

Executive Summary

In FY 1997, the Economic Development Administration (EDA) solicited a proposal for a study that would: 1) ascertain whether EDA should encourage microenterprise programs to help alleviate structural economic problems; 2) examine the range of microenterprise programs and the distressed areas in which these programs work; and 3) determine in what ways the microenterprise strategy can complement existing EDA programs. Between September 1997 and September 1998, Rutgers University conducted the study. This report presents the project's findings.

PURPOSE OF THE STUDY

Economic distress occurs for a variety of reasons and manifests itself differently in different places. Regions that relied on defense-related industries have had to arrive at conversion strategies—often with EDA's help—in the wake of base closings. Resource-dependent regions, such as the Iron Range in northeastern Minnesota and the timber and fishing regions of the Pacific Northwest, cope with resource depletion, international competition, and/or a shift to substitute products. Older industrial regions, particularly the Northeast and Midwest, suffer from the movement of industry to the South and West. Strategies supported by EDA include local economic development planning, infrastructure investments, business incubation, tourism development, and revolving loan funds. This study examines how, specifically, the microenterprise strategy can complement EDA's existing tool kit of policies and programs that help these regions adjust to changes in their economies.

Microenterprise development has been touted by policymakers and the media as a way to alleviate poverty and create jobs both in the United States and in developing countries. Unlike most strategies designed to help people become economically self-sufficient, microenterprise programs help many people do a better job of something they are already doing to survive—starting small businesses. Instead of trying to channel people into the mainstream economy, these programs teach those with an interest in and inclination for self-employment how to strengthen their entrepreneurial skills, and start and stabilize their businesses. These programs motivate people who are interested in taking responsibility for their own lives and futures and provide them with the tools they need to make that happen. The relational skills that these programs

produce, particularly during the borrowing process, enable participants to take advantage of other programs and to create critical support networks.

We know little, however, about the effectiveness of microenterprise development in combating economic distress. EDA is the primary U.S. government agency focusing on helping

distressed economies achieve stability and growth. *Should EDA encourage microenterprise programs as a way to help alleviate structural economic problems?*

Access to credit and training—key ingredients for the creation, stabilization, and expansion of small businesses—is lacking in economically distressed areas of the United States. Microenterprise programs, which provide these two ingredients, have quickly multiplied in response to this need. This study illustrates the ways in which programs tailor themselves to the people and places they serve.

Thus far, little work has been done in studying the outputs, outcomes, and impacts that microenterprise programs produce in economic development terms. Existing research on microenterprise programs tends to focus on their effectiveness as social welfare programs rather than economic development tools. These studies (Clark and Huston 1993; Raheim and Alter 1995; Spalter-Roth, Soto, and Zandniapour 1994) also tend to evaluate programs at the level of the individual rather than taking the larger view of place-based outcomes. This research helps to fill that gap. We focus on the relationship between the microenterprise strategy and the local economy in order to determine whether and how microenterprise programs can help to alleviate economic distress.

Case studies of the following six microenterprise programs constitute the core of this research:

- The Institute for Social and Economic Development (ISED), Iowa
- The Northeast Entrepreneur Fund (NEF), Minnesota
- Women Entrepreneurs of Baltimore (WEB), Baltimore, Maryland
- West Company, Mendocino County, California
- Women's Economic Self-Sufficiency Team (WESST corp), New Mexico
- Working Capital, Lawrence, Massachusetts

All of the programs chosen for study are located in areas that have been hard hit by economic restructuring and/or are experiencing economic distress for some other reason. One (West) is based entirely in a rural area, two (WEB and Working Capital) operate in urban areas, three (WESST, ISED, and NEF) work in areas that contain both urban and rural areas, and two (ISED and WESST) serve entire states. In addition, we chose programs that have:

- been in existence for at least five years, giving them a long enough track record to be studied;
- had relatively stable leadership, allowing for institutional memory; and
- maintained solid records since they began operations.

All are representative of mature microenterprise programs currently operating in the United States.

FINDINGS FROM CASES

Previous studies of microenterprise development focus on either the programs, the entrepreneurs, or the businesses. Given the orientation of these studies, our findings are grouped in field, program, business, and entrepreneur categories. These findings, listed below, are more completely discussed in Chapter 2.

Field

- The number of programs, as well as activity within individual programs, is in a period of rapid expansion.

Whereas only a handful of programs were in operation ten years ago, current estimates place the number of U.S. microenterprise organizations at close to 400. According to Malcolm Bush of the Woodstock Institute, the “unbelievable” rate of expansion “speaks to the fact that there is a sector of economic problems we are not touching with regular economics.”

- The microenterprise field has begun to mature.

The programs that have existed the longest, including most of those studied for this project, have entered a mature phase. They are stable, have begun to diversify, and can talk much more precisely about what their mission is and how they plan to fulfill it than they could even five years ago. This maturity has also created a group of people who have been working in the field for more than ten years and have begun to conceive of and fill different needs.

Programs

- Microenterprise programs respond to the economic context in which they operate and adjust their mix of training and lending services accordingly.

The more mature and most successful organizations have a greater understanding about the region in which they work. Programs that operate in an area with a low-skilled population are likely to spend more resources on training than programs in which the target population has greater skills. This is particularly true of inner-city programs and those serving clients who have depended on public assistance for a long time. Programs that operate in remote rural areas must focus on the problem of access to markets, whereas this tends not to be an issue in more urban areas. In addition, programs continue to respond to changes in the economic and political landscape. For example, many programs have created innovative responses to welfare reform.

- Microenterprise programs are learning organizations that continually refine their methods.

In its 1993 Update, the Mott Foundation found that 61 percent of the programs surveyed had changed their lending standards since they began (1993, 5). These changes might involve implementing stricter, more “banklike” procedures, adding peer lending, requiring participants to borrow in “steps” from smaller to larger loans, or narrowing or expanding the target market. In some areas, clear trends exist.

- Programs are extremely diverse in terms of size, mission, type of lending, and target population.

Each of our six case study programs focuses on a somewhat different population within its region and offers different mixes of lending and training as a result. This diversity reflects the diversity of goals that programs pursue. Even though the basic goal of providing credit and training to entrepreneurs characterizes all programs, the emphases range from working mostly on self-esteem to poverty alleviation to more traditional economic development goals of job creation and business expansion. All programs have a common mission of helping disadvantaged people explore the potential of self-employment as a way to become self-sufficient.

- Most programs do some form of targeting and/or directed outreach.

Although nearly all microenterprise programs gear their services to low-income entrepreneurs, the vast majority also target or emphasize serving specific populations ranging from women to displaced workers to migrant farm workers. Programs that target do so in recognition of structural problems that make it difficult for certain groups to gain access both to employment in the formal economy and to resources such as credit and training. They also seek to combat regional employment problems. For example, West Company targets unemployed timber and fishery workers and Working Capital targets Latino immigrants.

- The transaction cost of loans made by microenterprise programs is high, although overall cost per client served is low.

We found that the cost of making loans is very high, especially when compared to traditional credit institutions. However, since most microenterprise clients do not receive loans directly from their programs, the cost per client served is relatively low.

- Microenterprise programs have little trouble raising capital for their loan funds, but covering operating costs (which include training) continues to be a struggle.

Almost all of the program directors we interviewed said that lending resources were available. All stressed the need for additional resources for their training and technical assistance programs. This situation has arisen because many funders and policymakers continue to think of microenterprise development as a credit strategy that makes loans to poor people who then pay them back. Although many programs do provide access to credit, they have increasingly emphasized the training component of their programs.

- Virtually all programs provide training as well as lending.

As programs have matured, they have increasingly incorporated training into the range of services offered. Nearly all programs require borrowers to undergo some basic business training in sales, marketing, and finance, and many require would-be entrepreneurs to write a business plan. Jack Litzenberg, a funder with the Charles Stewart Mott Foundation, which has funded microenterprise programs in the U.S. from the beginning, claims that

microenterprise programs “provide an entry point into understanding how the economy works.” Staff at nearly all programs also maintain that starting a business is not the only measure of success. They claim that the process of going through their training programs makes clients more employable, and that clients make better decisions about how to achieve self-sufficiency and whether self-employment is the right choice for them.

- Microenterprise programs often catalyze networks of social service providers and community groups.

Due to the multiplicity of many program clients’ needs, we found that all of our case study programs enjoyed strong relationships with other service providers. More and more, programs are formalizing cooperation by creating partnerships, affiliates, and consortia as a means of reaching scale and reducing direct costs. These relationships differ from place to place.

In terms of lending, the model of the approachable, small-town banker is rapidly disappearing in much of this country, making it even harder for high-risk entrepreneurs to obtain access to business credit. In some ways, microenterprise programs have taken over this kind of character lending, both by making loans directly to entrepreneurs who “do not look good on paper” and by vouching for them with banks that respect and trust the work these programs do.

The community development element of microenterprise program activity—which involves connecting people to each other and to critical organizations, training residents, and helping them to access resources—is often overlooked, perhaps because this aspect is more difficult to see and evaluate.

- Scale and sustainability are two big problems facing microenterprise programs.

Given the small size of loans and high cost of training, it will be difficult—if not impossible—for programs to achieve any kind of self-sufficiency. Programs are reliant upon funding from a mix of sources, both private and public. Clark and Kays (1995) make the case that scale and sustainability are appropriate success paradigms in the less-developed-country context, but that U.S. programs require a different paradigm that may include indicators such as the ability to graduate clients to the formal banking sector, the ability to deliver cost-effective technical assistance and training, and the ability of programs to find cost-effective and client-effective service delivery mechanisms (1995, 3-4).

Businesses

- Most microbusinesses are home-based sole proprietorships operating in the service sector, and most are less than five years old.

Nearly half of the microentrepreneurs we interviewed have businesses in the service sector. Fifty-three percent of the businesses of self-employed former welfare recipients and an even higher percentage of the businesses of self-employed current welfare recipients operate in the service sector. Service businesses require little start-up capital, gain easy entry into the market, and often require little in the way of overhead, equipment, and space. Self-employment is very labor intensive. Twenty-nine percent of the microentrepreneurs

surveyed for the SELP study report working more than 60 hours per week, and the majority of these (58 percent) devote between 76 and 100 percent of their time to their business (Clark and Kays 1995, 20).

- Self-employment by itself does not sustain most of microentrepreneurs' households.

We found in most cases that self-employment is used in conjunction with other income sources—a practice known as income packaging—to meet household expenses. This usually means a spouse with a waged job (that provided some benefits, like health insurance) or additional employment of the microentrepreneur in the waged sector. The fact that wage labor does not adequately provide for many families' needs reflects the growing phenomenon of working poverty. Given that many current jobs offer only temporary or part-time employment, some entrepreneurs may vary the energy they put into their business depending on the other opportunities available to them at a particular time. Conversely, microentrepreneurs may retain formal wage labor in order to ensure adequate income while their business is stabilizing. Although the majority of microentrepreneurs have not become self-sufficient through their businesses, the business income that they contribute in many cases raises the household over the poverty line.

- The majority of these businesses fail to provide any kind of benefits, such as health care and child care.

Of the entrepreneurs interviewed for this project, only three of the 17 with employees said that they provided benefits for those employees. More than 40 percent of all microentrepreneurs interviewed for this project have no health insurance. Of those that do, most obtain it through a spouse's job or public assistance. Just 10 percent of those interviewed reported having health insurance through their business.

- Microenterprises create few jobs.

In our study group, only 29 percent of the entrepreneurs interviewed reported having any employees. Those 17 reported a total of 41 part-time and 28 full-time employees. Low job creation results from a variety of factors. First, most of these businesses are young and still in the process of stabilization. Second, many operate in distressed areas where the potential for growth is not great. And third, many of the entrepreneurs we interviewed are not interested in growing their businesses. They worry about taking on the responsibility of other workers and about the added work of managing a large business.

- Most microentrepreneurs have some business-related debt.

Of all the microentrepreneurs interviewed for this project, 76 percent had some business debt. This ranged from loans from family members for a few hundred dollars to tens of thousands of dollars in home equity and other commercial loans. Loans were used for all purposes, from operating expenses to purchases of specialized equipment to obtaining inventory and supplies. And while some microentrepreneurs obtained financing solely from a microenterprise program, most listed multiple sources of financing, including "traditional" credit sources such as commercial bank loans, credit unions, and vehicle financing agencies. We also found that many microentrepreneurs finance their business with credit cards.

Entrepreneurs

- ❑ Microentrepreneurs need more than just credit.

Most microentrepreneurs cited the training they received as being just as important as—if not more important than—any financing. We found that only 22 percent of the microentrepreneurs we interviewed had any prior business training. Although many had had critical experience in their line of business, they lacked the business training and skills to help them become successful entrepreneurs.

- ❑ Microentrepreneurs exist across a broad socioeconomic spectrum.

Microenterprise development in the United States was originally targeted at the lowest end of the socioeconomic spectrum. Our study and other research find that gaps in access to credit and training exist across the categories of race, class, and gender. The range of household income reported by our case study programs indicates that income level is not the only factor impeding access to credit and training.

- ❑ Most microentrepreneurs have had some college education and some experience in their business.

While many program participants are low-income, nearly all existing data shows that the typical microentrepreneur is a skilled worker who pursues self-employment in order to increase her income or improve her life. In addition, microentrepreneurs are relatively well-educated. Ninety-six percent of the microentrepreneurs interviewed for this research have completed high school or have obtained an equivalency degree. Forty-six percent of the study respondents have had some college or hold a technical degree, and 24 percent of the participants have a college degree. An additional 10 percent have completed some postgraduate work.

- ❑ Most microentrepreneurs are women.

Eighty percent of the microentrepreneurs interviewed for this project are women. While many programs specifically target women, even those that do not find that the majority of their clients are women. Increasingly, women are charged with ensuring the economic and social stability of households, and they often need a wider range of options to help them. Their use of microenterprise programs is evidence of their willingness to experiment with alternative ways of achieving self-sufficiency.

- ❑ Microentrepreneurs can be divided into two types.

The SELP study found that the majority of respondents (53 percent) sought self-employment because they needed more money or because they were unemployed. This group may have viewed self-employment not as a real choice but rather as their only economic option. It is increasingly difficult to find jobs that pay a family wage and provide benefits.

A second group is comprised of those generally possessing a skill or love for a particular activity that could serve as the basis for starting a business. These “true entrepreneurs” would always prefer to work for themselves.

- Most microentrepreneurs have strong support networks and are fiercely determined to succeed.

The entrepreneurs interviewed for this study work well in excess of a standard 40-hour week. And when times get tough, they work harder, either putting more energy into their businesses or picking up extra side work to supplement their income. They also rely heavily on family and friends. Many of the entrepreneurs we interviewed told stories about family members who watch their children or work in their businesses.

- Microentrepreneurs have a strong attachment to place.

Although the economic literature views labor as a mobile input to production, many of the entrepreneurs we interviewed are very attached to the places in which they live, regardless of how poor the economy is. Often they pursue self-employment because they perceive it to be the best available option for making some money while continuing to live where they live. The segment of the population that is attracted to the microenterprise strategy is a segment that does not want to move. The businesses that they create are also unlikely to be footloose. Therefore, although they are small and may take a long time to develop, these businesses should be perceived as resources and nurtured.

MICROENTERPRISE DEVELOPMENT COMPARED TO OTHER ECONOMIC DEVELOPMENT STRATEGIES

Economic development has to do with enhancing the economic health of a region. Economic development programs and policies aim to accomplish this mission by supporting the generation, stabilization, expansion, and attraction of businesses to a particular area. Typical economic development strategies include tax abatements, subsidies, and low-interest loans to businesses. Microenterprise programs work within the economic development sphere because they provide loans and training that result in business creation and expansion.

Microenterprise program staff rarely see their programs strictly as job creation mechanisms. As a result, microenterprise program goals include job creation as only one of the range of outcomes to be produced. Most programs focus on self-sufficiency through self-employment for the particular microentrepreneur but also consider decisions not to pursue self-employment or to obtain a regular job as successes. Despite this, microenterprise programs perform well when compared with other job creation strategies.

The fact that microenterprise development is a relatively small strategy that requires a long time frame in order to show results creates a policy barrier that the microenterprise strategy has been forced to confront. Microenterprise development is not a readily accepted economic development tool because it combines elements of the traditionally separate policy categories of economic development and poverty alleviation. In recent years, both of these fields have begun to shift in ways that have created room for strategies such as microenterprise development to emerge. The shifts in economic development include a movement from business attraction and retention to business generation and an orientation based on investment in a particular area.

This new orientation of economic development, as well as the logic by which the microenterprise strategy has emerged and gained in popularity, seems relatively straightforward. Microenterprise programs focus on business generation rather than business attraction. In addition, programs are usually conceived and operated at the local level by grassroots

organizations. Finally, most microenterprise programs began as private nonprofit organizations, bringing in local, state, and/or federal government partners at a later stage. This structure has enabled both the programs and their public partners to behave in a more entrepreneurial fashion.

The shifts in approaches to poverty alleviation, which are admittedly more theoretical than practical, include universal programs with a targeted component rather than strictly targeted programs and increased use of asset-based strategies (such as the Earned Income Tax Credit) as opposed to income-based strategies (such as Unemployment Insurance). The microenterprise strategy clearly makes sense in light of these changes when considering how best to alleviate poverty. Programs exist in both targeted (WEB, ISED) and universal (Working Capital) forms. In addition, the microenterprise strategy is clearly based on a philosophy of asset building rather than maintenance. The goal of most microenterprise programs is to provide people with access to the resources they need in order to attain economic self-sufficiency.

The target population of most microenterprise programs has no other access to these critical resources. Therefore, these programs function to create a new class of entrepreneurs and a set of businesses that most likely would not exist otherwise. Microenterprise programs also contribute to economic development outcomes indirectly, through the training they provide and economic literacy skills they teach. Many of the program participants who do not go on to start businesses leave programs able to participate in the mainstream economy in ways that they could not prior to their involvement with microenterprise programs. Microenterprise development is a valuable tool in the economic development toolbox and does aid in economic adjustment. This strategy fills a niche that no other strategy or program fills.

In fact, microenterprise development has a cost per job created comparable to more traditional forms of economic development. As illustrated in Table ES.1 and more fully discussed in Chapter 3 of this report, we found microenterprise development to have a cost per job created similar to that of other traditional development strategies.

TABLE ES.1
Cost per Job for Various Economic Development Strategies

<i>Type of Economic Development</i>	<i>Cost per Job</i>
<i>Industrial Recruitment</i>	
Tax cut only (<i>Bartik</i>)	\$1,906 to \$10,800
Automobile Plant Attraction (<i>Milward and Newman</i>)	\$11,000 to \$50,580
<i>Business Incubation</i>	
Business Incubation Works (<i>Molnar et al.</i>)	\$1,500 to \$2,000
<i>EDA-Sponsored Programs</i>	
Public Works Program (<i>Burchell et al.</i>)	\$4,857
<i>Microenterprise Development</i>	
NEF	\$4,900 to \$5,000
ISED	\$4,114
Women Venture	\$6,155

Sources: Bartik (1992); Milward and Newman (1989); Molnar et al. (1997); Burchell et al. (1997b); program data.

More important than the actual cost per job created is the appropriateness of a particular economic development strategy for a region. In rural regions, industrial recruitment strategies are simply not successful; microenterprise development can, on the other hand, serve as a viable long-term strategy for a region. Unlike industrial recruitment—where a plant will open with 1,500 jobs—microenterprise programs take time to start and develop successful businesses. Across our case study programs, we found that a microentrepreneur will work with a program for several months before starting his or her business; it will then take additional time to nurture that business into a successful enterprise. Because even the oldest microenterprise programs have existed for only ten years, we do not know the true potential of this strategy as a regional economic development tool.

POLICY RECOMMENDATIONS

Recommendations at the Federal Level

- ❑ Educate economic development planners and policymakers about the practice of microenterprise in the United States.

Misconceptions about the practice of microenterprise still abound in the economic development community. Most often, the distinction between microlending and microenterprise is misunderstood. By showing the critical value of the training elements of microenterprise, better-informed policy can result.

- ❑ Integrate microenterprise development into local economic development strategies.

Support for microenterprise was strongest in places where it was part of an overall economic development program and where economic development practitioners did not expect these programs to produce results beyond their capacity. In these cases, programs fill a niche that adds value to state or regional economic development planning.

- ❑ Support operating expenses.

Program directors and field experts across the board expressed the need for greater funds for general operating expenses. Sufficient resources are available for programs' lending activity. However, the increased emphasis among programs on training means that they require more in the way of operating support and will be less likely to become self-sufficient through their lending activity. Funders who expected these programs to achieve self-sufficiency must revise their expectations and definitions of program success.

- ❑ Support proven programs and models.

The oldest microenterprise programs are just passing their ten-year mark. Such programs have continually refined and improved their methods for serving target populations. Leaders in the field should be consulted as to what works.

- Coordinate policy across public agencies.

Federal support for small business development currently comes from a number of different organizations. The SBA, the CDFI program of the Treasury Department, and welfare reform programs under HHS all have different objectives and different criteria. Such support should be coordinated at the federal level.

- Support state-level intermediaries.

These organizations provide a crucial link between funders and practitioner organizations. Intermediaries are state-level organizations that raise federal funds to support the microenterprise strategy, use that support to leverage state funds, and channel these resources to local microenterprise programs throughout the state. Intermediaries are new players in the microenterprise field and are as yet unproved, but early lessons from Montana and Nebraska suggest that this type of organization provides several benefits.

- Support the design and use of appropriate evaluation mechanisms.

All programs are not equal and should not be judged by the same standards. In addition, the fact that microenterprise development is a long and complex process means that more longitudinal evaluation must be conducted. Finally, given that programs and entrepreneurs define success broadly, indicators of success must be expanded beyond those used in traditional economic development evaluation (e.g., job creation, income generation, tax base enhancement). The Aspen Institute's MICROTEST strategy is making progress in this area, incorporating a range of programs into a process of determining appropriate indicators.

Recommendations at the Program or Regional Level

- Encourage entrepreneurs to pursue growth/emerging business sectors.

Entrepreneurs should be encouraged to pursue sectors that have the greatest potential to yield incomes at levels that support self-sufficiency. Microenterprise assistance programs are more likely to promote viable small businesses if they avoid traditional small business fields, targeting their assistance instead to firms operating in the emerging lines of business. At the same time, we recognize that training people for emerging sectors, rather than what they are already good at, would require a different program intervention.

- Help qualified entrepreneurs secure larger loans.

Once entrepreneurs have successfully started their businesses, they often have greater capital needs. They should be assisted in making the transition from microlending to traditional credit mechanisms. Strategic relationships with other lenders need to be forged by microenterprise programs.

CONCLUSION

The microenterprise strategy works if it is well integrated into the larger economic development plan of a region. Making this happen requires expertise on the program side and an understanding of the role that the microenterprise strategy can play from those who create economic development policy at the state, local, and regional levels. According to Malcolm Bush of the Woodstock Institute, “The microenterprise strategy is creative and relatively cheap.” The risk of trying it, therefore, is not especially great. Because the microenterprise strategy does not fit easily into traditional notions of what constitutes economic development, it requires some vision and imagination, as well as the willingness to experiment, in order to implement it. The microenterprise strategy can play a critical niche role in the larger economic development plan for distressed regions. There is ample room at all levels for government to do important work that would help maximize the potential effectiveness of the microenterprise strategy. These areas of involvement include funding, coordinating policy, educating key players in the economic development process, and brokering relationships. There is great opportunity for EDA to play a leadership role in these areas.