MICROENTERPRISE IN INTERNATIONAL PERSPECTIVE: AN OVERVIEW OF THE ISSUES

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Abstract

This issue of the International Journal of Economic Development is a special symposium on microcredit programs in developing, developed and transitional economies. This introductory paper reviews current issues debated among advocates, critics and policy-makers in the microcredit field and weaves in symposium papers as examples for more detailed study. Even though the symposium covers much material, it cannot do justice to this rich field of endeavor.

Introduction

Poor people, especially women, could contribute to wealth creation of nations and improve their own quality of life if they could start, maintain or grow a small business. When poor people do not participate in self-employment or seek to employ others, economies waste human capital and governments incur great expense in supporting poor, dependent populations. But poor people often lack capacity necessary to become economically independent and they cannot fully access societal resources to help in attaining this goal. Poor people are often under-educated, inexperienced in business, in poor health, saddled with large families they can barely care for, isolated in rural villages or urban ghettos, or discriminated against because of race, religion, ethnicity or gender. Poor people lack access to capital necessary to drive existing or potential businesses, for want either of personal assets or collateral, or of financing from friends, family or acquaintances willing to invest. As such, credit from banks or other formal financial institutions, the engine of economic growth in every country, eludes poor people, holding them down.

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Microcredit programs offer loans and/or technical assistance in business development to poor people. Generally, programs have one or more of three goals: (1) improvement of self-sufficiency and welfare of poor entrepreneurs, (2) development of stable sources of income and full-time employment, and (3) expansion of microenterprises to a larger firms (OECD, 1996).

Recent microcredit programs owe their development to dissatisfaction with earlier methods of aiding poor populations in developing countries. These were often large infrastructure or public works projects that frequently failed to meet poor people's needs (Cassen, 1993).

Microcredit programs of all stripes have exploded in popularity in the 1990s, although they have been in existence since the 1960s. Adams and Von Pischke (1994) note, however, that microcredit programs of today are based on exactly the same rationale as failed programs to help small farmers in the past. In the United States, more than 200 microcredit programs exist, offering targeted groups loans from $200 to $25,000, occasionally more (Sevron, 1997; Edgcomb, Klein and Clark, 1996; Shorebank Advisory Services, 1992; Himes and Servon, 1998). Cumulatively through 1996, U.S. microcredit programs served 200,000 people in 54,000 businesses with loans over $44 million (Edgcomb, Klein and Clark, 1996).

Hillary Clinton recently drew national attention to the need for such programs through speeches and news conferences. The U.S. Small Business Administration added microcredit to its portfolio of finance and technical assistance programs for small business. Community Development Agencies (CDCs) have broadened their activities to include microcredit. The U.S. Department of Treasury provides incentives for financial institutions to invest in microenterprise in its Community Development Financial Institution (CDFI) initiative. Banks, feeling pressure from federal legislation--Community Reinvestment Act--requiring them to invest more capital in poor neighborhoods and sensing some untapped market opportunities in microcredit, often fund programs. Charles Mott Foundation and Ford Foundation began to fund microcredit programs, evaluate them, and publicize their successes and best practices (Shorebank Advisory Services, 1992; Community Economics Corporation, 1993; see also, Economic Opportunities Program, 1997). Programs, once exclusively

offered in developing countries, ACCION International's, for example, have been imported in U.S. cities (Himes and Servon, 1998).

Internationally, microcredit programs are even more prevalent. A 1998 United Nations report estimated that more than 3,000 small financial institutions have pioneered microcredit programs (Rossette, 1998). Cameroon alone has 250 programs, while Kenya has 34 non-governmental organizations (NGO) operating in the country (Snow and Buss, in press). The U. S. Agency for International Development (USAID) began funding microenterprise programs in eligible developing countries around the world--Africa, Asia, Near East, Eastern Europe, Former Soviet Republics, Latin America and Caribbean--investing $138 million in microcredit programs in 40 countries during FY 1996. The World Bank allocated $218 million for small loans in an effort to reach 100 million families by 2005. The European Union's PHARE (EVCA, 1997), TACIS (TACIS, 1997), and European Bank for Reconstruction and Development (EBRD) support numerous microcredit programs in countries of the former Soviet Union and Eastern Bloc (OECD, 1996). USAID even co-sponsored a widely-attended international summit in 1997 to draw attention to the need for microcredit (Szabo, 1997). Just as importantly, USAID, World Bank, and the European Union have begun evaluating programs and developing best practice models for wide distribution in the development community. Even international private charities, like CARE and OXFAM, have developed microcredit programs.

Much of the impetus for microcredit programs has been inspired by the Grameen Bank in Bangladesh, established in 1976 by Professor Muhammad Yunus as a research project (Khandker, Khalily and Khan, 1995). Grameen Bank--a kind of credit union numbering more than 2 million members--provides small loans to rural poor people, 94% of whom are women, in about 35,000 villages. To date, Grameen has lent about $2.1 billion to 2 million borrowers. Grameen Bank's admirers have tried to replicate it in other countries, including the United States. Many, though, have failed (Bouman and Hospes, 1994). And some studies question whether Grameen actually operates what it claims (Jain, 1996).

In spite of its continued popularity and recent growth, microcredit has not been without its critics (Buckley, 1997). Governments in developing countries may support microcredit, not

because it is a good policy, but because they fear implementing large-scale land reform (Khandker, Khalily and Khan, 1995). Microcredit may force poor people or groups of borrowers into debt they cannot repay, or into businesses where they can barely subsist (Montgomery, 1996). Heavily-subsidized microcredit distorts capital markets, crowding out private credit or channeling resources away from more productive investments and politicizing the process (Adams, Graham and Von Pischke, 1984; Seibel, 1994). Even if microcredit programs succeed, they make little difference in economies, even in small developing economies. The poorest of the poor are rarely helped and often hurt (How Bankable Is Microfinance, 1997). Those who receive subsidized credit in many cases likely do not need it (Seibel, 1994). Most do not have positive impacts and many are highly inefficient. Although these criticisms appear well-founded, there exists considerable disagreement about how extensive they are and whether they can be corrected.

Issues Ongoing in the Field

A reading of the burgeoning volume of materials on microcredit suggests that the following are major (but certainly not all) issues in developing, implementing or monitoring programs concern advocates, critics, and policy-makers:

- ***Program Rationale***. Microcredit is justified for many, because they perceive private capital markets to have failed in reaching poor people in need and deserving of credit. Others claim either that private capital markets are well-functioning or that microcredit is unwarranted, with credit problems associated more with government regulation or failure. What is to blame, market or government failure? Is there really a credit gap?

- ***Poverty Assessment.*** Microenterprise programs are generally targeted not only to very, very small businesses, but also to poor people, many of whom are women. This seems straightforward, but is not. Not all poor people can operate businesses successfully or pay back loans obtained. Offering credit may make some people worse off by obligating them to debt they cannot repay. For others, they may already have access to credit, but are drawn by better terms offered by subsidized microcredit programs. This wastes money by funding what would have been undertaken anyway. Still others may borrow without intent to repay, or even to use loans for business.

How can programs avoid adverse selection and moral hazard problems while still targeting loans to poor people?

- ***Economic Environment***. In many parts of the world, microcredit programs help participants faced not only with problems common to small business everywhere, but also additional worries--economic crisis, war, political instability or transition, and natural disasters. Can microcredit contribute to the positive resolution of these problems? Is microcredit a good safety net? Or, is program money wasted under these circumstances?

- ***Impact Assessment***. Because government, international donor organizations, and charitable foundations subsidize microcredit programs, holding them accountable has become mandatory. Funders want to know whether programs impacted poor participants, financial institutions and economies as expected. But impact can be measured in many ways, sometimes supportive, sometimes critical of microcredit; sometimes credibly, sometimes not. What is the impact of microcredit? What do different measurement strategies and options reveal about program impacts?

- ***Performance***. In an age of reinventing government, management wants to keep programs on course, while effectively responding to evolving markets and client needs. Yet, because they tend to operate on a shoestring, often with staff who may be inexperienced in finance, programs may run inefficiently and perhaps fail. Can microcredit programs become performance-based as have their private sector counterparts? Or, should they? How does performance relate to impact?

- ***Sustainability.*** Most observers believe that for microcredit to be successful, they must be self-sustaining, rather than heavily subsidized by government or donor organizations, at least until they mature. If not self-sustaining, they become just like any other social program. Should microcredit be sustainable?

- ***Social Intermediation.*** In addition to extending or brokering credit for poor people, microenterprise programs typically build capacity among poor people to eventually engage in entrepreneurial activity on their own, including obtaining credit--social intermediation. To varying degrees, this involves working on other

deficits in education, housing, nutrition, family planning and the like. Are sustainability and social intermediation incompatible goals? How can these goals be reconciled? Should they be?

These issues will be discussed in sections below. But first, analysis considers why credit for small business, especially for microcredit, is a problem and provides an overview of generic microcredit programs designed to address these issues.

Credit, Small Business, and Microlending

Across the globe, numerous factors conspire to reduce credit available for small business, especially microenterprise, including: (1) lender perceptions of and reality in lending to poor people, (2) characteristics of formal institutions extending credit, and (3) government interventions. In general, formal institutions perceive, often correctly, that extending microcredit may be a bad investment for these reasons.

- ***Profitability***--Returns on microloans are only marginally profitable or often loss making. Banks profit much more in making a few large loans than dozens of smaller ones. Banks are profit-making entities, often owned by shareholders, not charities. ACCION, for example, makes loans to hawkers and street vendors in Latin American countries. Were banks to make such loans, shareholders and other borrowers would be subsidizing them, something not viewed by bankers as their responsibility.

- ***Risk aversion***--Microenterprise borrowers are at much greater risk of not paying back loans. Their businesses are highly prone to failure, they have little collateral, and they are likely to use loans for other purposes. Banks do not like to take high risks, especially for low returns. In many cases, bank regulators would not allow microlending.

- ***Information opacity***--Microenterprise borrowers are difficult to evaluate in loan screening. They have no credit histories or have bad ones. They have little track record in business. Only borrowers know the likelihood that they will repay a loan, and there is little objective information available to banks to evaluate this prospect.

- ***Transaction costs***--Microenterprise borrowers pose high costs in screening and processing loan applications, servicing loans once made, and recovering capital under loan default. This substantially lowers profitability—if profits exist at all--from loans made under microcredit schemes.

Even though formal lenders may correctly assess the negatives of microcredit, they may further reduce credit available to borrowers for non-economic reasons, the former may require government intervention, the latter would not:

- ***Discrimination***--Depending on the country, borrowers often face bias in lending because of poverty status, race, ethnicity or gender. Prospective borrowers might be creditworthy, but are none the less denied credit even when profits are to be made. This is very unlikely when one considers the people to whom loans are made.

- ***Poor decision-making***--Bankers are not infallible in their lending decisions, quite the opposite, judging from the number of bank failures in America 10 years ago and Russia today. Some banks may simply miss investment opportunities presented by poor people.

Some characteristics of formal financial systems can reduce overall credit available to borrowers, and reduced capital tends to squeeze out small business lending generally, leaving little room for microcredit provided by formal institutions.

- ***Market structure***--Such factors as institutional size, organizational complexity, market share, and branch bank location affect lending capacity. Very large banks may have capital they can target to microcredit, smaller banks may not. Banks without branches in rural areas may not be able to reach many microenterprises even should they want to do so.

- ***Market concentration***--Lack of competition allows banks to lend to traditional borrowers, because they do not have to earn profits by competing in riskier markets. Increased competition in many countries, especially the United States, has forced banks into small business lending.

- ***Technology***--Most banks, in developed countries at least, use

software to screen loan applications, a technology that reduces transaction costs considerably and standardizes lending. Most programs penalize microcredit borrowers, because they cannot meet the thresholds necessary to be considered creditworthy.

Government intervention also may reduce capital available, either directly or indirectly, leaving microcredit squeezed even more, but none the less opening up opportunities for non-profits.

- ***Monetary and taxation policy***--National government monetary policy can channel large amounts of capital away from credit into other investment instruments. This is especially a problem in developing countries where exchange rates and interest rates are highly politicized. Taxes levied by government make some lending profitable, forcing banks into other investments. Importantly, poor monetary policies—especially inflation and instability—reduce savings among the poor and affect group-based microcredit programs adversely (see below).

- ***Regulation***--Government bank regulation greatly reduces capital available for lending to small business, because banking system stability is valued over more widespread access. Even if banks wanted to lend to microenterprises, regulators in many countries would not allow much of it.

- ***Political intervention***--Political interference in credit markets is rampant, especially in developing countries. Politicians direct funds into moribund state-owned firms, political cronies, or into the pockets of wealthy people, but rarely into the hands of poor people seeking credit. Poor people may need their own credit system.

Microcredit advocates have designed programs that reduce risk and increase profitability, while at the same time nullifying effects of private financial and government action as discussed below. Advocates see problems in credit markets as market niches for their services.

Microcredit Programs

Microcredit programs may be classified along at least six dimensions: (1) targeted toward poor people or *women* only; (2) *individual* or *group*-based; (3) *savings*- or *credit*-led; (4) *parallel* or *linked*; (5) *credit-only* or credit and other services; and (6) *government* or *non-governmental organization* (NGO) sponsored. Examples of every combination may be found in practice somewhere in the world.

Microcredit is targeted to poor or under-served people, but may be directed mostly toward women. In Uganda, for example, as presented by Barnes, Morris and Gaila in this symposium, the Foundation for Credit and Community Assistance (FOCCAS) and Foundation for International Community Assistance (FINCA) serve only women, while a comparable program, Promotion of Rural Initiatives and Development Enterprises (PRIDE), serves all. In Boston, the Center for Women and Enterprise, as reported on by Dumas in this symposium, helps only women to get started in business through its microenterprise training and technical assistance programs. The rationale for this is that women, especially in developing countries, traditionally have been excluded from commerce, and hence have greatly reduced life chances. Microcredit offers women opportunities for independence.

Microcredit programs work either with individual borrowers or with groups comprised of individual borrowers. ACCION, in the United States, with the exception of its New York program, makes loans to individuals in much the same way as a bank would (Himes and Servon, 1998). By contrast, Working Capital in Boston, as described by Snow in this symposium, lends to groups. A group of entrepreneurs contribute their savings to a central fund, then on a rotating basis, they have rights to borrow against it. In some cases, microcredit programs hold the group accountable for loan repayment should individuals default. Savings can be used as a kind of self insurance against default on repayment. In addition to leveraging capital and serving as a source of emergency funds (see section below on “economic environment”), groups often are required to meet regularly to monitor loan activity, collect repayment of interest and principle, and offer mutual support as in the case of programs in Uganda. This substantially lowers transaction costs, making microcredit programs viable (Zander, 1994). Savings requirements give groups a sense of ownership, commitment, and

responsibility, not likely with government grants that may seem more like handouts. Some analysts, the UN Capital Development Fund (UNCDF), argue that savings exposed to risk in lending are a necessary condition for successful group lending.

Critics suggest that group lending takes up too much of members' time, better devoted to other pursuits; obligates participants financially for the adverse behavior of others, potentially giving bad credit ratings for some because of the actions of a few; and can be coercive for some members over others. Exclusion from credit is a problem.

Some programs focus almost exclusively on credit provision, while others include varying degrees of social intermediation, defined as "…a process in which investments are made in the development of both human resources and institutional capital, with the aim of increasing the self-reliance of marginalized groups, preparing them to engage in formal financial intermediation." Or, "…social intermediation is financial intermediation with a capacity-building component, aimed at those sectors of society that lack access to credit and savings facilities (Edgcomb, 1998: p. vii)."

Microcredit programs either offer credit directly to poor people, replicating formal financial institution operations (referred to as parallel models), or broker deals between borrowers and private lenders (referred to as linkage models). In places where banks have no operations, microcredit programs tend to substitute for them, as in the case of sparsely populated rural areas, for example. In places where banks are operating, but do not lend to microentrepreneurs willingly, microcredit programs tend to link formal lenders and borrowers, say a branch bank and non-profit service provider. In some places, both programs co-exist.

NGOs typically operate microcredit programs, but government may provide them as well. Some are affiliated with international charities, like CARE, others set up by donors and government, like SEED Foundation in Budapest, Hungary (Szabo, 1997; OECD, 1996). In this symposium, Reese offers an overview of microenterprise programs operated by church groups in the United States. In some cases, private financial institutions offer microcredit directly. Wells Fargo Bank recently set aside a fund of millions of dollars to lend to small business

women who likely would not otherwise obtain credit. Dumas, in this symposium describes some of the major programs in the United States.

Microcredit programs differ in goals to be attained, usually expressed as one of three alternatives:

1) Create a credit delivery system (e.g., solidarity groups; ACCION International);

2) Create community-controlled financial institutions (e.g., village banks; FINCA/Honduras) or manage loan pools within them; or,

3) Support a broad-based social and economic entity. [e.g., Self Employed Women's Association (SEWA)] that promotes access to markets, information, technical know-how, and social support.

Snow's paper in this symposium explores the institutional aspects of microcredit.

There seems to be as many models for microcredit programs as there are programs in operation (see Otero and Rhyne, 1994, for detailed descriptions). Table 1 summarizes many of the possibilities for group-based microcredit programs.

Market Failure, Efficiency and Equity

Because microcredit programs are funded either by public monies that must compete with other programs and policies, and/or by donor funding that must be spent responsibly, programs must show that private credit markets have failed and that government or donor interventions are necessary to correct this failure. This is important to microcredit programs, because inability to demonstrate market failure puts them in competition with other social programs that may have more utility or appeal to policy-makers, or citizens for that matter.

Advocates for microcredit, having evaluated credit markets, conclude that the unwillingness of financial institutions to lend, market competition among lenders, government policies, political decision-making, and discrimination, especially against women, suggest that credit markets have failed and that intervention is necessary to correct this if poor people are to become independent (Hulme and Mosley, 1996; Barton, 1997; Besley, 1994).

Some critics of microcredit programs reject the notion of widespread market failure, usually along three dimensions: (1) They point out that the vast majority--three-fourths--of businesses, not only among poor people, but also among those better off, are started and operated with *informal capital*--entrepreneur savings, retained earnings, or loans from friends, relatives or acquaintances, not to mention pawn shops and even loan sharks. The informal market works quite well (Adams and Fitchett, 1992). Informal lenders know clients much better than either banks or microcredit programs. Because poor people are shut out from formal credit sources, one cannot conclude that the market has failed. In fact, informal sources of credit are often much more favorable to borrowers than formal sources (Adams, Graham and Von Pischke, 1984; Bolnick, 1992). (2) Further, they argue, in a competitive market, lenders have every incentive to extend credit to borrowers on whom they can profit. If one lender overlooks a market, another will step in. The fact that lenders do not lend has more to do with the lack of creditworthy ideas and unacceptably high risk, than with market failure. (3) Because no microcredit program has survived without subsidies, this alone demonstrates that credit was available, but borrowers rejected it at its fair market cost (see next section below). By definition, this is not market failure. The demand for cheap credit is infinite (ERS, 1997). (4) Those who reject market failure interpretations would agree that government intervention is often detrimental to credit markets. But they argue that because government failure created credit problems, there is no reason to assume that government can correct this by further intervention in the form of subsidized credit.

Some advocates continue to assert that government must intervene in private credit markets as another way to redistribute wealth to poor people, just as government taxes wealthier people to make transfer payments to the poor. From this perspective, credit seems to be more a right than an opportunity. This strategy is problematic in that it claims a right that many would not assert exists. And, it forces microcredit to compete with other social programs, sometimes unfavorably. Most advocates reject this line of reasoning.

A competing approach tries to reconcile these positions by offering a *growth through equity* rationale for intervention (Schwecke, 1995). This approach suggests that if poor people would likely receive welfare payments from government in any case, then why not give

those wanting it, credit instead of welfare. In the best case, poor people would become economically self-sufficient; in the worse case, society is no worse off, because they would have received welfare anyway. This approach, although appealing on its face, has been criticized for at least two reasons: (1) Amounts spent on a welfare transfer payments--say food stamps--are different in value to that amount spent on a loan to a poor person. Food stamps may represent considerably more value to a poor person than a loan. Therefore, monetary values are not equivalent. (2) The approach does not consider *opportunity costs*--benefits foregone in not pursuing other courses of action in favor of another. Providing health insurance, rather than a loan, may be a better investment (Rogaly, 1996; How Bankable Is Mircofinance, 1997). One can not simply assert that lending--costs and benefits--is equivalent to transfer payments; this must be demonstrated.

Reconciling these disparate positions is impossible without further study yet to be undertaken, but there seems to be a kernel of fact upon which all might agree. In developing countries, many microcredit programs require borrowers to open savings accounts or pledge their own capital as insurance against loan default. Even though microcredit programs are subsidized, some borrowers pay higher than market interest rates. Most borrowers must offer collateral in exchange for a loan. Business opportunities for which loans are sought are vetted either by peer groups of fellow borrowers or by technical assistance providers. And borrowers absorb a great deal of the transaction costs in lending. So, many microcredit programs are not other forms of transfer in disguise. Therefore, some might argue that removing barriers to credit for these worthy borrowers to enhance efficiency is a legitimate role of government, donors or charities.

Impact, Performance and Assessment

Even though microcredit programs have proliferated across the globe and many international donor organizations have funded evaluations of them, they remain enigmatic. There appears to be confusion or disagreement among researchers, practitioners and funders about what to evaluate and how to evaluate it. Of course, this is not peculiar to microcredit, economic development as a field suffers the same shortcoming (Bartik, 1994). To complicate matters, researchers are continually frustrated at the lack of performance data and poor bookkeeping in many programs (Gurgand, Pederson and

Yaron, 1994).

Accountability. Critics split on whether to treat accountability as a question of auditing institutional accounts or to link it with impact assessment. An auditing perspective limits assessments to whether microcredit programs expended funding according to regulations imposed by lenders, governments, or regulators. The problem with this approach is that when microcredit programs raise capital claiming that certain outcomes and impacts will be achieved, funders and policy-makers expect programs to achieve them. When they do not, they must be held accountable. By measuring accountability only in auditing terms, programs can expend funds according to the letter of the regulations imposed, while not having a positive impact. This is the equivalent of common problem in medicine where the operation is deemed a success, but the patient died. Many critics are suspicious of programs that want to limit accountability to compliance rather than impact. They probably should be.

Others view accountability as associated with outcomes and impacts. But, there is disagreement in the field about what to measure as evidenced below (see also Copestake, 1995).

Outcomes. Outcomes may apply to (1) performance of programs--e.g., Did the program become sustainable? Did it reach out to the appropriate target groups? Were acceptable rates of loan repayment achieved?; (2) benefits to clients--e.g., Did clients start viable businesses? Did clients social welfare improve? Did clients become customers, rather than clients?; and (3) economic impacts--e.g., Were unemployment rates reduced? Did poverty rates improve? Were more tax revenues generated? Some outcomes can be used to better manage programs, while others only measure effects. Some critics would like to see these three perspectives integrated so that each relates directly to the others (Hulme, 1997). Practitioners could find ways to improve program operations that in turn impact on clients and economies. And, impacts on clients and economic measures would improve performance. Some go further and suggest that evaluation generally can be used to empower clients of microcredit programs. A fairly intense survey of the literature failed to turn up any evaluations that achieved this synthesis.

Methods. Methodological issues abound in this field. Consider

these: (1) Evaluations of microcredit programs should ask two questions: What was the situation before microcredit intervened as compared to the situation now? (before/after) And, what was the situation with and without microcredit? Nearly all evaluations in the field focus on the before/after question. They try to quantify how clients' lives changed for better or worse by participating in the program. But this is more limiting than it seems. If clients' lives would have improved anyway, even without participating in microcredit programs, or if economies would have improved anyway without microcredit programs, then this evaluation framework cannot separate out the contribution of programs from other factors. Advocates could not reasonably claim that the impacts would not have occurred **but for** the program. In this symposium, I've selected two studies, Uganda and Mali, as representative of research that tries to be more rigorous in its impact assessement.

To address the but for question, evaluators must ask what happened with and without the program. Social scientists refer to this as establishing the **counterfactual**. Ideally, evaluators would select several locations that are comparable; then in some, microcredit programs would be established, and in others they would not. This creates treatment and control groups. Few evaluations in the literature take this approach (Sebstad and Chen, 1996; Gaile and Foster, 1996). Some justify not asking the counterfactual claiming that it is unfair to give credit to one group but not another for research purposes. Critics, nonetheless, are suspicious of evaluations that do not assess the counterfactual (Adams, Graham and Von Pischke, 1984). They ought to be.

(2) Evaluations often look at the costs and benefits of microcredit programs. Many evaluations published in the literature use bad economics in their assessments. Some common errors include (Buss and Yancer, 1999): confusing government and market failure, considering only “second-best” uses of funding, treating means as ends, excluding important alternative projects or policies, miscalculating multipliers, externalities, and willingness to pay, and including past expenditures to determine future benefits (sunk cost fallacy).

(3) An approach relatively unique to microcredit program evaluation is the use of the Household Economic Portfolio Model. This model treats the sources of revenue and expenditures of a household as a portfolio to

which a small business contributes. In short, it looks at where households acquire money and where they spend it to understand program impacts. Microcredit allows the poor household to take advantage of opportunities, that is, to assume risks it could not otherwise take, in order to obtain higher returns (Dunn, Kalaitzandonakes and Valdivia, 1996). The Uganda case study in this symposium illustrates this method.

Evaluators. Microcredit programs, with few exceptions, operate on a shoestring budget. As such they have limited resources to conduct evaluations that are scientifically sound and comprehensive enough. Often for good reason, program managers are loath to divert program monies into evaluations. They also tend to lack personnel with the skills necessary to carry out evaluations. (The Mali case study reports on the feasibility of a practitioner-led evaluation.) Even evaluations carried out by third parties on behalf of programs or funders fall well short of the mark because of funding and resource constraints. Some critics are suspicious that many evaluation studies are conducted by advocacy groups having an interest in program longevity. Unfortunately, the field on the whole seems to be forced to rely either on no evaluations or limited ones. Consequently, it is difficult for policy-makers to judge whether microcredit programs represent the best use of public or donor funds.

Sustainability and Outreach

Government subsidizes microcredit programs through a variety of mechanisms, direct and indirect: interest rate differences between the market rate and rates paid on concessional borrowed funds; foreign exchange losses on foreign currency-denominated loans assumed by the state rather than the program; obligatory deposits by other financial institutions or other public institutions in the program at below market interest rates; direct reimbursement by the state or donor of some or all operating costs incurred by the program; exemption from reserve requirements, forced investments and taxes; and direct financial or non-financial transfers. Microcredit programs may also be capitalized by through debt-for-development conversion. For example, NGOs purchase country debt at a discount in secondary markets, then sell it to a central bank in excess of local currency costs, with the excess used for microcredit programs.

Government, international donors and charitable organizations also underwrite microcredit programs through grants or low interest loans, grants being more appropriate for social intermediation programs, and loans for microcredit programs.

A major issue in microcredit is whether programs should have as their goal, *sustainability*, defined as: when return on equity, net of subsidies received, equals or exceeds the opportunity cost of a program's equity (Yaron, 1994; Von Pischke, Schneider and Zander, 1996). In lay terms, this means, after government subsidies are removed, did the capital invested in microenterprises yield a return on investment at least as high or higher than the capital would have earned were it invested in something else. Other analysts use a less rigorous definition, distinguishing between sustainability and *self-sufficiency*. Sustainability becomes: "…ability of the microcredit program to maintain its operations and continue to provide service to its customers or clients. A program is sustainable when a combination of external grants, loans, and internally generated revenues are sufficient to cover all program expenses over the long term" (OECD, 1996, p. 52). And self-sufficiency "…occurs when the microcredit program can cover all of its operating expenses (including loan losses and the cost of capital) entirely with internally-generated sources of income" (OECD, 1996, p. 52).

Research shows that no microcredit program has yet to achieve sustainability (OECD, 1996), as measured by the widely used *subsidy dependence index* (SDI), that quantifies the extent to which the lending interest rate would have to be raised to cover all operating costs if public subsidies received by a program were stripped away; 100% means interest rate would have to double to make up for subsidies. Some programs have come close to achieving sustainability—Grameen Bank and BRI Unit Desa System of Indonesia (Boomgard and Angell, 1990), for example, most others have a considerable way to go (OECD, 1996). Research further shows that no microcredit program can be sustainable at its inauguration. Programs near to achieving sustainability have only been able to do so by becoming more efficient, usually over a period of years. No program is self-sufficient.

Several issues revolve around sustainability and/or outreach. First, for programs offering credit only, should they be self-sufficient or sustainable to continue operations? Or, should they strive for

sustainability or self-sufficiency, but be allowed to continue, even when they do not attain it? Second, as credit only programs become more sustainable or self-sufficient, do they become too much like banks, and in the process give up the development goals for which they were originally established? Third, for social intermediation programs, with or without a credit component, should they be sustainable, if not self-sufficient?

Advocates argue that programs should strive for sustainability, but should not be abandoned if they fail to attain it. Their concern is this: microcredit programs, by definition, cannot be fully sustained because they require considerable capacity building among the poor, something not found when assessing the efficiency of formal lending institutions. As such, microcredit should be evaluated on the extent to which financial systems and their instruments reach the poor directly, increasing their participation in market processes and by this empowerment in political processes. In short, economic efficiency, or sustainability, must be balanced against *outreach*. Striving for sustainability makes programs more economically efficient than they would be were they not held accountable. Snow and Woller, Dunford and Woodworth independently analyze the sustainability issue in depth in this symposium.

Advocates also argue that as microcredit programs without social intermediation become more sustainable or self-sufficient, they become more like formal lenders, again abandoning the poor they were chartered to serve. In economics, this is referred to as the principal-agent problem in which government has one set of development goals, and programs have another set. The *caisses villageoises* in Mali provides a model to reduce this risk for policy-makers (see this symposium). As such, they should strive for self-sufficiency and sustainability, but should not be held to that standard. There are exceptions: PRODEM, an NGO in Bolivia spun off a commercial bank, BancoSol whose portfolio is entirely built on microloans (Gonzales-Vega, et al, 1996). Advocates further worry that as proponents of microcredit increasingly lobby for and obtain more funding, they will also loose the development goals they were chartered to attain (How Bankable Is Microfinance? 1997; Rogaly, 1996; Dichter, 1996).

Critics retort that failure to hold microcredit programs to the sustainable or self-sufficiency standard allows many weak

organizations to persist when they should be terminated. They point out that most of the 3,000 or so programs in operation are not well run, yet exist because they hide behind the cloak of having to provide credit and outreach. Critics fear that the rapid growth in size and in number of programs has empowered the microcredit movement to such an extent that it cannot be held accountable; it has become too powerful and tied to political interests, just as have previous development advocates. Consequently, microcredit will inevitably require more subsidies and bailouts just as the case with state-owned banks and enterprises. In Sri Lanka, government forgave loans to village-level financial institutions on a broad scale (Von Pischke, Schneider and Zander, 1996).

Advocates are divided on the issue of how to achieve outreach and sustainability (Von Pische, Schneider and Zander, 1996). Some believe that only when sustainability is achieved can outreach be effective. Others believe that outreach is necessary to achieve sustainability. This has major program ramifications. The issue has yet to be resolved.

Poverty Assessment

Much of the literature on microcredit focuses on poor people. This is somewhat misleading when the field is examined on the whole. Programs serving the poor are concentrated in Africa, Asia and South America, but programs in North America, Europe and former Soviet Bloc countries are not exclusively targeted to the poor, only the under-served. In this symposium, Buss analyzes small businesses developed during the initial stages of the transformation from communism to democratic capitalism in Russia, and reports that these entrepreneurs are not poor by any stretch.

Poverty assessment in the context of developing countries concerns screening of potential clients not only for eligibility for programs (do they earn below a certain threshold), but also for their likelihood of succeeding in a business and paying off a loan (Hatch and Frederick, 1998). Poverty assessment is also important in establishing baselines for evaluation research. This is difficult. Microcredit programs do not have a lot of resource to perform “due diligence” reviews of clients. And the more they perform, the higher the transaction costs and less sustainable programs become.

Program designers face a basic issue: have program staff evaluate clients or have client groups evaluate themselves. Neither has been effectively resolved (Hatch and Frederick, 1998).

Economic Environment

Because many microcredit programs, at least in developing countries, target poor people, assistance must be offered in areas where war, violence, and natural disaster are commonplace (Doyle, 1998). This raises several questions about microcredit: "How can microenterprise strategies help create or substitute for the social safety nets that are not there? How can they function preemptively to strengthen the ability of clients to survive emergencies when they hit? How can they help people suffering from the most serious disasters overcome them? (MBP, 1999)"

The problem faced by lending institutions located in countries in crisis is that their fortunes and those of borrowers are closely tied together, something not true in stable countries for the most part. For example, Russian entrepreneurs' fate hang on a strong economy, but so do the banks. Banks do not like to lend to borrowers who are likely to fail. Buss, in this symposium shows that banks do not lend to small business in Russia, for example, for this reason. In stable economies, banks lend to a portfolio of borrowers representing diverse sectors so that when bad loans occur, the entire investment portfolio is not wiped out.

Microcredit programs operating in unstable economies face the dilemma above to an even greater extreme, because all of their clients are likely affected by instability. Most advocates of microcredit do not endorse setting up credit programs in unstable areas, but some do. They argue that microcredit can channel capital into economies to aid recovery, stimulates savings that can be drawn down by entrepreneurs in emergencies, and provides stability by creating insurance schemes against loss. As noble as this approach seems, critics argue that the probability that funding will be wasted is quite high, and that traditional disaster aid programs should be the focus. This remains a new, and unresolved area for debate.

Program Success and Failure

The OECD recently reviewed the literature on microcredit programs and developed a list of factors that account for why programs succeed or fail (OECD, 1996). They found that successful programs included the following:

- Programs found a way to effectively balance their developmental goals—alleviation of poverty—against the need for sound financial management practice. Successful programs stray neither too much in one direction or the other.

- Programs had in place strategic plans to achieve permanence. Ad hoc decision-making is fatal in an already high-risk venture as microcredit.

- Programs strove for financial self-sufficiency and appropriate size. Expansion beyond program goals to alleviate poverty poses problems. Programs, in economic terms, sacrifice economies of scale and encounter diminishing marginal returns when they pursue excessive growth. Growth is always possible because there typically is an unlimited demand for cheap credit. Colombia's NGO Corposol, for example, failed because it tried to grow too rapidly, in the process losing economies of scale necessary to serve poor entrepreneurs (Steege, 1998).

- Programs attained high degrees of cost-effectiveness and sustainability. As observed above, those programs that honestly seek these goals are much more likely to succeed than are others who only mouth the words.

- Programs client-oriented (see Bennett and Goldberg, 1993). Managers are effectively able to evaluate costs, risk, valuation of opportunities, and likelihood of loan repayment (see also Von Pischke, Schneider and Zander, 1996). As a strategy, successful programs assess market demand, then supply it. Unsuccessful programs supply products, then try to induce demand (Schneider and Libercier, 1995; see also Brand, 1998).

- Programs streamlined screening, lending and monitoring costs. Reducing transaction cost are the life's blood of

microcredit. (Von Pischke, Schneider and Zander, 1996).

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