of skills, but microenterprise programs are limited in how they can facilitate savings, and it is difficult and costly to build the human capital required for entrepreneurship.

This following sections describe how aspects of the economic and socio-cultural context in the United States hinder the promotion of self-employment for the poor. Most of these factors are positive features with side effects that dampen the push toward self-employment. This is not necessarily a bad thing. For example, poor people may be better off with a strong safety net and low incentives for entrepreneurship than with a weak safety net but strong incentives for self-employment. The paper also offers recommendations for how to improve microenterprise development in the United States. Most important, funders—whether public or private—should structure support so as to strengthen the incentives for microenterprise programs to experiment to find innovations that decrease the cost of services and/or increase the worth of services.

2. DIFFERENCES IN TYPICAL MICROENTERPRISES

The microenterprise sector in the United States differs from that of Bangladesh, Bolivia, or Indonesia. “Self-employment is not as easily pursued in the United States as it is in international contexts” (Edgcomb, Klein, & Clark, 1996, p. 59).

Table 1 lists examples of types of microenterprises in the United States and in the developing world. Most US microenterprises

Table 1. *Examples of types of microenterprises in the United States and the developing world*

United States	Developing world
—Care for children or pets	—Plant crops and fatten livestock
—Cut hair or polish nails	—Do odd jobs, especially on farms
—Cook food and sell drinks at festivals	—Cook food and sell drinks on the street
—Sell Avon, Amway, or Mary Kay	—Petty trade in food, clothes, or toiletries
—Clean homes, cars, or offices	—Take in laundry
—Trade and/or repair clothes or cars	—Make and/or repair clothes or cars
—Paint or repair houses	—Build or repair houses
—Cut grass or trim branches	—Collect and sell wood, charcoal, or water
—Kill pests	—Carry loads or messages
—Repossess cars	—Drive a bus or truck
—Work with wood	—Work with wood or metal
—Rent video tapes	—Show movies from video tapes
—Deejay parties	—Play in a band
—Drive cabs	—Run a rickshaw
—Quilt or knit blankets	—Husk rice or shell peanuts
—Sling newspapers or brochures	—Sell newspapers or lottery tickets
—Make and sell arts and crafts	—Scavenge for things to recycle
—Make and sell fake jewelry	—Make and sell baskets or rope
—Buy and sell drugs	—Shine or repair shoes

produce nontraded services such as childcare, haircuts, retail sales, transport, or home, car, or office maintenance. What little manufacturing there is involves custom work such as cabinets, crafts, or clothes. Some illegal microenterprises distribute drugs. The average person in the United States does not spend a large share of his or her budget on purchases from microenterprises.

In contrast, developing-country microenterprises produce both services and manufactured goods. Most of these small firms are subsistence farms. Many sell cooked food from the sidewalk or food staples from a small store. The average person in the developing world does spend a large share of his or her budget on purchases from microenterprises.

Most microenterprise programs the world over target the working poor. They do not promote the high-demand, fast-growth small firms that may account for a large share of new jobs in the United States. Such “gazelles” are usually started by people such as consultants, architects, or computer programmers who have high human capital. Microenterprise programs typically have little to offer these growth microenterprises.

Instead, microenterprise programs focus on low-demand, slow-growth firms. This is sensible because poor, low-skill people are more likely to succeed in such survival-and-maintenance activities. These simple businesses require low levels of financial and human capital, but they also have low returns.

3. LOANS TO GROUPS OF BORROWERS

The success of microenterprise development in the developing world rests mostly on the innovative use of joint-liability groups to make loans to people without traditional collateral (Morduch, 1999a). Each group member is liable for the debts of the others; if one does not repay, the others must pay, or else all will lose access to future loans.

Groups can decrease social costs if they tap into existing social capital and use it to shift screening, monitoring, and contract enforcement from the lender to the group. Total costs decrease if the social capital was built in the past. In the developing world, this is often the case because group members live or work in the same place or already run informal savings clubs among themselves (Adams & Fitchett, 1992).

Group loans may increase social benefits if their financial intermediation relaxes financial constraints or if their social intermediation relaxes nonfinancial constraints. For example, weekly meetings of groups in the Grameen Bank not only provide access to loans but also—as a by-product—break down the constraints of *purdah*, giving women a socially acceptable excuse to walk in public, to meet women from outside their compound, and to hear their first names spoken with respect (Larance, 2001).

Microenterprise programs often prefer group loans to individual loans because they value social capital, because they aim for community-level outcomes, and because, as inexperienced lenders, groups shift many tasks to borrowers. Furthermore, group loans can reach poorer borrowers than individual loans (Conning, 1998). Based on balances and numbers of loans outstanding at 283 US programs surveyed by Langer *et al.* (1999), the average individual loan was \$10,630, but the average group loan (per member) was \$1,802.

Groups in the United States, however, have been a disappointment (Ashe, 2000; Taub, 1998). Most of the first programs copied the group concept as conceived in Bangladesh, but have since switched to focus on training and/or individual loans (Schreiner & Morduch, 2001). Less than one-sixth of US microenterprise programs make loans to groups (Langer *et al.*, 1999). “Group-lending approaches in the United States do not carry with them the efficiencies anticipated by the performance of peer programs in the developing world” (Edgcomb *et al.*, 1996, p. 41).

Group lending in the United States has struggled for four reasons. First, social capital among the poor is weak. In the market, most trades are one-shot and impersonal. Unlike the developing world, the United States lacks concentrated, personalized markets where the same buyers haggle over each price with the same sellers each day or each week. The faceless, nameless trades with set prices that characterize US markets do decrease transaction costs because they do not require buyers and sellers to invest in reputations. As a side effect, however, they stunt the growth of the social capital that would nourish joint-liability lending. In the household, people get their livelihoods from wage jobs or from public assistance and thus are not forced to form many multi-stranded, long-term economic and social relationships beyond the family. Furthermore,

social capital is an asset that evaporates to some extent with each move, and people in the United States move often. Without constant contact to build trust, joint-liability groups lack the necessary social capital (Woolcock, 1999).

The second reason that groups have struggled is that the US poor are diverse. In theory, joint liability works best with homogenous members because then all members face the same risks. In practice, this can hold in Bangladesh or Bolivia because many entrepreneurs are farmers or petty traders and because every village has scores of people who want to raise chickens or peddle soap. Small towns in the United States, however, may not support more than a couple beauty salons or résumé services. Furthermore, few poor people in the United States can find four friends who want to start a small business. The mix of cultures in the United States may also decrease social capital if people tend to avoid others who differ in these ways.

Third, US groups often fail because microenterprise programs do not enforce joint liability (Bhatt, 2000; Hung, 2001). It is not nice to make an honest borrower pay the debt of a defaulter, but forgiveness sets an example that unleashes an avalanche of arrears because group members no longer have selfish reasons to select trustworthy peers, to watch them, and to pressure them to pay.

Fourth, groups break down because even poor people in the United States—if they have a clean credit record—can get individual loans through credit cards. Revealed preference suggests that most borrowers would prefer to avoid groups and thus to avoid the high transaction costs needed to maintain friendships, coax and cajole delinquent partners, and mete out punishments.

Joint liability also means that honest borrowers must sometimes pay defaulter's debts. This can spark a domino effect in which those who would have paid their own debts choose instead to default to avoid paying for their fellows (Besley & Coate, 1995; Paxton, Graham, & Thraen, 2000). Groups also break down because the fortunes of members diverge through time. Some members have more luck, skill, or effort and so want bigger loans, but poorer members cannot afford to be saddled with big debts should their less-poor partners default, so the group breaks up.

Joint-liability groups are the main innovation in microenterprise development in the developing world, but they do not work well in the

United States. US programs should recognize this and move on to look for innovations appropriate to their context.

4. SIZE OF THE MICROENTERPRISE SECTOR

The US microenterprise sector is small. Microenterprise accounts for 60–80% of jobs in the developing world but, according to Edgcomb *et al.* (1996), 8–20% in the United States (and this estimate may be too high). Alternatives to self-employment—wage jobs and public assistance—reduce the size of the sector and the pool of entrepreneurs.

The US economy is large and well-integrated with global markets. While this increases overall well-being, it also precludes the three types of self-employment most common in the developing world. First, few manufacturing microenterprises in the United States can compete against factories. Second, few small retailers can compete against chain stores. Third, few very small farms can survive on their own in the United States.

The alternative to microenterprise in the developing world might be starvation. Wage jobs are scarce, and there is no public safety net. In contrast, the United States not only has abundant wage jobs but also a safety net for the jobless.

(a) *Self-employment and the safety net*

A safety net reduces the number of microenterprises in five ways. First, it prevents starvation and thus decreases the push toward self-employment. Second, the receipt of public assistance requires less effort (and implies less risk) than self-employment. Third, income tests on public assistance reduce the rewards to the risk and effort of self-employment because assistance decreases as business profits increase. A fourth and related point is that asset tests discourage saving (Hubbard, Skinner, & Zeldes, 1995; Powers, 1998; Sherraden, 1991). Without savings, there is no self-employment; nothing else can finance pre-venture capital and living expenses until the business turns a profit. The problem is less that limits on income and assets reduce public assistance and more that the limits kick in before a small firm can support its owner. Fifth, the safety net may decrease entrepreneurship because people who

receive transfers may not think of self-employment as an alternative (Friedman, 1988).

In the United States, the safety net places a floor on economic well-being, and this makes microenterprise development more difficult. Of course, the safety net should not be loosened just to push people toward microenterprises. But US programs should recognize that their job is more difficult than in the developing world.

(b) *Wage jobs and the pool of microentrepreneurs*

The pool of low-income entrepreneurs in the United States is shallow. Entrepreneurship requires all the effort and skill of a wage job, but it has higher risk. People able to be self-employed can usually earn more in wage jobs (Spalter-Roth, Hartmann, & Shaw, 1993). Thus many entrepreneurs have a special vocation for self-employment or have failed at wage jobs.

Income from microenterprise is often low because most poor entrepreneurs start with low levels of investment and enter sectors with low barriers (Bates, 1997). Thus, they have low productivity and face high competition. Small firms in depressed areas may face low demand if they sell things that customers could do for themselves or could do without. All of this leads to high effort, high risk, and low profits.

The main impact of microenterprise programs—in both the United States and in the developing world—is not to increase income but rather to smooth income in the face of shocks (Cohen & Sebstad, 2000; Morduch, 1998, 1999b; Sherraden *et al.*, 1998; Taub, 1998; Zeller & Sharma, 2000). For example, microenterprise borrowers can use loans to finance not only their business but also their consumption. Furthermore, self-employment income also buffers wage income; owners of small firms can work more in the business when household expenses spike or when there is slack time in a wage job.

The pool of poor entrepreneurs in the developing world is not as picked-over as in the United States, where most people who can get wage jobs already have wage jobs. In the developing world, wage jobs are so scarce that even people with high skills and entrepreneurial spirits may not find wage jobs. Thus, the average unemployed person in the developing world probably has almost average luck, skills, and entrepreneurial spirits, but the average

unemployed person in the United States probably has below-average luck, skill, or entrepreneurial spirits (Novogratz, 1992).

Of course, there are exceptions. Some people start small firms to do work that they love, to be their own boss and to set their own hours, to bequeath a business and an example to their children, or to feel the pride of achievement (Himes & Servon, 1998; Sherraden *et al.*, 1998). Self-employment may also shelter women and minorities from discrimination. Finally, self-employment may provide the flexibility that parents—especially mothers—require as they raise children.

5. ENTREPRENEURS AS DECATHLETES

In the United States, entrepreneurship is complex. Like decathletes who sprint, jump, and throw in 10 events, owners of small firms must excel in many tasks. They not only provide a service or manufacture a good, but they also pay taxes, comply with regulations, supervise employees, attract customers, and find suppliers. Entrepreneurs must wear many hats, and some of them may not fit well. In contrast, wage workers need to excel at fewer tasks.

Self-employment in the developing world is less complex. Employees, if any, are usually children or relatives who are simple to monitor. Most customers are neighbors, and many small firms can simply ignore regulations and taxes.

Like wage workers in the United States, microentrepreneurs in developing world must excel at only a few tasks. For example, woman in Bangladesh can husk rice if she can get paddy from a less-poor neighbor, remove the chaff, and then pick out dirt and rocks. It is a tough job, but anyone can do it. Likewise, raising a milch cow requires only land and time. In the Dominican Republic, a woman can buy 100-pound sacks of brown sugar wholesale and sell retail to neighbors. In India, a woman can clean, refill, and sell used ballpoint pens.

The United States has small markets for husked rice, fresh milk, cups of brown sugar, and recycled ballpoint pens. Even if there were demand for simple, small-scale enterprises, owners in the United States would still have to pay taxes and meet codes, maintain a locale, and deal with many suppliers and customers. In the United States, even a simple microenterprise can be complex.

6. GOVERNMENT AND FORMALIZATION

More than developing-world governments, the US government does what it is supposed to do. Sometimes, this increases the cost of microenterprise. For example, two-thirds of new US businesses in 1995 were run from the home (Dennis, 1998). Working from home allows the owner to care for children, to get help from family, to work during slack times of the day, and to utilize the illiquid investment in the home. Working from home also avoids the need to commute. Zoning laws, however, may prohibit home-based firms, and child-labor laws may forbid that children help their parents. In the developing world, these laws may be on the books, but they are seldom enforced as in the United States.

US entrepreneurs face red tape (Dennis, 1998). Taxes and regulations have implicit noncash transaction and opportunity costs that may swamp their explicit cash costs. Furthermore, the quasi-fixed nature of these costs impinges regressively on small firms.

Of course, red tape in the developing world can make red tape in the United States look like gift wrap (de Soto, 1989). Formal microenterprises in the United States must pay taxes and comply with codes, but they also benefit from police and contract enforcement by the courts, from credit bureaus, and sometimes from waivers on means tests for public assistance. To note that effective government may not always facilitate microenterprise is not to indict effective government, because formalization has its benefits. For example, informal microenterprises—such as those in the drug trade—may need to resort violence to enforce contracts. They may also hide income and assets to keep public assistance, and they cannot easily establish creditworthiness. In addition, zoning laws protect neighbors from noise and pollution, and child-labor laws protect children from abuse. Even without microenterprise, the US poor would be better off than the developing-world poor, and largely due to better government.

Some US laws may impede self-employment needlessly. Usury caps, for example, might make sense if lenders held a monopoly and if borrowers had no choice but to borrow. In the United States, this is not usually the case. In fact, usury laws probably decrease access to microfinance in two ways. First, they do not let lenders recoup the (mostly fixed) costs of small, short loans to high-risk borrowers without

traditional collateral. Second, usury laws give high interest rates a bad name. Even if lenders could raise rates enough to make a profit on microenterprise loans, they might choose not to do so for fear of being called usurers.

7. ACCESS TO FINANCIAL SERVICES

Financial services include loans, deposits, insurance, and payment services. *Access* implies supply at a price that covers the long-term costs of an efficient supplier and that is less than the value of the service to the user (Navajas, Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 2000). Lack of access is not problematic unless the cost of supply is higher than it needs to be or if markets are imperfect. Financial markets are imperfect, but not all interventions are improvements.

Access to financial services in general—and to loans in particular—constrain entrepreneurship in the developing world more than in the United States. This means that US microenterprise programs must help the poor to build savings or to build human capital. This is more difficult than making loans.

(a) *Access to financial services in the developing world*

In the developing world, lack of access to financial services constrains many microenterprises. For example, the fixed-cost structures of banks lead them to discourage small, frequent deposits from the poor. Moreover, their branches are far from the poor (physically and culturally), and they stay open for just a few hours a day.

The poor in the developing world do save, and they respond to greater access to deposit services (Robinson, 2001; Rutherford, 2000). They save because their income does not always coincide with their expenses and because they do not have public assistance or formal insurance to buffer catastrophic risks. They do not, however, save much in financial deposits. Instead, they store wealth as cinder blocks, lengths of barbed wire, gold nose-rings, sacks of grain, pots, livestock, bottles of rum, petticoats, favors for neighbors, and children. These stores of wealth, however, have some disadvantages compared with financial deposits. They are less liquid and can rust, run away, be consumed, or otherwise lose value through time. Of course, financial deposits can also lose

value to inflation and/or devaluation, especially in the developing world.

The best microenterprise programs in the developing world find innovative ways to reduce the fixed costs of deposit services for the poor. For example, Bank Rakyat Indonesia (BRI) has small, plain branches. Simple procedures allow low-skilled—and low-wage—employees to manage without computers. Before the Asian meltdown, BRI had about 18 million depositors and two million borrowers, with aggregate deposit balances twice aggregate loan balances (Yaron, Benjamin, & Piprek, 1997). After the meltdown, the number of depositors *increased*.

Few poor entrepreneurs in the developing world have checking accounts, and other payment services (except wire transfers from migrant workers abroad) are not well-developed. If deposits are the forgotten half of development finance (Vogel, 1984), then payment services are the forgotten third, and loans are the remembered sixth. Insurance has also been undeservedly ignored (Zeller & Sharma, 2000).

Most banks in the developing world make loans only to those with wage jobs or with mortgage collateral. This creates a vacuum for microenterprise programs in a niche with a broad pool of creditworthy entrepreneurs.

(b) *Access to financial services in the United States*

Some studies find that a lack of access to loans constrains US entrepreneurs (Holtz-Eakin, Joulfaian, & Rosen, 1994; Lindh & Ohlsson, 1996). The reasons for the constraints include racial discrimination, lack of a credit history for recent immigrants, and a scarred credit history. Still, if a lack of access to loans is a constraint, then it is usually because lenders require assets as collateral, and assets require saving (Bates, 1997). Just as home lenders require a down payment, business lenders require entrepreneurs to put something of their own, besides the loan capital, at risk.

US microenterprises usually do have some access to loans. For example, one-fourth of the clients of a large network of US programs had had defaults or bankruptcies, and more than half of all clients used their loans to consolidate debt from other sources (Himes & Servon, 1998). Almost anyone in the United States with a wage job and a clean credit record can get a credit card. Most microentrepreneurs or their spouses have wage jobs (Spalter-Roth *et al.*,

1993), and credit cards probably meet most demand for microenterprise loans (Bates & Servon, 1998). Although credit-card debt is high priced, it has low transaction costs and very low total costs. Likewise, loans from the so-called fringe banks—pawn shops, check-cashing outlets, and rent-to-own stores—have high prices but low total costs (Caskey, 1994). Competition has pushed nonbank financial intermediaries—if not banks—closer to the poor.

Poor people in the United States also have access to savings and payment services. Existing microenterprises must have had some savings when they started, and some of these savings may have been held as financial deposits. Half the low-income people and microenterprises surveyed in a Hispanic neighborhood of Chicago had deposits in banks (Bond & Townsend, 1996). Even banks, pressed to do something to reduce financial exclusion, have begun to look down-market (Merton & Bodie, 1995).

Poor people in the United States also have access to a wide range of payment services. Post offices, check-cashing outlets, and grocery stores sell money orders and cash checks. Automatic-teller machines provide some payment services, if often unsafe or inconvenient.

Broad access to financial services in the United States is good for microenterprises but bad for microenterprise programs. In the developing world, the best programs can turn a profit from lending. In the United States, microenterprise programs cannot compete with for-profit lenders. Although savings may be more useful than loans for self-employment, the role for microenterprise programs in savings is probably small.

(c) *Savings services and microenterprise programs*

Most microenterprises are financed not with debt but with savings (Bates, 1996; Bond & Townsend, 1996; Dennis, 1998). If a microenterprise does get a loan, it is usually linked to the purchase of a physical asset such as a barber chair or a lawnmower. During gestation, the entrepreneur cannot get a loan for research expenses nor for living expenses, so without savings, most new firms will fold before they fledge.

For new microenterprises, savings has some advantages over loans. Savings screen for skills and entrepreneurship where information is the least asymmetric—the self. Often entrepreneurs

start small, part-time, and with savings to test their skill and the market. This lets them cut their losses if the venture fails. Businesses that use savings also avoid fixed repayment obligations that could cause bankruptcy if cash inflows vary.

The dilemma is that most microenterprises need savings more than loans, but microenterprise programs have no clear role to facilitate savings. Programs can attract borrowers, especially if they make large, uncollateralized, low-interest-rate loans. They can also subsidize the development of business plans and thus indirectly reduce the need for savings. But programs cannot, by law, take deposits. Also, deposits, unlike loans, do not directly generate revenue for the program.

Individual development accounts (IDAs) are one option (Sherraden, 1991). Deposits by poor people in an IDA in a bank are matched if used to purchase a home, post-secondary education, or microenterprise assets. The number of IDA programs has exploded in the United States, going from zero when Sherraden (1988) proposed the idea to more than 400 in 2000. Both George W. Bush (Bush, 2000) and Al Gore (Kessler, 2000) had billion-dollar IDA proposals in their campaign platforms, and 29 states had passed laws to provide for IDAs. The United Kingdom has proposed IDA-like accounts (HM Treasury, 2001). Still, an IDA program for microenterprise does little more than raise funds for the match, provide entrepreneurship training, and monitor the use of withdrawals. Banks do the rest, and there is no technological reason why banks could not do it all at a lower cost.

US microenterprises, unlike developing-world microenterprises, are probably constrained less by lack of loans than by lack of savings. Unfortunately, microenterprise programs cannot provide saving services directly. Thus, efforts to relax financial constraints on US microenterprises should focus on banks.

8. CLASSES FOR SKILLS AND ENTREPRENEURSHIP

With competition for loans and little role in savings, US microenterprise programs have focused on training. More than 90% of US programs offer training (Langer *et al.*, 1999). It is more difficult, however, to impart skills and entrepreneurial spirits than to make loans.

The earliest developing-world programs started with training, but now most focus on loans. In contrast, the earliest US programs started with loans, but now most focus on training.

Human and financial capital are complements, but US programs have three other reasons to bundle classes with loans. First, training may help inexperienced lenders to screen potential borrowers. People who can pass a class—often with a business plan as its capstone—are more likely to be able to repay their loans. Second, class attendance is a way to vet self-employment for waivers on means tests for public assistance. Third, funders prefer to pay for loans rather than training, so some training programs make loans in order to get funds for their true mission (Servon, 2001).

The record in the developing world suggests that loans and training do not mix well. For example, the World Bank mostly failed to use subsidized loans to induce subsistence farmers to adopt new technologies (Adams, Graham, & Von Pischke, 1984; Von Pischke, 1991). Larger, richer farmers captured the subsidies (often through default), and access to subsidized funds discouraged banks from developing deposit services for the poor.

Developing-world microenterprise programs that mixed loans and training found that good teachers were not always good lenders and vice versa. Borrowers were confused when training was a gift but cash was a loan. Furthermore, some programs felt it was unfair to dun defaulters whose ventures failed in spite of their training.

Perhaps the most important lesson from the developing world is that programs should build a firewall between their lending and training activities (Helms, 1998). This improves transparency and sharpens incentives to decrease costs and to increase value.

(a) *Skills*

The two prerequisites for entrepreneurial success are human and financial capital. Loans matter only when skills and savings are present. Wealth is the biggest constraint on debt (Berger & Udell, 1998), and, according to Bates (1997, p. 4), “no serious studies have demonstrated that small amounts of debt can overcome human-capital deficiencies that otherwise minimize chances for business success.”

Both in the United States and in the developing worlds, most training covers general business skills. Rather than tell a cook how to

cater, a gardener how to cut grass, or a cobbler how to fix shoes, they focus on general business skills such as bookkeeping, financial management, spreadsheets and word processing, marketing, and taxes. "The objective is to provide the practical knowledge to do the myriad of little things it takes to start and sustain an enterprise" (Balkin, 1992, p. 141).

Some experimental evidence suggests that—because the range of problems microentrepreneurs may face is very large—classes and counseling are best provided as on-call responses to problems met in practice rather than as up-front attempts to immunize against anticipated problems (Schreiner, 1999a). Furthermore, sector-specific training for regulated sectors such as childcare and food preparation have helped poor entrepreneurs comply with regulation and get licenses. Successful private-sector examples include schools for truck-driving and cosmetology.

In general, however, it is difficult to transfer human capital in short courses. Entrepreneurship training is more difficult than job training because the "goal is not merely to provide business skills, but to help develop a new and viable organization" (Drury, Walsh, & Strong, 1994, p. xiii). More resources are required to train decathletes than to train specialists. Furthermore, program staff may lack experience in adult education or in entrepreneurship itself. In the end, microenterprise classes may have greater impacts on self-esteem more than on skills or income (Raheim & Alter, 1998; Spalter-Roth, Soto, & Zandniapour, 1994).

Training in the United States drains program budgets for two reasons. First, it requires a lot of staff time, and skilled labor in the United States is expensive. Second, most programs do not charge for training (Langer *et al.*, 1999).

Free training ignores two of the most important lessons from the developing world. First, fees produce feedback that improves the quality of training: students will not pay more than what the class is worth to them. Even a nominal fee is better than no fee. Second, microenterprise training will probably never be profitable. In general, loan-led programs in the United States lose less money than training-led programs (Edgcomb *et al.*, 1996). Profitability matters if funders may one day lose interest in microenterprise development.

Of course, there may be a market failure if training produces more social gains than social costs even though it does not produce more

private gains than private costs for either programs or students. Lessons from the developing world can point to ways to structure subsidies so as resolve the market failure and still preserve incentives for quality and efficiency. For example, a program in Paraguay gives entrepreneurs vouchers for part of the price of self-employment training (Schor & Alberti, 1999). Entrepreneurs can receive vouchers whether or not they also receive loans. They combine the voucher with their own funds to pay the trainer of their choice. Professional training institutes teach general skills, and private entrepreneurs transfer hands-on their own specific skills as bakers, seamstresses, or mechanics.

(b) *Entrepreneurship*

Even with observed traits constant, people are not the same. The difference is *entrepreneurship*, the oomph that drives sacrifice in the present in the hope of a better future. Entrepreneurship matters because self-employment requires unsupervised work with high risks and low rewards (Dennis, 1998). Unfortunately, entrepreneurship is difficult to teach.

Taub (1998) speculates that poor people in the United States may have low average entrepreneurship because they are not used to self-employment and because their peers do not expect them to take risks in a new venture. Other evidence, however, suggests that some poor people are entrepreneurial. In 1995, 2.6% of families with incomes below \$10,000 in the United States started new ventures (US Bureau of the Census, 1997). An unknown number of additional low-income people do informal work that is not reported as self-employment because it is illegal, paid in cash or in kind, or is too small or infrequent to be thought of as a business.

9. CONCLUSION AND RECOMMENDATIONS

Microenterprise programs in the United States face challenges unknown in the developing world. Abundant wage jobs and a safety net weaken the push toward self-employment. Even small ventures are complex and must comply with regulations, pay taxes, and compete in global markets. Group loans do not work well, and private lenders take the best individual borrowers. Poor entrepreneurs need to build human and financial capital, but

training decathletes—especially for entrepreneurship—is costly, and microenterprise programs can do little to facilitate savings. Microenterprise development is much more difficult in the United States than in the developing world. The rest of this paper discusses ways to address the challenge.

(a) *Structures of incentives for innovation*

Microenterprise development in the developing world reduces costs through innovative joint-liability loans. Microenterprise development in the United States requires incentive structures to prompt the search for similar innovations. The incentives of funders determine the incentives of programs (Schreiner & Morduch, 2001).

Experiments and change are difficult, and public and private donors can sometimes smother invention. After all, most experiments, like most small firms, fail, and administrators who fund failures are not promoted. Furthermore, short-term electoral cycles may reward those who can claim quick results or who can disburse a lot of money. This leads to too much focus on current “best practices” and concentrates funds in a few programs widely recognized as being among the best, whether or not these programs have ceased to innovate (Hulme, 2000). US microenterprise programs are still in the stage of research and development, and funders should restrict assistance to those with concrete plans to try something new to decrease the costs of supply and/or to increase value to users.

The incentives faced by microenterprise programs derive from the incentives faced by the people who work in public and private donor organizations. These structures change at a glacial pace, but a first step might be to measure the output of administrators not as funds disbursed but rather as the number of microenterprises served per unit of resources disbursed. The intent is to reward funders who seek out programs that make an effort to control costs.

(b) *Costs and outputs*

Microenterprise programs can cut costs by cutting output, but would defeat the purpose. A better first step toward better incentives is to measure both costs and outputs. In the developing world, such measurement has helped to speed innovation (Schmidt & Zeitinger, 1996).

Even without credible estimates of program benefits, estimates of costs and outputs can help to ensure that development funds are well-spent (Devarajan, Squire, & Suthiwart-Narueput, 1997).

Many microenterprise programs in the United States are quick to relate anecdotes of successful entrepreneurs, but most are slower to publish cost studies. Exceptions include a cost analysis of the largest IDA program (Schreiner, 2002), rough estimates that put costs for a large sample of US programs at about \$2,000 per client in 1996 and about \$1,300 per client in 1999 (Schreiner & Morduch, 2001), and an excellent study of outputs and costs by Edgcomb *et al.* (1996) which implies that the cost per dollar-year of borrowed purchasing power in the seven oldest and best-known US microenterprise programs was about \$1.50. Whether these costs are high or low compared with output is not the point; what matters is that the mere measurement of costs and benefits creates incentives to improve.

(c) *The safety net*

Public managers must remember that although the context of the United States often mitigates against microenterprise, it is probably better to have many wage jobs, an effective safety net, a good government, global trade, and taxes and regulations with teeth. After all, the goal is not more microenterprise but rather improved well-being for people, and microenterprise may or may not be the most effective means to that end.

(d) *Savings and debt*

The low-income self-employed in the United States are likely constrained more by lack of savings than by lack of loans. Although low-income communities often lack the social capital to make borrowing groups work, individuals with decent credit records can get small individual loans, through credit cards if nothing else. Larger loans, however, require collateral. Collateral requires assets, and assets require saving.

How can microenterprise programs promote saving? IDAs are one way. Programs might also require not only a business plan but also some minimum savings to cover operating and living expenses as a new venture gets off the ground,

somewhat like the escrow accounts for emergencies required of low-income home buyers.

(e) *Modest claims*

In the United States, microenterprise is not a panacea but a vitamin. Advocates should seek not to promote but to improve, being “careful not to overstate benefits” (Raheim & Alter, 1998, p. 59). Microenterprise is “clearly not the answer to the urban poverty problem” (Servon, 1997, p. 175), and self-employment alone “will not result in the alleviation of poverty in the long run” (Raheim, 1997, p. 51).

The need to attract funds may sometimes tempt advocates to hype potential and to hide problems. A more sober view can only help to push programs to try harder to seek for welfare-improving innovations.

(f) *Hire expertise*

Good leaders of not-for-profits do not always make good trainers or good bankers. Although anyone with money can make a loan, a good lender gets repaid and does not make loans that end up harming borrowers. Former entrepreneurs often make the best trainers, but few employees in not-for-profits have this experience. Just as an agricultural-extension project should hire agronomists, a microenterprise program should hire former entrepreneurs, professional loan officers, and teachers.

(g) *Training and loans*

US microenterprise programs focus on training and loans. But what kinds of classes should they give? Whom should they target? Some evidence suggests that long-term, on-call advice is better than general, up-front classes. The risks and problems faced by small businesses are too diverse to predict and address beforehand.

In the developing world, few microenterprise programs make loans to start-ups, but in the United States, most microenterprise programs focus on start-ups. Bendick and Egan (1987) suggest that scarce development funds would be better spent to strengthen existing small firms.

(h) *Monitor self-employment*

Microenterprise practitioners should search for ways to monitor effort toward self-employ-

ment that do not require attendance at classes or indebtedness. Means tests on public-assistance programs are meant to prevent the abuse of public assistance, but lawmakers have been willing to waive the limits if they believe that the waivers are short-term and that the waivers can help someone to escape from poverty for good.

It is difficult, however, to monitor self-employment effort. In wage jobs, the employer monitors effort (Dennis, 1998). With job training or post-secondary education, the educator monitors effort. But self-employment has no natural monitor. Pleas to raise or to waive means tests to get rid of their side effects on self-employment will not be heard unless alternatives can be found to serve the original purposes of the means tests. Class attendance or loan repayment might be good proxies for self-employment effort, but some poor entrepreneurs do not want or need training or debt. Microenterprise programs may want to develop direct monitoring techniques such as having business counselors visit clients once a week at their place of work.

(i) *Wage jobs and education*

Microenterprise programs should search for ways beyond self-employment to connect people to the workforce. Even if access to microenterprise assistance doubles the number of poor people who start small firms, more than 99% of the poor will not be affected (Schreiner, 1999a). The one matters, but not more than the 99.

A good microenterprise program will often discourage self-employment in favor of more education or job training. Self-employment may help a few extraordinary poor people—those with high human capital and/or entrepreneurial spirits—to leave poverty, but most of the poor will reach the middle class through education and wage jobs. Programs with the best interests of the poor in mind seek first to help them get more education and skills, then to search for a wage job, and only last to attempt self-employment (Balkin, 1989).

(j) *Banks and financial exclusion*

Some banks fulfill some of their obligations to address financial exclusion through grants to microenterprise programs who then make loans to microentrepreneurs. Policy should insist that banks make the loans themselves. If banks could not farm-out microenterprise loans, then they would put more pressure on

themselves to develop products attractive to many poor people that yet are profitable or at least minimize cost. The hope is that banks might learn to serve this niche for their own self-interested reasons. As it is, banks do not learn whether their perceptions of losses in this niche are true or whether innovation could produce profits.

The dilemma is that the not-for-profits that run microenterprise programs want grants from banks to bolster their budgets. More-

over, they do not trust banks to do a good job in this niche. As for banks, many are content with business-as-usual; a foray into microenterprise would only increase workloads and decrease profits. Regulators could correct this awkward incentive structure if they refused to consider grants to not-for-profits as a fulfillment of obligations to combat financial exclusion if the not-for-profit uses the grant to do lending, a main business activity of banks.

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