microenterprise
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MICROENTERPRISE DEVELOPMENT IN THE UNITED STATES: AN OVERVIEW

"In summoning people to match their talent and labor with small amounts of credit, microenterprise development meets low-income communities where they are, introducing new opportunities to create work, income and assets, and thereby affirming human worth and dignity."

-Jack Litzenberg, Charles Stewart Mott Foundation

THE DEFINITIONS

Microenterprise development is an income generating strategy that helps poor, low- to moderate-income, and other disadvantaged individuals start or expand *microenterprises*. Specifically, microenterprise development fulfills personal, family, and community needs by creating income, building assets, and contributing to local employment creation. As a proven economic development tool, microenterprise development assists these disadvantaged individuals in working their way out of poverty, fulfilling their dreams, and contributing to their community.

In the majority of microenterprises, the owner is the sole operator and worker. However, a microenterprise is any type of small business that has fewer than five employees and is small enough to benefit from loans of under $35,000. In general, microenterprises do not meet the credit and/or collateral requirements necessary to access conventional financial services. There are an estimated ten million[1] *microentrepreneurs* in the United States today—individuals from all walks of life who are seeking to start businesses or to use existing skills towards supplementing their income. They offer services ranging from car repair to day care programs, and products ranging from specialty foods to clothing.

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For further information, please contact:
Association for Enterprise Opportunity
1601 North Kent Street, Suite #1101
Arlington, VA 22209
Phone: 703.841.7760
Email: aeo@assoceo.org
Website: www.microenterpriseworks.org

FIELD
Website: www.fieldus.org

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Why would anyone, particularly disadvantaged individuals, be motivated to take on the risks of starting a business in a highly competitive economy? A huge variation in life circumstances explains the many different answers to this question (see Box 1).

Box 1:
Motivations for Pursuing Self-Employment

◆ Self-employment is one way to earn extra income to supplement the low wages typical of the current job market.	◆ 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.
◆ Women choose self-employment for the flexibility they need to balance home and work responsibilities.	◆ 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.
◆ Self-employment can be a promising option for workers in skill-intensive sectors who are laid-off. They often employ these skills in starting their own business.	◆ Individuals with disabilities seek economic independence through business ownership.

For almost two decades, microenterprise development (MED) programs across the United States have been assisting disadvantaged individuals in starting and expanding their businesses. The industry has grown tremendously as government, private industry, and the philanthropic community has embraced the need to support disadvantaged entrepreneurs in achieving self-sufficiency through microenterprise. The Association for Enterprise Opportunity (AEO), the MED industry's national trade association, estimates that total investment in MED is $100-$150 million per year.

As a result of this investment, the industry continues to grow in all directions—but especially in terms of the number of programs in existence, and the number of participants. The 2004 Directory of U.S. Microenterprise Programs[2], which contains FY 2002 data on the microenterprise industry, lists 517 programs in all 50 states, the District of Columbia, and Puerto Rico. Of these, 237 organizations submitted detailed survey information, which estimated a total of 626,277 participants served since program establishment. Across all microlenders, the total outstanding portfolio at the end of FY 2002 was an estimated $96 million. This is an increase of approximately $29 million over reported FY 2000 levels.[3]

Although linked by their support for microentrepreneurs, these microenterprise development organizations (MDOs) embrace different missions, which translate into diverse program methods and designs. 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.[4]

In addition, MDOs may target specific segments of the population such as low-income individuals, immigrants and refugees, TANF[5] recipients, women, and the disabled. MDOs may also choose to target certain sectors like food, artisan, agriculture, and services. Some MDOs focus on rural or urban microenterprise development. Regardless of their specific focus, the following set of core program elements have emerged during the past decade of practice:

- **Outreach services** are designed to recruit, screen, and assess existing or potential microentrepreneurs to determine their skills and readiness for self-employment.

- **Training and technical assistance** assists microentrepreneurs in developing the skills they need to plan, market, and manage their own business. Typical curricula include training on subjects like personal budgeting, budgeting for your business, communication skills, goal setting, and personnel management.

- **Access to markets services** assist entrepreneurs in tapping new markets for their businesses. These services are particularly important in rural areas, where microentrepreneurs can have an especially hard time making connections to outside markets. MDOs offer "retail readiness," and other courses to prepare microentrepreneurs for this obstacle.

- **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 on reasonable terms. Loans range from $500 to $35,000. The most important advance by MDOs on this front has been in the area of product development. The diversity of capital products available to entrepreneurs now spans from step-loans to equity investments.

- **Graduate services** are 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.

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 Microentrpreneurs. Major Findings Change Over Time (April 1998).

- **Asset development, financial literacy and education** training has become more common among MDOs that seek to increase the economic and financial security of their clients. Asset development, including savings, is increasingly recognized as a priority program component. Many MDOs provide access to Individual Development Accounts (IDAs)—restricted savings accounts for low-income individuals—credit counseling, financial education and free or discounted tax preparation services.

Who benefits from these services? A longitudinal study tracking 405 microentrepreneurs indicates that a majority are female, minority and relatively well educated (see Box 2). Most also own sole proprietorships operating in retail trade or services. Participants in microenterprise programs include a significant percentage of low-income clients, welfare recipients and the working poor. All suffer from lack of access to credit and business services.

THE EVOLUTION OF MICROENTERPRISE DEVELOPMENT IN THE UNITED STATES

Microenterprise development programs in the United States emerged as a logical extension of existing efforts to foster community economic development and alleviate poverty. Confronting a financial sector largely uninterested in serving the poor, organizations in the U.S. began making small loans to underserved populations across the country. Initially, MDOs focused on credit assuming that access to capital was the primary need of microentrepreneurs. As the industry matured, it began to diversify its approach to supporting microenterprise by offering intense business training and technical assistance in addition to access to capital.

In addition, MDOs began experimenting with loan and training products that better met the needs of their microentrepreneurs. For example, some MDOs successfully employ a "peer lending" approach, by which a group of borrowers come together to co-guarantee the small loans made to each member, thus replacing traditional collateral with "social capital." In the area of training MDOs have also utilized peer groups to provide a safe atmosphere for entrepreneurs to use their peers as a sounding board for business ideas.

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

- **Recent Legislation:** In 1999, the Program for Investment in Microentrepreneurs (PRIME) Act was passed. PRIME provides much needed funds for delivering training and technical assistance to very low- and low-income entrepreneurs.

- **Government Support:** Since federal Fiscal Year 2001, government funded programs that exclusively support microenterprise—such as the Small Business Administration's Microloan and PRIME Programs—have experienced over 34% cuts in funding. However, even as the federal government is cutting funds for these programs, federal agencies are increasingly including microenterprise development as an eligible activity in a growing number of federal programs. The consequences of moving away from concentrated sources of funding for microenterprise would make it more difficult for the industry to establish standard methods of lending and training, and more difficult for MDOs to access government resources.

- **Infrastructure:** As the microenterprise industry has grown, so has its necessity for practitioner networks that facilitate knowledge-sharing and capacity building at the state level. Currently, there are over 30 State Microenterprise Associations (SMAs) in the U.S. Through SMAs, MDOs work together to advance microenterprise-friendly policy and to provide opportunities for networking, training, and capacity building.

- **Industry Standards:** The microenterprise industry, through AEO's *Microenterprise Standards and Accreditation Project*, is working to set benchmarks for performance and scale. The long-term vision of this project is to develop behavioral and numerical performance standards and—eventually—an accreditation program for the industry.

- **Expansion:** As the microenterprise industry continues to grow, it has begun to apply microenterprise as an approach to successful community and economic development among rural, refugee/immigrant, youth and disabled populations. This growth can largely be attributed to the success the industry has experienced in serving other disadvantaged populations.

- **Partnerships:** Over the past few years, corporations such as American Express, Prudential, Hewlett-Packard and COVAD Communications have partnered extensively with AEO to invest in the microenterprise development industry and build its capacity to service low-income microentrepreneurs.

- **Funding:** Over the past few years, the microenterprise industry has received increased support from the private sector—especially in terms of corporate giving. AEO estimates an investment of over $100 million annually from banks and corporations across the country. These investments can come in the form of capital for loan pools, grants to provide training and technical assistance, and/or the provision of equipment and services (see Box 3).

Box 3: Funding Sources for Microenterprise Development

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.

FOUNDATIONS	Giving for microenterprise development includes such foundations as the Kellogg Foundation, the Charles Stewart Mott Foundation, and local foundations.
FEDERAL GOVERNMENT	The federal government funds microenterprise development through various programs, including the Small Business Administration (SBA) Microloan Program, and the SBA Program for Investments in Microentrepreneurs. The departments of Labor, Housing & Urban Development, and Agriculture also house programs that support microenterprise development.
STATE & LOCAL GOVERNMENT	Loan capital for revolving loan funds, operating grants, and technical assistance grants represent the support for microenterprise development provided by state and local policymakers.
CORPORATIONS	Many corporations support microenterprise through direct philanthropic grants. Examples include Hewlett Packard, American Express, and most banks.
FEDERATED FUNDS	Federated Funds, like local United Ways, can provide excellent, ongoing support for microenterprise development organizations. Federated Funds can be a source of relatively large "core" funding.
EARNED INCOME	More and more microenterprise development organizations are incorporating earned-income strategies into their operations to increase their self-sufficiency and long-term sustainability. Some examples include fee-for-service strategies, and charging fees for access to computer labs and technology.
SOCIAL ENTREPRENEURSHIP	Some microenterprise development organizations are incorporating profit-making businesses into their organizations, with the resulting income used to meet the organization's mission. Good examples are the retail stores of Mountain Microenterprise in Asheville, NC, and the Women's Rural Entrepreneurship Network in New Hampshire.
FUNDRAISING	An increasing number of microenterprise development organizations have annual fundraising events—such as dinners or lunches—that are successful in raising significant funds.
RELIGIOUS INSTITUTIONS	AEO estimates that approximately 15-20% of MED programs receive some support from religious institutions. Often, individuals and religious institutions view support for microenterprise for low and moderate-income individuals as a key component of a social ministry.
INDIVIDUAL GIVING	Microenterprise development organizations are taking a closer look at individual giving as a way to increase their base of funders.

TRACK RECORD

Does microenterprise development make any difference? How stable and profitable can these microenterprises really be? These are inevitable questions for the microenterprise industry as it faces skepticism rooted in the risks associated with small business, the 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 variety of ways. A large number of microentrepreneurs patch together earnings from more than one source to make ends meet; the majority have two or more sources of income including part-time wage income and public assistance.[6]

Over the years, there have been several major studies on the effects of microenterprise on poor, and low- to moderate-income individuals. By and large, these studies have shown that microenterprise does indeed increase incomes and, more importantly, assist individuals in moving out of poverty (see Box 4). They also enjoy high survival rates—rates higher than the national estimated averages for traditional small businesses. Below are findings in these three major areas—increased income, progress out of poverty, and business survival—from two of these studies.

Box 4: The Economic Impact of Microenterprise Development

	The Aspen Institute Self-Employment Learning Project [7]	The Aspen Institute's Microenterprise Welfare to Work (WTW) Learning Assessment [8]
Increases in Income	◆ Assets and net worth were more significant for the low-income cohort (n=133) of the sample than for the non-poor. ◆ The average household income for the poor increased by $10,507 over five years compared to a $6,000 decrease for the non-poor.	◆ Two years after program enrollment, the median household income of participants grew from $10,114 to $18,952—an increase of 87%. ◆ Those who had earned income solely from self-employment drew an average of $8,104 from their businesses to support their household income.
Progress out of Poverty	◆ By the end of the study, 53% had moved out of poverty. ◆ 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% to 17% over the five-year study period.	◆ Receipt of TANF (welfare) dollars declined dramatically among the survey sample—from 94% at intake to 25% towards the end of the study. ◆ Over the two-year study period, the median household assets of respondents increased by $1,075, or 253%.
Business Survival	◆ 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% after four years).	◆ 37% of participants were operating a business two years after enrolling in the training program. At enrollment, 21% of respondents reported that they were operating a business. ◆ Businesses grew stronger in the two-year period of the study. For surviving businesses, the median monthly sales grew by $600. ◆ Average net worth grew by 34%, while median net worth grew by 26%.

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. 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. Cost measures, taken from 2003 MicroTest data, indicated that:

- Average cost per client was $2,416 (n=63) and cost per assisted business was $4,232 (n=62).
- The median operational cost rate (what it costs programs to manage each dollar in their microloan portfolio) was $.42 per dollar in 2003 (n=43) compared to $.61 per dollar in 2002 (n=51).

It is important to note that programs that achieve scale in their lending and client portfolios, by streamlining services, or by developing innovative partnerships, often also become more efficient on a cost per client (or other unit) basis. In addition, increasing scale is key to bringing down costs, a definite challenge in an industry that is fragmented among small providers who are not yet close to reaching potential economies of scale as defined by the estimated number of microentrepreneurs.

CURRENT 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, immigrants, the disabled, and home-bound workers. MED has demonstrated that these populations can, in fact, be bankable entrepreneurs. The chief challenge going forward is to translate this success into a widely available, mainstream employment option. Other challenges include:

- **Getting to Scale:** An AEO study using data from the U.S. Census and Department of Commerce shows that there are roughly 21.5 million microenterprises (businesses with five or fewer employees) throughout the United States.[9] Further studies by the ASPEN Institute indicate that, of these, there are roughly 10 million underserved microentrepreneurs that might benefit from the targeted services provided by microenterprise programs.[10] However, data from the 2004 Directory of Microenterprise Programs estimates that 626,277 of these microentrepreneurs were served by the 237 respondent programs since program establishment.

- **Adopting a Standard System for Outcome Measures:** Funders require data that demonstrates the performance and results of their investments. As such, an increasing number of MDOs are using MicroTest as a reporting instrument to respond to funders' needs for high quality performance data and useful management information. MicroTest recognizes the full range of MED services and provides data on client demographics, scale, credit and training program effectiveness, and sustainability. Related to this effort is the Microenterprise Standards and Accreditation Project (MSAP) that is utilizing MicroTest data to develop performance standards for the industry.

- **Product Development:** The industry needs to continue innovating with new credit, equity and savings products that respond to client needs. In addition, practitioners should look at improving the quality of training and technical assistance to help microentrepreneurs achieve more robust business outcomes. Recent innovations include developing membership programs, offering computer technology training and computer labs, mobile training, and web-based training.

- **Growing Microenterprise In Rural Areas:** Reaching microentrepreneurs in rural areas is a continuing challenge for the industry. There are currently several initiatives in place that are trying to address the unique set of problems encountered by rural microentrepreneurs.

- **Increasing Government Support:** With federal funding priorities shifting dramatically over the past four years, it is critical to permanently establish microenterprise as a viable option within government community economic development programs.

ENDNOTES

1 Elaine Edgcomb and Joyce Klein, Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States, (The Aspen Institute, 2005).

2 2004 Directory of U.S. Microenterprise Programs. Available at www.microenterpriseworks.org/planned internet location.

3 Britton Walker and Amy Kays Blair, 2002 Directory of U.S. Microenterprise Programs, (Washington, DC: The Aspen Institute, 2002).

4 John Else, Microenterprise Development in the U.S., (Geneva: ILO,2000).

5 Temporary Assistance for Needy Families (welfare).

6 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.

7 Ibid.

8 The Aspen Institute's Microenterprise Welfare to Work (WTW) Learning Assessment is a longitudinal study of 590 Temporary Assistance for Needy Families (TANF) recipients who enrolled in and received services from 10 different microenterprise programs between January 1999 and June 2000. The results of this study are confirmed by less comprehensive evaluations

9 AEO Microenterprise Employment Statistics. United States Spreadsheet, 2002. http://www.microenterpriseworks.org/services/policy/mees/UnitedStates2002.pdf

10 Elaine Edgcomb and Joyce Klein, Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States, (The Aspen Institute, 2005).

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III. Nelson, Candace. Going Forward: The Peer Group Lending Exchange. (Toronto: Calmeadow, 1994).

IV. The Aspen Institute, Economic Opportunities Program. "Microenterprise Assistance: What Are We Learning About Results? Key Findings from the Aspen Institute's Self-Employment Learning Project." (Washington D.C.: The Aspen Institute, 1997).

V. The Aspen Institute, FIELD focus Issue #3 - *Designing Microenterprise Programs for Welfare Recipients* (2000), http://fieldus.org/publications/Field_Forum3.pdf.

FOR FURTHER INFORMATION

The Association for Enterprise Opportunity (AEO) is the national association of microenterprise development organizations. It holds an annual forum for members, serves as a nexus of communication about the industry and advocates at the federal level on behalf of its members. AEO's website contains additional information about microenterprise and links to many other resource organizations. www.microenterpriseworks.org