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Microenterprise Development in Upstate New York

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Over the past 20 years, microenterprise development (MED)[1] has emerged as a strategy to combat poverty and stimulate economic growth by funneling capital into underserved markets. By providing assistance to low-income people to establish microenterprises – businesses with five or fewer employees – MED is intended to help them move beyond low-wage jobs or off public assistance and to start building personal wealth. Since the 1980s, the number of MED programs in the United States grew from just a handful to over 550. They now help an estimated 114,000 clients a year,[2] providing financial capital, training and technical assistance for microbusinesses in such diverse sectors as catering, child-care, automotive repair, and cottage-crafts. As competition for funding sources increases, MED programs are receiving more scrutiny and are increasingly concerned with demonstrating their effectiveness.

The ability of MED programs to simultaneously achieve the goals of alleviating poverty and promoting economic development is challenging. While nearly all programs target low-income populations to reach their poverty alleviation objectives, many face difficulties in qualifying significant numbers of people who also have the necessary business skills and experience to start and successfully manage a business. And the businesses that do emerge are more likely to be small in scale, with narrow profit margins and few jobs created. As a consequence, the characteristics of MED programs that enable them to serve a unique role toward alleviating poverty also cause them to score less well in terms of traditional performance measures than other programs that have the primary purpose of economic development. We suggest that an assessment framework that fully incorporates the unique characteristics of MED will help program directors, policymakers, and funders to better demonstrate the contributions of these programs.

In this report, we draw on national studies and a new survey of MED programs in upstate New York conducted by the Buffalo Branch of the Federal Reserve Bank of New York to discuss these issues. First, we describe the development of MED in the U.S. and its dual objectives. We then discuss some of the shortcomings of using traditional economic development and poverty measures to assess MED's effectiveness. Lastly, we describe how these programs work in practice in upstate New York using the new survey data.

The Microenterprise Development Strategy

MED programs offer assistance for starting or growing very small or "micro" businesses by providing small amounts of credit – usually under $10,000 and no more than $35,000 – business training, technical assistance, and other services. The programs are housed in a variety of settings including community-based organizations, local government agencies and credit unions. They target their services primarily to low-income people, women, minorities, the unemployed, immigrants, and refugees who might be considered a high credit risk by traditional lenders because of their inexperience or poverty, or because the dollar amounts are too small for a bank to extend profitably.

MED has evolved in the U.S. over the past 20 years into a strategy to address both economic development and poverty alleviation concerns. A primary objective of the strategy is to help low-income people become successful entrepreneurs, move beyond low-wage jobs or off public assistance, and build personal wealth. At the same time, these entrepreneurs create or expand businesses, generate new jobs and contribute to economic growth.

Although MED programs share these common goals, programs vary in how they operate. Without a single set of guidelines or practices, they differ in how they are structured, what groups of people they target, and what services they offer. Most programs combine lending with training on topics such as business plan writing, budgeting and marketing, along with one-on-one technical assistance. Often, MED services are added to an organization already serving a targeted group such as women, minorities or immigrants. Some programs rely on peer networks, which help screen applicants, provide support, and assume group responsibility for the debt.

MED is relatively new in the U.S., gaining popularity only since the 1980s. The strategy was shaped by a range of domestic influences, but it is most strongly linked to the international programs pioneered by organizations such as Grameen Bank in Bangladesh and ACCION International in Latin America. These international programs are widely cited for alleviating poverty in some of the poorest regions of the world. In these areas, loans of just $50 to a few hundred dollars have been used to establish businesses such as street vending or weaving. They have assisted 8 to 10 million households[3] and consistently have loan repayment rates as high as 97 percent.[4]

The MED strategy gained momentum in the U.S. in the 1990s under the Clinton administration. New funding opportunities were created including the Small Business Administration's (SBA) MicroLoan Program and the Community Development Financial Institutions (CDFI) Fund.[5] With passage of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996,[6] welfare benefits became subject to a five-year limit and microenterprise was promoted as an employment alternative. The federal government is still the largest single source of funding for MED programs, providing about $60 million a year or about 36 percent of total funding.[7]

Goals and Strategies for Economic Development and Poverty Alleviation

As the field matures, programs are increasingly concerned with showing their effectiveness in promoting business and job growth, gains in personal income, and financial security for participants. Many program administrators report feeling a heightened urgency to demonstrate success in the face of funding concerns, especially given the SBA's proposed elimination of the MicroLoan Program.

One Client's Story:

After taking the Succeeding in Small Business classes in Cayuga County, Jim Meyer applied for a $10,000 microenterprise loan from the county's Community Development Program in order to open a bookbinding business in an old factory building. Three years later, when rent was going up on his leased space, he purchased his own building in downtown Auburn with the help of a $30,000 microloan from the City of Auburn Community Development Program. Jim has added one full-time employee and has fully paid off his first loan to the county. But the benefits of this loan extend to the community, as well. Jim invested in the upper floors of his building and now offers nine units of much-needed Single Room Occupancy (SRO) rentals. These units are always full.

Unfortunately, the combination of social and economic development objectives that have helped the microenterprise strategy gain prominence and financial support has turned out to be less complementary in the U.S. than in developing countries where small amounts of business credit led to rising standards of living among the very poor. In the U.S., these goals have proved difficult to achieve simultaneously. While nearly all programs target low-income populations to meet their poverty alleviation objectives, many have difficulty qualifying large numbers of people who wish to be entrepreneurs and have the necessary business skills and experience to start and run a business with a microloan. Additionally, the businesses that do emerge are likely to be small in scale with narrow profit margins. As a result, the characteristics of MED programs that enable MED to serve a unique role in alleviating poverty also cause it to score less well in terms of economic development using traditional performance measures.

To illustrate this inherent tension in the dual objectives of MED, we draw on findings from several recent studies.

MED AS ECONOMIC DEVELOPMENT

With the aim to create new jobs and enhance business revenues, MED is a form of economic development. However, traditional success measures of economic development fail to account for the unique characteristics of those who qualify for microenterprise program support or the distinctive character of the businesses they typically start.

Individuals who use MED programs generally face particular challenges. For many, credit is not the only barrier to entrepreneurship; they also lack sufficient skills in business management, accounting and marketing. This is particularly true in the U.S. where they may face complex regulations

related to food handling or permits for outdoor vending. Such challenges are significant for target populations such as individuals coming off welfare, leaving a low-wage job, adapting to a new culture and language, or transitioning to a new field. Similarly, MED businesses, often personal or professional services or crafts and retail, generally have low overheads and start-up costs, but also slim profit margins. Risk of failure in the early years is particularly high for these businesses.

Traditional measures also fail to account for the challenging business conditions the microentrepreneurs face. High interest rates and mandatory training classes increase the cost of borrowing in terms of money and time. While helping clients establish or repair their credit history, programs may limit the amount that they can borrow well below the $35,000 limit that is considered a microloan. Some programs only offer step loans whereby borrowers begin with a loan of $500 and gradually "step up" to higher loan limits as balances are paid and credibility is established.[8]

When gauged by traditional economic development measures such as growth in business profits and job creation, MED results are not striking. In a study of six major microenterprise programs for the U.S. Economic Development Administration, monthly business profits ranged from $0 to $4,600, with a median value of $200.[9] In another study of 96 MED program participants, 34 successfully launched a business. Only 13 of these businesses reported any profit and of these 13, only seven had profits over $500 month.[10] Measures of business profits, however, did not make clear how much the entrepreneur was drawing as salary expense.

Another traditional measure of business development is job creation. By definition, a microenterprise will have no more than five employees and most microenterprises are sole proprietorships, providing a job for the owner alone. In findings from the Self-Employment Learning Project (SELP), a five-year study of seven microenterprise programs, 66 percent of the businesses employed only the owner and the overall job creation rate was 1.2 jobs (in addition to the owner) per business.[11]

The survival rate for microenterprises served by programs, however, is comparable with other small businesses. The SELP study reports that 49 percent of the businesses started were still operating after five years. This is slightly higher than the survival rate among small businesses generally, which the SBA reports to be 47 percent after four years.[12]

MED AS POVERTY ALLEVIATION

MED may also be assessed as a poverty alleviation tool since most programs try to help low-income individuals increase their income and build wealth. However, traditional measures of poverty relief such as rising personal income and advancement out of poverty are difficult to apply to MED.

Gains in personal income among microentrepreneurs in the SELP study were mixed. When a sub-group of just the low-income program participants was evaluated, 72 percent had increased their household income over the course of the study, and 53 percent had increased it to a level above the poverty line. What is more, these microentrepreneurs also reduced their dependence on government assistance by an average of 61 percent. However, among all program participants, there was an average decrease in income.[13] In what is known as "income patching," many program participants were found to combine income from several sources, including Temporary Assistance for Needy Families (TANF), Food Stamps, Social Security, or traditional wage work.

MED also has a limited reach to those living in poverty. While MED programs generally target low-income populations, not everyone can qualify for and productively use the funds. In the Aspen Institute's MicroTest survey of 63 of the largest and oldest MED programs, an average of only 25 percent of the loans went to people below the poverty line.[14]

PROGRAM SPECIALIZATION

The dual objectives of economic development and poverty alleviation have led many MED programs to emphasize one objective over the other, reflecting their particular history, community affiliations or funding requirements and the range of training and credit needs among their clients. Programs that emphasize economic development generally devote more resources to lending than training. They focus on clients who are most prepared to start or grow a business, create more jobs, manage larger amounts of credit, and advance into the mainstream financial system. Often, this focus comes at the expense of serving the most economically disadvantaged.

In contrast, programs that emphasize poverty alleviation generally devote more resources to training than lending, sacrificing some impact on economic development. The most disadvantaged clients often have the greatest needs in pre-business development services such as business and marketing plan writing and financial management training. Even when the training does not result in a new business, it often helps in more qualitative ways by strengthening financial management skills, enhancing participant confidence, and repairing poor credit histories, which are building blocks to rising above poverty.

Researchers using the MicroTest data identified patterns among MED programs that reflect this specialization in either economic development or poverty alleviation. They took the programs' relative emphasis on lending versus training as the basis

for separating programs into the two categories of "credit-led" and "training-led," which they took to reflect an emphasis on either economic development or poverty alleviation, respectively. They found that programs that focused on training lent only 13 percent of all dollars distributed, with an average loan of $3,600. An average of 70 percent of these loans were to low- and moderate-income people.[15] In contrast, programs that focus on credit lent 87 percent of all dollars distributed and had a higher average loan size of $6,700. An average of 60 percent of loans in this group went to low- and moderate-income people.[16] Among all programs, an average of 64 percent of lending was to low- and moderate-income people with a range between 12 and 100 percent.

MED in Upstate New York

New data collected from upstate New York provide an opportunity to compare strategies and view trade-offs in balancing economic development and poverty alleviation. In the spring of 2005, the Buffalo Branch of the Federal Reserve Bank of New York conducted a survey on MED programs that do lending within the five counties of Cayuga, Erie, Monroe, Niagara, and Onondaga. New York State as a whole has the highest level of MED activity in the U.S. in terms of the dollar value of credit extended and the number of start-up businesses assisted, with active programs in every corner of the state.[17]

METHODOLOGY

Data were collected on the five-year period from 2000-2004 using a combination of electronic mail questionnaires, and personal and telephone follow-up interviews. Of the fifteen microlending programs identified in the study area,[18] fourteen responded to the survey. While this sample is small and results cannot be generalized to all of upstate New York, they represent 93 percent of the lending programs in these counties, which include the major population centers of Buffalo, Rochester and Syracuse.

PROGRAM PROFILE

Over the study period, these 14 programs served over 2,100 clients and made 313 loans valued at nearly $4.3 million. Consistent with the national pattern, about half of the businesses served were new start-up businesses and the other half were ongoing. Overall, MED programs supported primarily retail businesses, followed by personal and professional services. Client businesses include such diverse enterprises as specialty food production (for example, premium ice cream and savory bean pies) automotive repair, bookbinding, food catering, home building and repair, jewelry-making, hair care and child care.

The entrepreneurs represent different socioeconomic backgrounds (Table 1). About half of the loan recipients were low- and moderate-income people, about half of the loan recipients were women, and one-third were minorities. However, the average loan size was highest in the "other" category, representing white males with higher incomes.

Lending policies varied among the programs. The average interest rate was about 8 percent but rates ranged from 4 percent to 12.5 percent. Nearly all programs required collateral of some sort, but most were flexible in what they would accept including vehicles, tools and equipment. Most loans were for four- or five-year terms.

Table 1: Microlending Activity in the Upstate New York Study Area, 2000-2004

	Number of loans	% of total number of loans[a]	Average loan size	% of total value of loans[a]
Low- and moderate-income[b]	153	49%	$9,681	35%
Women	159	51%	$10,332	38%
Minorities	91	29%	$8,462	18%
Other	89	28%	$17,031	35%

[a]These numbers add up to more than 100 percent because some loans are counted in more than one category. For example, a loan to a Hispanic woman would be counted in two categories.
[b]"Low- and moderate-income" is defined as individuals earning less than 80 percent of the median income in their area, consistent with the definition used by the U.S. Department of Housing and Urban Development (HUD).
Source: Buffalo Branch, Federal Reserve Bank of New York, 2005.

The programs themselves are often small, staffed by only one or two people who may have other job responsibilities. Five programs are housed in county or municipal government agencies, five in credit unions, and four in community-based organizations or community development corporations (CDCs). One large CDC operates in multiple counties, extending across much of the upstate region. This one organization is responsible for making 43 loans in

Table 2: Specialization of Program Activity in the Upstate New York Study Area, 2000-2004.

		Poverty-focused group	Economic development-focused group
Average proportion of lending to low- and moderate-income clients		99%	13%
Number of clients served (combination of training and lending)		1298	811
Number of loans disbursed		105	194
Total dollars loaned		$ 1,148,997	$ 2,849,564
Average loan amount		$ 7,683	$ 18,379
Jobs created	*Full-time*	121	247
	Part-time/ seasonal	13	76
Number of programs in group		6	8

Source: Buffalo Branch, Federal Reserve Bank of New York, 2005.

the study area, valued at $840,000 and representing 20 percent of the total lending activity in the study.

MED programs act in collaboration with a range of organizations including traditional banking institutions, small business development or other training centers, the state-wide umbrella organization MicroBiz New York, and support organizations such as the Local Initiatives Support Corporation (LISC) and The Enterprise Foundation. Where there are multiple MED programs, such as in Buffalo and Rochester, partnerships have been fostered such as MicroBiz Buffalo.

PROGRAM SPECIALIZATION

Program specialization seen at the national level is also evident in upstate New York. Nearly all MED programs in the upstate New York study area aim to address both poverty alleviation and economic development. However, when sorted by their level of lending to low- and moderate-income people, the data show differences in strategy and client base that distinguish programs as either emphasizing economic development or poverty alleviation. We refer to the two groups as either "poverty-focused" or "economic development-focused" programs (Table 2).

Over the study period, an average of 99 percent of the lending by the six poverty-focused programs went to low- and moderate-income people. These programs focused on training, which was provided to the majority of their clients, and they were more likely to require clients to go through a training program in order to qualify for a loan. They made fewer loans than the economic development focused group and the average loan size was less than half as large.

By comparison, an average of 13 percent of the lending by the eight economic development-focused programs went to low- and moderate-income people. These programs focused on clients who already have business skills. Making almost twice as many loans as the other group, they provided almost three times the capital and generated the majority of the jobs.

The different approaches between these groups are further evidenced in the program directors' responses to more qualitative questions. When program directors were asked to comment on the importance of credit history in loan decisions, responses from the poverty-focused group included "loans are approved to those who do not qualify for conventional credit" and "bad credit - no go / no credit – ok." A different emphasis can be seen in the comments from the economic development-focused group: "Creditworthiness is critical" and "experience has shown that past credit history has a direct bearing on how the applicant will handle new debt."

Future Directions

The field of microenterprise development continues to evolve. Funding constraints have encouraged programs to achieve greater self-sufficiency and rely less on outside funding for sustainability. According to one survey, 80 percent of programs say that their biggest concern is sustainability.[19] In the upstate New York study, program directors say that while their loan funds are still secure, it is increasingly difficult to get funding for "soft costs" such as training and program administration.

MED programs will benefit from a variety of initiatives underway that focus on gaining a clearer understanding of the critical stages through which individual organizations must move to reach scale, a critical step for long-term sustainability.

People working in the MED field appreciate the importance and challenge of measuring and demonstrating effectiveness. The Association for Enterprise Opportunity (AEO, the national member organization for MED programs) is working to establish

minimum performance and accreditation standards for criteria such as the number of minority clients served, number of loans dispersed to low-income people, and operational efficiency.[20] Since 2004, AEO has also begun to collect data from across the country on outcomes such as number of jobs created and changes in personal income.

Looking forward, we see ongoing discussion and collaboration among MED programs, state umbrella organizations, national groups such as AEO, the Aspen Institute's Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD) and other interested parties. Such activities can stimulate innovation in pursuing alternative funding sources and the models and methodologies to help ensure the field's long-term growth and sustainability.[21]

Conclusion

Across the country, entrepreneurs found to benefit from MED include workers in low-wage jobs; parents returning to the workforce; rural and urban populations where employment is limited; veterans, people with disabilities, older people and the poor who face obstacles in the traditional labor market; and immigrants learning a new language and culture. However, because their businesses are often small, their profits modest, and they are rarely among the very poor, the benefits of MED are not fully reflected in traditional economic development and poverty alleviation measures.

At the same time, MED programs often specialize to focus on particular clients and needs, which often extend well beyond simple financial credit. Such specialization reflects the trade-offs in achieving greater economic development or poverty alleviation outcomes.

Charting a course for a secure future for MED programs requires addressing the inherent tension in the strategy between poverty alleviation and economic development. While there is room for both goals, it is important to understand and prepare for the inevitable trade-offs and compromises. The efforts underway to establish industry standards are important toward creating a framework for measuring MED performance. ■

[1]The term "microenterprise" has no universally accepted definition. For the purposes of this analysis, we are using the commonly accepted definition used by the Association for Enterprise Opportunity that a microenterprise is a business with five or fewer employees that requires $35,000 or less in start-up capital and that does not have access to the traditional commercial banking sector. Microenterprise development is the broad field of programs and activities that support the establishment and growth of microenterprises.

[2]E.L. Edgcomb and J.A. Klein. *Opening Opportunities, Building Ownership*. Washington, DC: The Aspen Institute (February 2005). http://fieldus.org/li/sof.htm.

[3]J. Morduch. "The Microfinance Promise," *Journal of Economic Literature*. Vol. XXXVII (December 1999).

[4]N. Bhatt and Shui-Yan Tang. "Making Microcredit Work in the United States: Social, Financial, and Administrative Dimensions," *Economic Development Quarterly* (August 2001).

[5]The MicroLoan Program was established under the Small Business Credit and Business Opportunity Enhancement Act of 1992. The Community Development Financial Institutions Fund was established under the Community Development Banking and Financial Institutions Act of 1994.

[6]The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193).

[7]J. F. Else. "Microenterprise Development in the U.S.: Is There a Case for Public Support?" in *Action Enterprise Creation by the Unemployed – The Role of Microfinance in Industrialized Countries*. Geneva, Switzerland: International Labour Office (March 2000).

[8]L. J. Servon and T. Bates. "Microenterprise as an Exit Route from Poverty," *Journal of Urban Affairs*, Vol. 20:4 (1998).

[9]L. J. Servon. *Microenterprise Development as an Economic Adjustment Strategy*. Prepared for the United States Department of Commerce Economic Development Administration (December 1998). www.eda.gov/PDF/1g3_9_micro.pdf.

[10]N. Bhatt. *Inner-City Entrepreneurial Development: The Microcredit Challenge*. Oakland, CA: Institute for Contemporary Studies Press (2002).

[11]The Self-Employment Learning Project is the largest longitudinal study of microentrepreneurs, tracking 405 individuals from 1991-1997. This study does not differentiate among full-time, seasonal or part-time jobs. P. Clark and A. Kays. *Microenterprise and the Poor: Findings from the Self-Employment Learning Project Five Year Survey of Microentrepreneurs*. Washington, DC: The Aspen Institute (1999).

[12]Clark and Kays 1999.

[13]Clark and Kays 1999.

[14]J. Black, *et al. A Measure of the Microenterprise Industry: A Report from MicroTest*. Washington, DC: The Aspen Institute (2003).

[15]"Low- and moderate-income" is defined as individuals earning less than 80 percent of the median income in their area, consistent with the definition used by the U.S. Department of Housing and Urban Development (HUD). For a family of four in 2004 in the counties selected in upstate New York, this average ranges from $42,900 to $47,050.

[16]Black *et al.* 2003.

[17]B. A. Walker and A. K. Blair, eds. *2002 Directory of U.S. Microenterprise Programs*. Washington, DC: Aspen Institute (2002).

[18]A couple of state and national programs, including TrickleUp and Count Me In, are potential MED microlenders but no lending activity within the study area could be determined for the years 2000 to 2004.

[19]Bhatt 2002.

[20]A detailed description of these standards can be obtained at www.microenterprise.org/projects/MSAP/index.htm.

[21]See, for example, Edgcomb and Klein 2005.

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