

MICROENTERPRISE DEVELOPMENT IN THE UNITED STATES: AN OVERVIEW

In a world dominated by “micro” everything from waves to chips, microbusiness and microbanking are now very much a part of the community economic development landscape. Microentrepreneurs who own microenterprises take microloans from microfinance institutions or other agencies operating microenterprise programs for the self-employed. What does it all mean? What are microenterprises? How should they be supported? What do they contribute to community economic development and poverty alleviation?

THE DEFINITIONS

A microenterprise is a sole proprietorship, partnership or family business that has fewer than five employees. It is small enough to benefit from loans of under \$25,000 and generally too small to access commercial banking services. Microenterprises are a subset of small businesses (which can have up to 500 employees and still be considered “small”). But in the majority of microenterprises, the owner is the sole operator and worker, leading many to refer to this phenomena as self-employment. Although these two terms are often used interchangeably, *self-employment* refers to the status of the business owner while microenterprise refers to a very small business.

There are an estimated two million *microentrepreneurs* in the United States today. They offer services ranging from catering to tax returns, operate day care programs, produce specialty foods, design clothing and make all kinds of unique products. But, one might wonder, why would anyone be motivated to take on the risks of starting a business in a highly competitive economy, especially when wage-paying jobs are so plentiful? A huge variation in life circumstances, including job loss, divorce, birth and death, explain the many different answers to this question:

- ◆ Self-employment is one way to earn extra income to supplement the low wages typical in the current job market.

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- ◆ Women choose self-employment for the flexibility they need to balance home and work responsibilities.
- ◆ Immigrants and refugees often lack the certifications, licenses or language skills required to find professional jobs for which they may be qualified. Starting a business is preferable to minimum wage labor.
- ◆ For many low-income people self-employment offers the chance to use talents, realize suppressed dreams and find fulfillment that is rarely possible with their options for low-wage labor.

Box 1:
The Draw of Self-employment

When, in 1997, Levi Strauss and Company offered \$6,000 “re-employment bonuses” to 6,400 laid off sewing machine operators, 75 percent of them started their own microbusinesses.

To support this employment option for the economically disadvantaged, a host of new programs have emerged since 1985 that together constitute the field of *microenterprise development*. In the year 2000, there are an estimated 700 microenterprise development programs across the United States, up from approximately 100 a decade earlier. The *1999 Directory of U.S. Microenterprise Programs* lists 342 programs in 46 states, which together served 55,756 clients and loaned almost \$33 million in 1997. Programs tend to be small; half of them serve fewer than 100 clients per year.

Although linked by their support for microenterprises, these programs embrace different missions which translate into diverse program methods and design. Some emphasize **increasing family income** through business creation; their focus on poverty alleviation and economic self-sufficiency leads to helping unemployed workers, welfare recipients and very low-income people start their own businesses. Others give priority to businesses that show potential for growth, thus **generating jobs and contributing to a community’s economic development**. These programs tend to work with microentrepreneurs who have been in business for at least one or two years (Source: Else, 2000). In addition, programs may target specific segments of the population defined by income, ethnicity, gender or geographic location. Although a range of strategies and services are required to respond to these diverse client groups, the following set of core program elements, combined in many different ways, have emerged during the past decade of practice:

Outreach services recruit and orient existing or potential microentrepreneurs, enabling them to decide for themselves whether or not to join a program.

Training and technical assistance help microentrepreneurs develop the skills they need to plan, market and manage their own business. Curriculum spans a range from economic literacy to foster control of personal finances via budgeting skills and knowledge of basic financial instruments to writing a business plan. Building self-confidence and teaching appropriate, business behavior are often included in the curriculum.

Capital in the form of individual or “peer” group loans from in-house loan funds or from collaborating banks provides disadvantaged entrepreneurs with financing for their businesses in affordable amounts and terms. Loans range from \$500 to \$25,000.

Ongoing assistance is often available to program clients after they have completed the core training or taken a loan. This “after-care” helps fledgling microentrepreneurs successfully negotiate the many challenges they face in marketing, quality control, legal issues and business expansion.

In addition to these common core elements, practitioners are testing new services that are critical to microentrepreneurs. Facilitating **asset development**, including savings, and **access to markets** are increasingly recognized as priority program components, and in some cases, are ushering in new roles for programs that become actors in the production and marketing chain.

Who benefits from these services? The *1999 Directory of U.S. Microenterprise Programs* counts 281 direct service agencies that have worked with a cumulative total of almost 238,000 people. A longitudinal study tracking a sample of 405 of these clients indicates that a majority are female, minority and relatively well educated (see Box 2). Most are also sole proprietorships operating in retail trade or services. Fifty-seven percent of these businesses are less than four years old; 47 percent have gross monthly sales of under \$1000. While not the most disadvantaged, participants in microenterprise programs include a significant percentage of low-income clients, welfare recipients and the working poor. All suffer a “poverty of access” to credit and business services.

**Box 2:
Microenterprise Program
Client Profile**

Ethnicity:	
African-American	42%
Hispanic	18%
Asian	2%
Gender:	
Women	78%
Education:	
High School Grads	83%
Post H.S.	58%
4-Yr. College	19%
Graduate Degree	8%

Source: SELP Longitudinal Survey of Microentrepreneurs. Major Findings Change Over Time (April 1998)

THE EVOLUTION OF MICROENTERPRISE DEVELOPMENT IN THE UNITED STATES

Microenterprise development programs in the United States emerged as the logical extension of existing efforts to foster community economic development and alleviate poverty. Yet, confronting a financial sector largely uninterested in serving the poor, a few human service and economic development organizations piloted microenterprise programs modeled after innovative and successful experiences with informal sector entrepreneurs in developing countries (e.g. the famous Grameen Bank in Bangladesh) and unemployed workers in Europe. They included:

Women’s economic development organizations grappling with the feminization of poverty in the 1980s, realized that financial independence was essential to ending women’s dependence on welfare. When initial investments in job training did not yield significant results, organizations such

as the Women's Economic Development Corporation in St. Paul, Minnesota looked for ways to help women create their own jobs.

Anti-poverty agencies — both community action agencies (CAAs) and community development corporations (CDCs) — with roots in the 1960s war on poverty — saw microenterprise development as a new strategy they could use to promote economic self-sufficiency. CAAs such as the Central Vermont Community Action Council added microenterprise development to its range of social services. CDCs, revitalizing poor urban neighborhoods through housing, strip malls and small business development, piloted microenterprise programs as another tool to generate employment.

The U.S. Department of Labor and a nonprofit policy center, the Corporation for Enterprise Development, together with practitioners launched pilot projects in the late 1980s to test self-employment as a job strategy for those receiving unemployment benefits and as a self-sufficiency option for welfare recipients.

Replicators of group lending models originally piloted in Latin America and Asia include the Good Faith Fund in Arkansas, Working Capital based in Boston and ACCION International (with six offices in the United States).

Demonstrating the promise of a new strategy, these pioneers inspired dramatic growth in the field through the 1990s, attracting rural policy centers, refugee resettlement agencies, community colleges, credit unions, employment, housing and social service programs to the field.

Initially, microenterprise programs focused on credit. In developing countries, thousands of poor microentrepreneurs were taking, and repaying, small, short-term loans under an innovative system called peer or solidarity group lending. This method, now well known, has many variations, but the basic idea is that a group of borrowers come together to co-guarantee the small loans made to each member, thus replacing collateral with peer pressure. In addition to taking responsibility for many of the loan processing functions, the borrower group is a nexus for support, networking and training for its members. For those in the community economic development movement in the United States who were somewhat suspicious of individual entrepreneurship, peer lending offered a way to deliver financial resources directly to disadvantaged individuals in consonance with an agenda of empowerment.

However, the initial focus on providing credit to poor microentrepreneurs changed relatively quickly. Many programs have abandoned peer lending for more traditional individual loans. But more significant is the fact that microentrepreneurs are not seeking loans in large numbers. Of the 55,756 clients served by the practitioner programs listed in the *1999 Directory of U.S. Microenterprise Programs*, only 6,000 (11 percent) are borrowers.

As practitioners recognized the diverse challenges their clients faced in starting and operating a busi-

ness, they shifted attention to training and technical assistance. Offered by over 90 percent of all microenterprise programs, these skill building activities are the most important components of the field in the United States today. Training for business development focuses on business skills and often culminates in individual business plans. Training for low-income and welfare clients takes a longer step-by-step approach in recognition of lower educational levels and entrepreneurial exposure, and often includes a focus on building confidence and personal skills. Technical assistance ranges from setting up incubators for new businesses to helping with product design and marketing.

While the shift from credit-led to training-led programs was perhaps the first important development in the evolution of the field in the United States, other milestones mark its progress:

- ◆ On the funding front, several legislative victories have either created new federal funding programs or made microenterprise activities eligible for existing ones (see Box 3). The most recent legislation, passed in 1999, is the Program for Investment in Microentrepreneurs (PRIME) Act which

Box 3: Who Funds Microenterprise Development?¹
 Financial support for microenterprise is a complex mix of dollars from federal, state and local government programs, plus private funding from foundations, corporations and churches. The chart below summarizes the major funding sources.

FOUNDATIONS	Total \$	Period	Yearly Avg.
Ford	\$28.9 million	1983-1999	\$1.7 million
Charles Stewart Mott	\$12.1 million	1983-1999	\$807,600
FEDERAL GOVERNMENT	Total \$	Period	Yearly Avg.
U.S. Dept. of Health & Human Services:			
Job Opportunities for Low Income Individuals	\$23.8 million	1990-1998	\$4.0 million
Demonstration Partnership Program	\$3.3 million	1987-1992	\$812,500
Office of Refugee Resettlement	\$5.9 million	1991-1996	\$1.2 million
Small Business Administration	\$209.2 million	1992-1999	\$26.1 million
U.S. Treasury: CDFI	\$25.8 million	1996-1999	\$6.5 million
U.S. Department of Labor	\$5.2 million	1994, 1997	\$2.6 million
U.S. Housing & Urban Development	\$20.1 million	1996-1998	\$8.1 million
U.S. Department of Agriculture	\$15.8 million	1997-1999	\$5.3 million
TOTAL FUNDING	\$350.1 million		\$57.1 million

Source: John Else, 1999, Overview of the Microenterprise Development Field in the United States.

provides much needed funds for delivering training and technical assistance to low-income entrepreneurs.²

◆ Microenterprise programs now face new opportunities and challenges created by federal welfare reform that replaced AFDC with new Temporary Assistance for Needy Families (TANF). On the one hand, asset and income limits for eligible participants, significant barriers to self-employment, have been reduced in most states. On the other hand, the legislation's strong emphasis on placing welfare recipients in wage jobs as quickly as possible serves as a disincentive to the intensive business and personal effectiveness training that this population needs to become successful microentrepreneurs. Efforts to overcome these challenges are spawning new adaptations to microenterprise products and services for welfare clients.

**Box 4:
Demand for Loans**

The weak demand for loans can be explained by:

1. aversion to risk among those in precarious financial situations;
2. lack of equity to cushion the entrepreneur when the business does not generate enough revenue to cover loan payments;
3. access to other, less complicated sources of credit such as credit cards.

◆ Microenterprise development's investment orientation to poverty alleviation has led to a broader vision of asset building and a new model for economic emancipation of the poor. Practitioners' efforts to improve the incomes of the poor have led them to understand the vital importance of also building their assets (e.g. personal savings and business equity) for longer term security, risk management and quality of life. Though not the exclusive domain of microenterprise development, Individual Development Accounts (IDAs), restricted savings accounts for low-income people modeled on Individual Retirement Accounts, are a new product emblematic of this evolution. This approach clearly ushers in new challenges encompassing institutional capacity to facilitate asset building and advocacy for policy or tax code changes that help the poor to save.

TRACK RECORD

Does microenterprise development make any difference? How stable and profitable can these microenterprises really be? These are inevitable questions for the microenterprise field as it faces skepticism rooted in the risks associated with small business, questionable effectiveness of such tiny amounts of capital, and stereotypes about the skills, determination and ingenuity of low-income people. Answers are complicated by the multiple goals of most microenterprise programs that require measuring not only economic, but personal and social outcomes as well. Defining and measuring these outcomes is further complicated by the fact that many microentrepreneurs move between their business and a wage job in a myriad of ways.

The Aspen Institute and its Self-Employment Learning Project (SELP) carried out a longitudinal study of seven microenterprise programs from 1991-1997 which tracked a sample of 405 clients over five years and included case studies of each agency. Many of the results of this study are confirmed by less compre-

hensive evaluations and include:

- ◆ Increases in income, assets and net worth were more significant for the low-income cohort (n=133) of the sample than for the nonpoor. The average household income for the poor increased by \$10,507 over five years compared to a \$6,000 decrease for the nonpoor. Business assets increased by an average of \$18,706 among the poor and \$13,120 for the nonpoor.
- ◆ By the end of the study, 53 percent had moved out of poverty.
- ◆ Over time microbusinesses show high survival rates—57 percent at the end of the five-year survey period (which compares favorably to the SBA’s estimated small business survival rate of 40 percent after four years).
- ◆ Reliance on public assistance declined both in dollars and in numbers of respondents receiving public assistance. The percentage of respondents receiving means-tested benefits dropped from 24 percent to 17 percent over the five-year study period.
- ◆ A large number of microentrepreneurs patch together earnings from more than one source to make ends meet; 50 percent have two or more sources of income including part-time wage income and public assistance.

Box 5:
Explaining a Patchwork
Quilt Approach to
Economic Survival

- 1. Workers use self-employment to supplement their low wages.**
- 2. Microentrepreneurs often keep their wage or salaried jobs to get health insurance, pension and other benefits.**

Despite these documented positive outcomes, the small income gains of microenterprises raise persistent questions about their actual potential as a path to economic self-sufficiency. In its poverty cohort, the SELP study found an average increase in household income of \$8,484, approximately one-third of which is attributed to the microenterprise. However, small gains can be very significant to the poor, especially given the prevalence of patching together several sources of income.

COSTS

High diversity of program size, location, target group and services makes costs difficult to determine and compare. SELP’s cost measures, based on 1994 data from seven programs, indicated that cost per client, cost per assisted business, cost per loan and cost per job all compared favorably to those of other employment and training, job creation and business assistance strategies. Nevertheless, the small size of most microenterprise programs translates into high costs. Training and technical assistance costs, ranging from \$630-\$12,000 per client, are rising as programs emphasize and expand these services. The

median cost per loan (including the costs of training and technical assistance) is \$7,300. Increasing volume is a key to bringing down these costs, a challenge in a field that is fragmented among small providers who are not yet close to reaching potential economies of scale as defined by the estimated number of self-employed microentrepreneurs.

FUTURE CHALLENGES

The practice of microenterprise development in the United States has made substantial progress in serving “hard-to-reach” groups such as women of color, welfare recipients, refugees and home-bound workers, and in demonstrating that they can, in fact, be bankable entrepreneurs. The challenge going forward is to translate this success into a widely available, mainstream employment option. Getting to scale is critical for increasing efficiency, decreasing costs and establishing legitimacy. While there are no easy answers for how to achieve this goal, exciting ideas are shaping the future agenda of the field. They include trying to integrate microenterprise into mainstream employment and training systems; better market research and more aggressive marketing; new product development (e.g. new credit, equity and savings products that respond to client needs); and improving the quality of training and technical assistance to help microentrepreneurs achieve more robust business outcomes.

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ENDNOTES

1. For further information about federal funding sources, see the Fifth Fact Sheet in this series entitled “Sources of Public Funding,” or visit the AEO website (www.microenterpriseworks.org), section II.
2. Although PRIME was passed in 1999, no funds were appropriated. AEO, the MAP Consortium and others are actively lobbying for an annual appropriation of funds to implement PRIME.

FOR FURTHER INFORMATION

The Association for Enterprise Opportunity (AEO) is the national professional association of organizations committed to microenterprise development. It holds an annual forum for members, serves as a nexus of communication about the field and advocates at the federal level on behalf of its members. Its Web site contains additional information about microenterprise and links to many other resource organizations.