

BEST PRACTICES IN MICROENTERPRISE DEVELOPMENT: A USAID PERSPECTIVE

Microenterprise development activities should respond to demand

The design and delivery of credit, savings, and other financial products and services should respond to the diverse financial needs of individuals and entrepreneurs. Ideally, careful market research should precede product development.

- The terms of microloans, for example, need to reflect the realities of the client's business opportunities, cash flow, and collateral. Whether a program offers individual or group loans, amounts are likely to be relatively small and repayment schedules short-term, collateral requirements flexible, and transaction costs low. Tailoring products to the very poor and rural households is particularly important in order to maximize microfinance's potential to reduce poverty. Market research often reveals that clients demand products beyond credit such as flexible savings or remittance services.
- Donor support for business services should facilitate linkages between private-sector providers of a wide variety of services — from accounting and information services to veterinary services and product design services — and the entrepreneurs who need them to maintain their competitiveness. For example, market access services should address microenterprises' needs to link both to suppliers of inputs for their goods and to buyers of their finished products.
- Payment mechanisms should take into account the levels and timing of clients' cash flows. For example, poorer clients may not be able to pay large, up-front fees for business services. This issue can be addressed by grouping clients for service delivery and payment, building fees into the margins of the products they sell to their buyers (who provide them services beyond marketing), or breaking up services such as training so that fees can be lower.

Service providers must cover their costs and achieve commercial sustainability

Few developing and transition countries can afford to subsidize business and financial services for their citizens on any substantial scale. Thus, if microenterprises are to have access to the services they need to succeed in business, those services must be offered on a sustainable

basis. Fortunately, sustainability has proven achievable in a wide variety of circumstances.

- Microfinance institutions (MFIs) must charge interest rates high enough to enable them to cover all their costs, including loan losses and the cost of raising new capital to expand. MFIs should achieve sustainability within five to seven years by charging adequate interest rates, controlling operating costs, and maximizing their efficiency. Business service providers must offer their services on a commercial/fee-for-service basis or cover their costs by embedding them in other transactions. Offering these services on a non-commercial basis distorts the business services market and threatens its long-term sustainability.
- Efforts to promote specific business services should be consistent with the larger objective of developing broad, sustainable business services markets that strengthen linkages within and between commercial sub-sectors.

A businesslike approach is key

- Delinquency management is critical to the development of sustainable microfinance institutions and a healthy financial sector in which poor people can rely on consistent access to financial services.
- To ensure that microenterprises have access to the business services they need in order to be competitive, donors should promote a strong business services sector by facilitating linkages between microenterprises and private-sector service providers — not by subsidizing the services themselves.

Services alone may not be enough. Achieving maximum impact of investments in microenterprise development may require addressing policies that constrain small businesses and compromise individuals' access to financial services.

- Limits on the assets poor people can use as collateral against credit can block their efforts to improve their lives.
- Onerous business registration requirements and regressive tax policies are just two examples of the kinds of policy barriers that disfavor microenterprises and can inhibit economic growth on a national scale, particularly in those countries in which microenterprises contribute substantially to the national economy. □