

□ THE ROLE OF MICROENTERPRISE ASSISTANCE IN U.S. DEVELOPMENT POLICY

By Emmy Simmons, Assistant Administrator, Bureau of Economic Growth, Agriculture and Trade, U.S. Agency for International Development

The U.S. government believes that a key component of its poverty reduction strategy lies in support for very small businesses called microenterprises, says Emmy Simmons, assistant administrator at the U.S. Agency for International Development (USAID). This support, she says, is now expanding to address some of the world's most difficult development challenges – rebuilding economies ravaged by civil wars and communities hurt by HIV/AIDS.

Simmons outlines key USAID strategies in support of microenterprise and how these efforts reduce poverty not only for the local entrepreneur but also for the local community. “As the predominant source of income and employment for hundreds of millions of people worldwide, the microenterprise sector’s influence on individuals, households, and national economies is clear and profound,” she says.

In many countries, microenterprises — small, informally organized commercial operations owned and operated mostly by the poor — constitute the majority of businesses. They account for a substantial share of total employment and gross domestic product (GDP), and they contribute significantly to the alleviation of poverty. They are often the chief economic defense of the most vulnerable households in high-risk environments, such as civil conflict, or during natural disasters. As the predominant source of income and employment for hundreds of millions of people worldwide, the microenterprise sector’s influence on individuals, households, and national economies is clear and profound.

For the past three decades, support for microenterprise development has been an important feature of U.S. foreign assistance. The United States Agency for International Development (USAID), the U.S. government’s lead agency for bilateral foreign assistance and humanitarian assistance, defines “microenterprise” as a firm of 10 or fewer employees, including unpaid family

workers, that is owned and operated by someone who is poor. USAID promotes microenterprise development by:

- Providing financial and technical assistance to institutions and networks that extend credit and financial and sustainable business-development services to poor households.
- Promoting policy reforms that enable the smallest businesses to compete against larger firms and achieve their income and job-creation potential.
- Supporting experimentation and research to identify and promote best practices.

The Microenterprise for Self-Reliance and International Anti-Corruption Act of 2000 established microenterprise development as an integral part of U.S. foreign assistance. The law authorized grants by USAID to support poor microentrepreneurs, further specifying that half of all funds benefit the very poor, usually living on less than one U.S. dollar a day. USAID works with more than 700 U.S., local, and international organizations to implement this initiative. The great majority are private-sector providers of financial and business services to the vibrant microenterprise sector.

As the leading bilateral donor for microenterprise development, USAID over the past two decades has created a remarkably effective approach to reducing poverty in a sustainable manner. Its partnerships with U.S. private voluntary organizations (PVOs) and microenterprise practitioners have shown that microenterprise assistance can help alleviate poverty and be commercially viable.

As a result of U.S. government support, more than two million poor people throughout the developing world have access to credit from a wide range of financial institutions. Loan recipients use the money to increase their incomes, build assets, and improve their lives. They

also prove their creditworthiness by achieving repayment rates that typically exceed 95 percent. More than three million poor people are depositing their savings in lending institutions, allowing them to better plan for their families' futures and cope with crises. Almost 670,000 clients benefit from USAID-supported business development services, which help them reach new markets, improve their skills and productivity, and raise their incomes.

WHY ARE MICROENTERPRISES IMPORTANT?

In many countries, especially those in Africa and Asia, the microenterprise sector constitutes the majority of the working population. A few statistics illustrate the key role that micro and small firms play in generating overall employment:

- Firms of five or fewer employees account for half of the non-farm workforce in Latin America and two-thirds of the non-farm workforce in Africa.
- Informal sector firms generate three out of every four new, non-farm jobs in Thailand and half of all new jobs in Indonesia.
- In Indonesia, firms with five or fewer employees account for almost half of total manufacturing employment while small firms account for an additional 18 percent.
- In Thailand, micro and small enterprises comprise more than 97 percent of all firms in the manufacturing and trade/service sectors. Micro firms generate 71 percent of total employment in the trade/service sector.

Many USAID-assisted microenterprise development programs have broad impacts on poverty as income from the enterprise increases and stabilizes household income. But the benefits are not just enterprise-related. Families often gain access to a range of financial services — for instance, specially tailored loans for school fees, medical emergencies, wedding and funeral expenses, insurance products, and remittance services that enable them to receive funds sent from abroad faster and at lower cost. Access to financial services is critical in helping poor households build up assets, cope with shocks, and seize new economic opportunities.

A 2002 study by CGAP (the Consultative Group to Assist the Poor, a 29-donor consultative group for

microfinance) cited examples of diverse benefits in a range of countries. In El Salvador, for instance, the weekly income of Foundation for International Community Assistance (FINCA)¹ clients increased on average by 145 percent. In India, half of SHARE² clients graduated from poverty. The CGAP study revealed equally impressive gains in education, health, and nutrition. In Vietnam, clients of a Save the Children partner organization, reduced food deficits from three months to one. In Bangladesh, nearly all girls in Grameen Bank-client households received schooling, compared to 60 percent of girls in non-client households.

Statistics at the national-economy level are also compelling:

- Firms of five or fewer employees generate a substantial share of GDP in many countries.
- No fewer than 90 percent of workers in India owe their livelihoods to informal sector employment.³ These workers contribute 60 percent of net domestic product and 70 percent of domestic income. More than half of the economically active population in the Philippines is employed in micro and small businesses.⁴
- Mexico looks to microenterprises for 32 percent of its gross domestic product and 64 percent of its total employment.⁵
- Approximately 49 percent of GDP in Peru and 70 percent in Nigeria and Egypt come from the micro-dominated informal economy.⁶
- In Ukraine, 2.6 million businesses — 87 percent of all businesses in that country — are self-employed individuals who produce, distribute, and/or sell goods in the local marketplace.

Microenterprises may also be integral to the success of key economic sectors. In South Africa, for example, the construction sector generates a third of GDP and includes 90,000 firms, of which 87,000 are micro- and small-scale. Outsourcing by large construction firms to specialized, small subcontractors is a very common feature of the industry. In Bangladesh, more than 90 percent of the firms engaged in the \$350 million shrimp export business are microbusinesses. In Honduras, microfirms account for 30,000 of 40,000 horticultural firms that emerged in the wake of Hurricane Mitch. They

partner with larger firms to compete in export markets and improve quality control and processing.

THREE AREAS OF USAID MICROENTERPRISE SUPPORT

USAID's microenterprise program focuses on three areas of strategic support: policy/enabling environment, business services, and microfinance.

A supportive policy environment, including a favorable business and investment climate, is critical to successful, sustainable microenterprise development. USAID supports reform of laws, regulations, and policies to facilitate the creation and operation of microenterprises and to expand access to financial and other services by the underserved poor. This can include helping countries streamline their business registration process; building the capacity of microentrepreneurs to work through independent business associations to advocate for policy reforms; and promoting anti-corruption efforts and tax reform.

A variety of organizations offer business development services (BDS) to help microenterprises increase revenues, build capacity, initiate new economic activities, or increase their leverage in the marketplace. Such services include marketing assistance, product development, business training, advisory or information services, productivity-enhancing technologies, and linkages to financial services.

USAID does not support direct subsidization of business services for microentrepreneurs. Instead, it supports the development of markets by helping BDS providers extend services that boost microenterprise income and competitiveness. Service providers often need help to tailor their services to poorer clients. Access to appropriate financial and business services enables microenterprises to seize new economic opportunities and increases the potential impact of sustained reductions in poverty levels.

Linking small producers to larger firms and lucrative markets is often the key to success. For instance, in Bangladesh the USAID-supported JOBS⁷ program supports firms producing hand-made sandals for export to Paris. With project assistance, the larger exporters organized groups of smaller producers to supply this market, providing them with inputs, designs, and quality control in addition to export services. The business services facilitated by JOBS helped flexible, labor-

intensive micro-firms enter emerging niche markets for which larger firms are not well suited.

In Haiti, 37 coffee-grower associations representing 25,000 small growers were assisted in development of a common logo for the "Haitien Bleu" premium coffee brand. Backed by consistent quality standards and a targeted market, Haitien Bleu has provided the micro producers returns significantly higher than they previously were receiving for coffee harvests without quality controls and premium designations.

Microfinance involves the provision of diverse financial services to families and firms excluded from the formal financial market. When this field was in its infancy, microfinance meant small loans for microentrepreneurs to use in starting or expanding their businesses. The predominant methodology was the group loan, based on the Grameen Bank model developed in Bangladesh, which required individual entrepreneurs to receive loans in groups, attend weekly meetings, and take responsibility for repayment by all group members.

Over the years, microfinance has grown to include a variety of lending methodologies. It now encompasses a wide range of financial services. Loans can be offered on a group or individual basis, with amounts and repayment terms increasingly flexible and tailored to client needs. Other microfinance services include savings deposit services, insurance, and transfer/remittance services. The list continues to grow as microfinance institutions develop new products in response to client demand.

Roughly two-thirds of USAID microenterprise funds support development of credit and financial services targeted to poor entrepreneurs and their households. These services typically include credit for working capital and investment, savings, insurance, and payments services of various types. USAID support led to the development of a number of successful microfinance methodologies over the past two decades, adapted to a wide variety of settings and client groups. Loan repayment rates typically exceed 97 percent.

USAID's support for microfinance focuses on two equally important objectives. The first of these is the development and expansion of strong microfinance institutions (MFIs) — those with effective governance structures and credible business plans to cover all operating expenses, including the cost of capital, through operating income within a reasonable timeframe. The

second objective is the promotion of products and services with the potential to reach poor and very poor entrepreneurs, especially underserved populations such as rural residents, women, and those in conflict or crisis situations.

The majority of USAID funds support very poor entrepreneurs — those considered to be well below the poverty line in their countries.⁸ Program features for these clients may include group guarantees as a substitute for traditional loan collateral and very small loan sizes with frequent loan repayments. By grouping clients, MFIs can achieve economies of scale and recoup their costs despite the very small revenue generated by each transaction. An important innovation permits clients to make frequent, very small savings deposits, reflecting the actual availability of cash in the household.

NEW DIRECTIONS FOR MICROENTERPRISE DEVELOPMENT

In recent years, USAID field-based microenterprise programs have moved toward integrating microenterprise development activities into broader programs that address problems faced by microentrepreneurs and their households, such as civil conflict and HIV/AIDS. For example, Constanta, a Georgian microfinance institution, was created in 1998 after the civil war, with assistance from Save the Children. It designed its products and outreach strategy to ensure service to women who were internally displaced persons (IDPs), typically supporting families on their own. Constanta now has more than 15,000 active clients and has served well over 20,000 very disadvantaged microentrepreneurs. It has received grants from USAID and other donors totaling just over \$4 million for its loan capital and operations. A recent impact assessment of 828 clients documented that 72 percent of clients had been able to improve their families' nutritional status, 28 percent had improved children's schooling, and 22 percent had created new jobs through microenterprise. Of the 74 percent of respondents that reported income increases, 92 percent attributed the increase to credit access that enabled them to tap new economic opportunities. Results such as these suggest that microfinance can be a powerful tool for poverty alleviation in even the toughest economic and political environments. Support for microfinance is one of the strategies the United States will use to accelerate reconstruction in places as diverse as Afghanistan and Sudan.

In areas devastated by HIV/AIDS, such as in Zimbabwe, USAID missions are using microfinance to mitigate the economic impact on orphans and others affected by the disease. Currently, one in four people between the ages of 15 and 45 in Zimbabwe has HIV, and some 624,000 children under the age of 15 have lost one or both parents to the disease. USAID funds programs to provide training, business skills, and financial services to affected communities. It also assists the national microfinance network, Zimbabwe Association of Micro Finance Institutes (ZAMFI), as well as local affiliates of international networks. This support to national and multi-country networks has been a key component of the USAID mission's strategy for addressing the multiple needs of Zimbabwe's economically active poor in an integrated fashion.

Strategies for making microenterprise work are expanding. U.S. commitment for making microenterprise work is expanding. More than ever the delivery of well-tailored financial and business services to this important sector of the economy is showing its ability to pull huge numbers of people out of poverty. □

1 The Foundation for International Community Assistance.

2 Society for Helping Awakening Rural Poor through Education, an associate of Women's World Banking.

3 (ILO), "Women and men in the informal economy: A statistical picture," p. 7 (no date) The International Labour Office defines informal sector employment to include both self-employment in informal enterprises (i.e., small and/or unregistered) and wage employment in informal jobs (i.e., lacking contract, benefits or social protection).

4 ILO, pp. 34, 36.

5 ILO p. 37.

6 "The Informal Sector: Refugees from Under-Performing Legal and Institutional Systems," presentation by Kate McKee, Washington, DC, 2002.

7 Job Opportunities and Business Support.

8 USAID Microenterprise Results Reporting, 2000, p. 26 (chart). Section 105 of P.L. 106-309 added a new Sec. 131 to the Foreign Assistance Act, which requires that 50 percent of all microenterprise resources be targeted to very poor entrepreneurs, defined in the law as those living in the bottom 50 percent below the poverty line as established by the national government of the country. The section also sets out loan sizes in different regions to serve as a standard for measuring the poverty level of clients, with loans in 1995 United States dollars of \$1,000 or less in the Europe and Eurasia region; \$400 or less in the Latin America region; and \$300 or less in the rest of the world.