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Microenterprise Development in the United States: Current Challenges and New Directions

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U.S. microenterprise programs provide business training, small amounts of credit (\$35,000 or less), or both to businesses with five or fewer employees. As the microenterprise field nears the end of its second decade in the United States, experts and practitioners agree that the field is in a difficult place; there appears to be relatively widespread agreement on the nature of the problems, which include a lack of standardized data, decreasing funding from some key sectors, increased competition, and difficulty in reaching the target market. The author argues that if the microenterprise field does not make some significant changes, it will neither sustain itself nor approach its potential. Strategies to address these challenges fall into three broad categories: restructuring, innovation, and accreditation and standardization.

Keywords: *Microenterprise; community development; economic development*

The U.S. microenterprise field is at a crossroads. Nearly 20 years after its inception, the number of programs within the field has grown to more than 550. Initial goals of scale and sustainability remain elusive, however. Practitioners and field experts are currently examining whether these goals remain appropriate. The environment in which U.S. microenterprise programs now operate is markedly different from the one in which they were initiated (Association for Enterprise Opportunity [AEO], 2002; Moy & Okagaki, 2001). It is characterized by greater sophistication, professionalization, and infrastructure but also by a challenging funding environment and a lack of appropriate incentives for the field to move forward.

U.S. microenterprise programs provide business training, small amounts of credit (\$35,000 or less) or both to businesses with five or fewer employees. Field experts and practitioners agree that the microenterprise field is in a difficult place; there appears to be relatively widespread agreement on the nature of the problems, which include a lack of standardized data and performance standards, increased competition, and difficulty in reaching the target market (AEO, 2002; Bhatt & Tang, 2001). Some excellent ideas have been proposed to address these problems. At the same

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time, current conversations lack the kind of new ideas that could truly bring the field to the next level. A representative interviewee put the situation this way: “Most microenterprise organizations are busy struggling to find the next dollar rather than thinking smart.” The purpose of this article is to look beyond current ways of thinking to generate a set of innovative strategies for the U.S. microenterprise field.

I argue that if the microenterprise field does not make some significant changes—at both the program and field levels—it will neither sustain itself nor approach its potential. Changes to be considered include restructuring the field, encouraging innovation, creating a legitimate accreditation process, and adopting standards. Some programs have begun to take important steps in appropriate directions—merging with other organizations and diversifying their product lines, for example—but these programs are the exception rather than the rule. Other programs, including some of the field’s early leaders, are shrinking in the face of the challenges noted earlier.¹

METHOD

Research for this article included a wide-ranging literature review, not only in the area of microenterprise development but also in the areas of community development banking and finance. In addition, I conducted 35 interviews with the following categories of individuals: 13 practitioners, 5 funders, 5 people who work in or lead community development financial institutions’ (CDFIs) trade associations, 3 researchers, and 9 other field experts. Many of these people agreed to be interviewed only with the assurance that their comments would be kept confidential because they perceive their own views run counter to the direction the field is moving. I developed protocols for each category of interviewee. In selecting interviewees, I began with practitioners considered to be leaders in the field (e.g., board members of the AEO, the field trade association), long-time funders of the movement, and those who have conducted research on or advocated for U.S. microenterprise development or both. I then employed the snowball method, asking each of these interviewees for names of other practitioners and field experts. I conducted 24 interviews by telephone and 8 in person. Given the stature of the interviewees and the kind of information I sought, I conducted the interviews as guided conversations, using the interviewees’ responses to direct the flow of the interview (Rubin & Rubin, 2004). I analyzed the text of my interview notes to discern trends and to ensure that quotes used to illustrate points typified interviewees’ comments.

I also analyzed data from the Aspen Institute’s *2002 Directory of US Microenterprise Programs* (Walker & Blair, 2002), categorizing programs according to particular characteristics such as size, age, primary activities (lending or training), and geographic scope. I analyzed data from the CDFI’s data project (CDP) to (a) compare microenterprise programs from this data set to those found in the Aspen directory and (b) compare the CDP microenterprise programs with other categories of CDFIs.² Although I was unable to obtain MicroTest data³ to conduct my own analysis, I did review the data collection forms and used statistics from this data set that were available from other documents. Strengths and weaknesses of the data sets used will be provided further on, in the section on insufficient data.

CONTEXTUALIZING THE MICROENTERPRISE DEVELOPMENT FIELD

The U.S. microenterprise field was initiated in the mid-1980s and had several important influences including the growth and development of the international microenterprise field⁴ and the women’s economic development movement.⁵ For the most part, U.S. microenterprise development organizations (MDOs) were initiated as locally based responses to a need for better economic options, particularly for people who lacked access to mainstream financial institutions. As a result, a majority of programs have targeted what are often categorized as *disadvantaged groups* such as women, public assistance recipients, displaced workers, and people of color (Edgcomb, 2002).

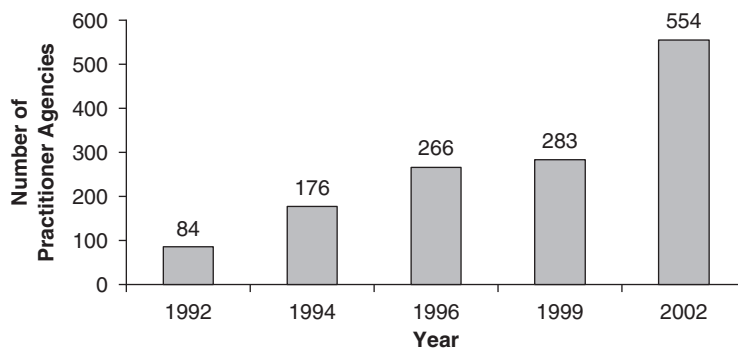


Figure 1: Number of Microenterprise Programs Providing Lending and Training to Entrepreneurs (Practitioner Agencies)

SOURCE: Directory of U.S. Microenterprise Programs (1992, 1994, 1996, 1999, 2002)

NOTE: The figure for 2002 includes all nonprofit microenterprise programs and is not strictly comparable to previous years.

The result of this type of development was that programs resembled each other in terms of their missions, services, and products but were also able to meet the needs of their particular constituencies and to respond to their specific contexts. Although this customization has clear advantages, such as the use of local knowledge and relationships to make character loans, it also has disadvantages that have made it challenging for programs to sustain themselves. Furthermore, given that the U.S. microenterprise movement followed the developing world micro movement, the former has been held to standards that were inappropriate given the great differences between the two contexts (Servon, 1999).

Broadly defined, the target market for microenterprise development products and services includes low- and moderate-income people who have difficulty accessing traditional sources of capital and technical assistance. MDOs were created, in large part, because no one else was serving this market. Now, there is both a broader range of community development financial entities and a range of other entities that have stepped in to begin to fill the void. Mainstream financial institutions have begun to move further downstream to market their services as advances in technology have decreased transaction costs and as they recognize the market that exists in these communities. Fringe financial services such as check cashing operations, payday lenders, and rent-to-own operations have grown tremendously in recent years, making huge profits from these groups. And new, socially responsible financial institutions are beginning to develop products that serve these communities without losing money.

The Aspen Institute's *2002 Directory of U.S. Microenterprise Programs* (Walker & Blair, 2002) includes 554 programs that provide lending, training, or both to entrepreneurs. This number is up from 84 programs in 1992, the 1st year that the directory was produced.⁶ Using these figures, the field has grown at an average annual growth rate of 56%. Figure 1 illustrates the trajectory of this growth.⁷

Since the first MDOs were created in the mid-1980s, the field has witnessed several developments that signal its increasing professionalization, including the emergence and growth of the AEO, the trade association for the field, and the creation of state microenterprise associations (SMAs) and state microenterprise intermediaries (SMIs).⁸ Other organizations, such as the Aspen Institute's Economic Opportunities Program and CFED⁹ have carried out several of the most important initiatives in the field.¹⁰

Despite these indicators of maturity, the microenterprise field remains fragmented and inefficient. A report issued by AEO (2002) puts the situation in perspective: "If the microenterprise development industry was a single business, then it could be characterized as having low market

penetration, high costs, increasing competition, inadequate expenditures in R&D and technology, and promising but insufficient returns on investment” (p. 10). Many nonprofits suffer from similar problems (Bradley, Jansen, & Silverman, 2003). However, MDOs are in the business of delivering financial services and training. As such, they face increased competition from other entities that are accessing programs’ target markets, such as banks and fringe financial services providers and pressure from funders to become more efficient. As these entities have rapidly expanded their market penetration, microenterprise development programs continue to experience difficulty reaching the markets they intend to serve.¹¹ The AEO report (2002) states that “while we embrace competition, it is clear that many of these competitors do not embrace the goal of creating economic and financial security for those at the margins” (p. 8). Edgcomb and Klein (2005) estimate the size of the market for the targeted services provided by microenterprise programs at about 10 million individuals.¹² If these estimates even approach accuracy, the microenterprise field has fallen far short of reaching its target market; analysis of the data from the most recent directory indicates that programs served 51,908 clients and 166,922 participants in 2000 (Walker & Blair, 2002).¹³

Part of the problem is that MDOs are neither pure financial services providers nor are they pure social services entities (Servon, 1997; Sherraden, Sanders, & Sherraden, 2004). Rather, individual programs sit at various places along a spectrum anchored at each end by different definitions of success and different models. Even if a program is clear about its mission, it may sell itself to a funder as being more of an economic development entity or more of a social services entity, depending on the funder’s agenda. Economic development and poverty alleviation have very different objectives. Those who are interested in economic development tend to look at outcomes such as job creation, tax base enhancement, and business growth (in terms of revenues and employees, for example).¹⁴ Those who concern themselves with poverty alleviation, on the other hand, are more interested in changes in individual and household income, the acquisition of particular skills (education and soft skills), and issues such as health insurance.¹⁵ The microenterprise field has historically sold itself as both and, indeed, many programs sit in the middle of that spectrum (Servon, 1997). Although a very small minority of programs does both things well, attempting to pursue both objectives can lead to mission confusion. This lack of a clear identity for the field as a whole has made it difficult to arrive at definitions of success, standards, and performance measures that can be embraced across the field.

CURRENT CHALLENGES

The U.S. microenterprise field faces several key challenges as it continues to evolve and achieve its potential. These challenges include fragmentation, insufficient data, lack of accreditation and regulation, narrow product lines, and inconsistent or unreliable funding streams.

The U.S. microenterprise field faces several key challenges as it continues to evolve and achieve its potential. These challenges include fragmentation, insufficient data, lack of accreditation and regulation, narrow product lines, and inconsistent or unreliable funding streams. Individual organizations, as well as the field as a whole, will need to confront these challenges head-on to remain viable.

Fragmentation

Although the creation and growth of AEO and the emergence of SMIs and SMAs have added greatly to the coordination of microenterprise programs, the field remains fragmented, consisting primarily of many small programs that have insufficient capacity to do all of what they try to do well. As one typical interviewee said, “In addition to the fact that microenterprise organizations are too small, there are too many of them and too many that are redundant.” Of the 554 MDOs listed in the *2002 Directory of U.S. Microenterprise Programs* (Walker & Blair, 2002), 191 engage in lending. Of these 191 MDOs, 167 program representatives responded to questions regarding the magnitude of their lending programs. Of these 167 respondents, 13 programs loaned more than half of all loan dollars in 2000.¹⁶ Of the 191 programs that do lending, 98 had fewer than 25 borrowers in 2000.¹⁷ Making loans requires a fair amount of capacity. It makes

TABLE 1
Select Characteristics of Microenterprise Development
Organizations by Program Type

	<i>Programs That Provide Only Training</i>	<i>Minimal Lenders (Value of Loans Disbursed in 2000 < \$100,000)</i>	<i>Larger Lenders (Value of Loans Disbursed in 2000 > \$100,000)</i>	<i>13 Largest Lenders</i>
Number of programs	100	86	81	13
Median number of clients served	60	62	108	332
Median loan fund		\$100,000	\$518,560	\$1,765,000 ^a
Median value of loans disbursed		\$30,000	\$293,932	\$1,200,000
Median number of loans disbursed		6	25	165
Percentage of programs providing technical assistance or training	100	97	91	77

SOURCE: Walker & Blair (2002).

NOTE: All values are for 2000.

a. $n = 11$.

little sense for programs to build this capacity in-house when they are making only six loans. For the purposes of sustainability strategies, it may make more sense to think of the field in terms of two components: those that are primarily lenders and those that are primarily trainers and that may or may not engage in some lending. It is certainly easier for those programs that specialize in lending to approach sustainability than it is for those that specialize in training. Table 1 illustrates some key characteristics of microenterprise programs based on these divisions.

The flip side of the intense customization provided by U.S. microenterprise programs is the inefficiency and high unit cost that come from widespread duplication of services. Most of these programs have developed their own curricula, their own systems for tracking data, and their own loan documentation. This vertical integration, although perhaps necessary during the initial phase of the microenterprise movement, is no longer functional.¹⁸ In some cases, it can cost up to \$4 for a program to lend \$1 (Edgcomb & Klein, 2005). The field is now characterized by inefficiency that makes it difficult to pursue the goal of sustainability. This fragmentation and lack of standardization have resulted in enormous duplication of effort and an inability for the field to benefit from potential economies of scale.

Although large areas of the country are not served by MDOs, some cities—Philadelphia and San Francisco, for example—house two or more programs, vying for the same funding dollars and the same clientele. The extent to which programs cover their costs ranges widely, even among the relatively high-capacity programs on which we have data. Table 2 illustrates these differences by comparing the self-sufficiency ratios (the ratio of earned revenue to operating expenses) of MDOs with the self-sufficiency ratios of other CDFIs. Although MDO loan funds are competitive with other community development venture capital funds and other loan funds, they compare less favorably with banks and credit unions, which serve broader clienteles and have a greater diversity of products. If we had data on the self-sufficiency ratios of a much broader range of MDOs, including those that do no lending, the MDO self-sufficiency ratios would likely be much lower. MicroTest data, which represents a greater number of programs, provides an additional argument for focusing on scale in programs that lend. According to these data, credit programs with 50 or more microloans outstanding had an operational cost rate of \$0.40; credit programs with fewer than 50 outstanding microloans had an operational cost rate of \$0.90, and those programs with fewer than 20 microloans outstanding had an operational cost rate of \$4.83 (see <http://fieldus.org/li/pdf/workingpaper2.pdf>).

TABLE 2
**Self-Sufficiency Ratios by Category of Community Development
 Financial Institution (CDFI)**

<i>Category of CDFI</i>	<i>Self-Sufficiency Ratios (%)</i>		
	<i>Average</i>	<i>Median</i>	<i>Count</i>
Microenterprise development organization loan funds	58.44	50.00	109
Loan funds	59.85	56.11	71
Credit unions	108.00	106.96	173
Banks	105.04	92.87	16
Venture capital funds	48.88	45.50	15

SOURCE: CDFI Data Project (2002).

NOTE: A microenterprise development organization is defined as an organization that provided direct financing to a microenterprise.

Insufficient Data

Standardized data are particularly important in a field as small and fragmented as the U.S. microenterprise field because aggregate data are needed to assess the costs and benefits of the intervention, to access capital, and to convince funders and policy makers of their worth. The microenterprise field has made important progress in terms of data collection in recent years, but it is still a long way from where it needs to be. MicroTest, an initiative of the Aspen Institute's Fund for Innovation, Evaluation, Learning and Dissemination, is a management tool designed to gauge and improve the performance of individual programs and the outcomes of their clients. The MicroTest framework has been developed through a collaborative effort with industry practitioners since 1997.

The MicroTest Web site documents that 77 programs currently participate in MicroTest (see <http://fieldus.org/li/microtest> for more information). Although MicroTest collects performance and outcomes data on an annual basis,¹⁹ it is important to recognize that not all of these programs participate in the performance or outcomes process each year. Performance data consist primarily of the type of information a program collects on its client intake forms, such as total number of clients, income status, race or ethnicity, and gender data. Outcomes data require tracking clients over time, which is clearly much more difficult and requires greater resources on the part of participating programs. Outcomes data collected by MicroTest include whether the client is in business, business sales, and household income.²⁰

Although getting 77 programs to participate in MicroTest is an impressive accomplishment, this number represents only 14% of the 554 practitioner agencies listed in the *2002 Directory of U.S. Microenterprise Programs* (Walker & Blair, 2002). Of these 554, 61 programs (11%) contributed performance data in the last round of data collection in the spring of 2003, and only 17 (3%) programs contributed outcomes data (Joyce Klein, personal communication, October 28, 2004, and November 3, 2005).²¹ None of these groups is a random sample, and it is unlikely that they are representative of the broader field. In the first MicroTest report (Black, Thetford, Edgcomb, & Klein, 2002) issued by the Aspen Institute, the authors noted that

MicroTest manifests the experience and energies of some of the *more experienced practitioners* in the United States. . . . Because it has attracted programs committed to measuring their performance and striving to improve it, MicroTest contains a number of the *field's leaders* in scale, portfolio quality and training effectiveness. (p. 9; emphasis added)

Comparing the programs that submitted performance data in the last round of MicroTest data collection with the larger field shows that those that submitted data are indeed higher capacity

TABLE 3
Comparison of Directory and MicroTest Data: Key Characteristics

	Directory Data			MicroTest Sample		
	Average	Median	Count	Average	Median	Count
Age of program	8.37	7	338	9.49	8	47
Loan capital fund	\$674,211	\$259,450	175	\$981,595	\$300,000	35
Number of loans (to date)	213	52	184	427	105	36
Number of loans (2000)	43	13	178	109	20	37
Participants (2000)	572	151	292	375	203	46
Participants (to date)	4,740	610	266	3,497	897	38
Clients (2000)	183	72	284	201	169	45
Clients (to date)	1,478	264	264	1,173	519	41

SOURCE: Walker & Blair (2002).

programs than the average.²² As Table 3 illustrates, the MicroTest programs were older, had a larger loan capital fund, made more loans, and had more participants and clients than did the average program. We must be careful, then, not to generalize from these data to the entire field.²³

When asked why more programs do not participate in MicroTest, field experts and practitioners told us that nonparticipating programs found it to be too costly, both in terms of financial and human resources. Only a minority of organizations in any group report to MicroTest, and the reporting organizations are self-selected.

The other major data collection effort in the community development finance field is the CDP. CDP brings together several of the key trade associations representing the different categories of CDFIs, an important accomplishment.²⁴ The National Community Capital Association (NCCA) estimates that approximately 1,000 CDFIs currently operate in the United States; CDP presents data on 442 of these organizations.

Despite the tremendous advances that these two data collection efforts represent, data in the community development finance field are woefully insufficient. Given the lack of representativeness, the data available have the potential to oversell the field. Finally, data were not collected with a mind to what might be needed to create relationships with mainstream financial institutions and other investors (Moy & Okagaki, 2001).

Lack of Accreditation

The issue of accreditation also addresses standardization. Lack of accreditation, regulation, or both make the microenterprise development field opaque and less likely to attract funding and investment. Funders and investors cannot be sure what they are getting when they choose to put their money into a microenterprise development program. There has been some movement in the microenterprise field toward accreditation. AEO recently initiated its national Microenterprise Standards and Accreditation Project, which “proposes *minimally acceptable* numerical performance standards drawing on data available from the MicroTest project” (AEO, n.d. emphasis in the original). The goals of the Microenterprise Standards and Accreditation Project are to

- ensure that entrepreneurs across the United States have access to, and information regarding, high quality microenterprise development services;
- increase the capacity of microenterprise development service providers to provide quality services through a coherent framework for the provision of these services, as well as recognition for those that meet quality standards;
- provide funders at the local, regional, and national level an effective mechanism to identify effective microenterprise development service providers. (AEO, n.d.)

AEO has proposed two broad sets of standards: numerical and behavioral.²⁵ Adopting a strict set of standards would potentially motivate a necessary winnowing of the field and provide funders with greater confidence that remaining programs were worthy of investment.

Narrow Product Lines

Despite the need for a wide range of financial services in the communities and among the groups that MDOs target, program product lines tend to be very narrow. According to the AEO (2002), "Many microenterprise programs do not substantively research clients' or potential clients' needs or diversify products to attract and retain customers" (p. 9). On the training side, programs tend to offer one curriculum to serve clients ranging from those who have only an idea for a business to those who have been in business for several years. Most programs offer few, if any, products geared to helping people stay in business once they graduate from programs.

On the lending side, product lines are similarly narrow and fail to address the diverse nature of credit needs (Wright, n.d.). Evidence of demand for financial services comes from the tremendous growth of fringe financial services, such as check cashing companies, payday lenders, and rent-to-own operations (Carr & Kolluri, 2001; Carr & Schuetz, 2001). Mainstream lenders are also beginning to tap into these markets as technological advances and credit scoring enable them to serve this market more cheaply. The very small business loans that MDOs tend to provide have relatively high costs and serve a very small niche, leaving clients to go elsewhere to fulfill their other financial needs. Certainly, a niche market is not a problem if the product line can sustain the organization; in the case of MDOs, it cannot.

Inconsistent or Unreliable Funding Streams

The vast majority of U.S. MDOs are heavily dependent on subsidies from government and philanthropic institutions. Public funding from some key sources, such as the Program for Investment in Microentrepreneurs has declined in recent years, and some philanthropic funding agencies that historically funded microenterprise programs, such as the Ford Foundation, are eliminating these programs. On the positive side, SMAs and SMIs are helping to increase the funding pool for programs in the states in which they exist, while also boosting the legitimacy and visibility of programs locally and at the state level. At least three states have actual appropriations from their general funds that are targeted to include microenterprise development: Nebraska, North Carolina, and Colorado (Eugene Severens and Michelle Levy-Benitez, personal communication, November 8, 2004). Yet the fact remains that few programs have devised ways to cover their costs of doing business in a significant way.

Ways Forward

How should the microenterprise field confront these challenges? The recommendations are made with three criteria derived from the interviews and literature review. First, they focus on creating new and leveraging existing infrastructure, both within and outside the field. Some programs have developed efficient systems for tracking clients, documenting loans, and similar activities. Other programs could purchase either products or the ability to use these systems, thereby reducing the inefficient duplication of effort that currently exists. Infrastructure that could benefit the field also exists at mainstream financial and fringe financial institutions. One interviewee summarized the words of many when he said, "The field has to look around for existing infrastructure to keep going." Second, the recommendations are framed with the goal of creating an appropriate incentive environment for programs. Currently, many programs have little incentive to merge, to become accredited, or to invest in data collection. The actors that have power over programs in the field—namely trade associations, intermediaries, and funders—have a potentially large role to play in creating the right incentive environment. "Forcing programs

to work together is something intermediaries can do,” asserted one experienced interviewee. Third, these recommendations aim to move the field from a social services mentality to a business mentality. This does not mean that programs should or must abandon their roots in social services or their goals related to social services. Rather, this criterion is based on the belief that if programs individually and the field as a whole do not seek out and employ sustainable business models, programs will be unable to achieve their social services goals because they will no longer be in business. Several interviewees talked about the importance of a new business model.²⁶ The executive director of Colorado-based MicroBusiness Development Corporation (MBDC) credited her ability to effect successful mergers to her business background (Kersten Hostetter, personal communication, October 2004). Commenting on the reticence of those in the field to make this shift, another explained, “There is an assumption in the community development finance field that the tools of capital are bad in and of themselves” (Charles Tansey, personal communication, September 16, 2004). Looking at programs through a business development lens means thinking in terms of concepts such as *revenue streams*, *customer satisfaction*, *efficiency*, and *innovation*. As Berenbach and Guzman (as cited in Wright, n.d) put it, “Market responsiveness is another element of success. Programs that want to attract and maintain a large client base must adopt a package of services and a means for service delivery that satisfy client preferences.”

Restructure the field. The following suggestions for restructuring the field follow trends in the for-profit sector, shifting from vertical integration to a more horizontal industry structure and pursuing greater economies of scale.

Mergers and partnerships. Mergers between organizations conducting similar or complementary activities make a great deal of sense in the current environment. Mergers allow for greater efficiency (e.g., one executive director, not two) and greater reach. In addition, where two or more organizations are operating in the same market, competition for resources is reduced. Programs currently have more disincentives than incentives to merge. Directors of programs do not want to lose their jobs. In some cases, these directors were the founders of their organizations; they may fear that their vision will be lost if they merge.

In Colorado, the MBDC has undergone two mergers in recent years and is considering a third. In one instance, the organization with which MBDC merged had just been turned down for a key grant and was on the brink of closing down its operations. According to MBDC’s executive director, the mergers did several things for her organization. First, they enabled MBDC to offer a much wider range of services and products—loans up to \$60,000 and peer lending, for example. Second, they lessened competition for funding. And third, the mergers allowed the organization to work more innovatively, attracting a broader client base. By way of illustration, the executive director said, “If all we were doing was serving the refugee population or the disabled, we’d be dead. But they are very valuable groups within the context of the organization. We can serve them better because we are a bigger organization” (personal communication, October 2004). MBDC’s size and product range also enable the organization to provide funders and policy makers with concrete evidence of impact, something many smaller providers cannot do. ACCION USA also recently merged with Cambridge, Massachusetts-based Working Capital, expanding its presence in Massachusetts.

In the South Bronx, Bethex Federal Credit Union,²⁷ partners with RiteCheck, a local, family run check-cashing operation. Doing so has allowed Bethex to provide a service that members clearly demand. In addition, Bethex members can use RiteCheck’s existing infrastructure, which currently includes eight locations. RiteCheck provides its services to Bethex at a discount, and Bethex guarantees the transactions. The check casher benefits from the increased business generated through the partnership. Existing RiteCheck customers learn about the benefits of belonging to a credit union. According to Bethex’s executive director, at least 100 new members have joined Bethex as a result of this partnership, and RiteCheck has also referred several small business borrowers to Bethex (Joy Cousminer, personal communication, October 10, 2004). Other

... these recommendations aim to move the field from a social services mentality to a business mentality.

innovative partnerships include the Woodstock Institute's initiation of partnerships between mainstream credit unions and other community-based organizations. These partnerships are unique because these two groups have historically not worked together before.²⁸

Other organizations are forming regional networks of partners, particularly in more rural areas. In northeastern Minnesota, the Northeastern Entrepreneur Fund is part of a 24-organization group that spans seven counties and is working to create a local system to grow entrepreneurs. In Appalachia, the Appalachian Center for Economic Networks works both with other nonprofit organizations and private businesses, playing a liaison role for its clients. According to Appalachian Center for Economic Networks' executive director, "We do virtually nothing as a single organization" (June Holley, personal communication, September 10, 2004).

Programs for which it does not make sense to merge or expand can enter into mutually beneficial partnerships with other organizations that provide complementary services.

*Separate training from lending.*²⁹ As was discussed earlier, the many programs that are essentially training programs with a small amount of lending should stop lending. Rather, they can originate loans and provide the necessary follow-up and technical assistance throughout the life of the loan but outsource expensive lending operations. In essence, the core of this idea is to divorce any part of the transaction that is not about the relationship between borrower and lender from the MDO. There are a few different ways that this type of restructuring can happen: (a) through the use of regional lenders, either CDFIs or mainstream financial institutions or (b) through providers of back office services.

Regional lenders could be established to handle all of the loans for the MDOs in a particular region. The MDOs themselves could provide training, technical assistance, and loan origination. They would pay the lender, who would handle all of the technical aspects of processing the loan. This is essentially the situation that is beginning to evolve in Atlanta, where the Atlanta Loan Fund has handled the loans of two local women's business development programs. More recently, Atlanta Loan Fund has entered into a more formal arrangement with two other programs that want to provide access to capital to their clients but do not want to handle the details themselves. These arrangements are too new to have exhibited the kind of results necessary to judge the workability of this option.

Separating training from lending would allow organizations to specialize in what they do best. An AEO staff member also sees the importance of training-led organizations expanding their services—eliminating lending would give them greater latitude to do this.³⁰ MDOs could be doing much more to support businesses after participants graduate from formal classes, supporting them with more individualized technical assistance, for example (Jason Friedman, personal communication, September 10, 2004 and January 18, 2005).³¹ Several interviewees discussed their belief that microentrepreneurs can and should pay for these services. Specializing in training would also allow these organizations to serve larger and more stable businesses, thereby helping to achieve the economic development goals of the MDO strategy.³²

Another way to essentially separate training from lending is for programs to continue to offer access to financing but to outsource the nonrelationship-oriented aspects of the transaction by purchasing services from a back office provider. MBDC currently provides back office services to six other organizations in the state and collects data from them using the MicroTest system. Another initiative has been launched to gauge the demand for such services among the members of AEO and the NCCA, the two primary trade associations in the field. Although analysis of the survey conducted has not been completed, early results show high demand for such services (Mary Mathews, personal communication, September 24, 2004; Kathy Keeley, personal communication, October 26, 2004).

On the more radical side, several interviewees questioned the costs versus the benefits of training, arguing that much less emphasis and investment should be used for training. Some researchers claim that there is little evidence that training generates sufficient return to warrant the magnitude of investment it requires (Bhatt & Tang, 2001; Ehlers & Main, 1998). It seems

more likely that training dollars are currently not sufficiently targeted to those who will benefit from them. As one interviewee put it, training dollars should be invested in “the 20 to 25% of a the program’s portfolio that consists of businesses with real growth potential” and “the 15% of the program’s portfolio that is in trouble at any given time; half of this 15% could probably get out of trouble with some help.” Some programs, such as ACCION USA and Count Me In, have been able to generate significant loan volume while providing minimal training in the case of ACCION USA and no training in the case of Count Me In. Count Me In borrowers receive no training and never meet program staff; the loss rate is 10%, which is in line with the rest of the field. At the very least, this line of argument would favor much more intensive screening processes on the part of programs. At this point in the movement’s history, the field should be able to determine who is most likely to get through the program. Sherraden et al. (2004) recommend that those who do not have the capacity to make it in business should be referred to another service rather than using valuable training dollars. Scarce training dollars must be spent much more wisely.

When asked why the field continues to support training so vigorously, one typical interviewee replied that the perceived need for training was one of the sacred myths in the microenterprise development field. Given the significant investment in training on the part of the field in general and programs in particular, it will be important to demonstrate the value-added of this investment to warrant its continuation. Many, myself included, have argued that U.S. MDOs produce many positive outcomes that do not include starting businesses; these include self-esteem, time management, household budgeting, and access to better jobs (Servon, 1999).³³ The field is in a different place now, however, and needs to take a hard look at the extent to which it should invest more in business-related outcomes or in helping people to function better in their lives. Although I have argued earlier that the tension between economic development and social welfare should not be set up as a false dichotomy, it remains important for the field to recognize that limited funds translate into tradeoffs that must be made. Making these tradeoffs wisely requires developing more specific criteria for what it means to succeed, both as a program and as a client.

Innovate

Many of the examples cited earlier are, in effect, important innovations for the field. In this section, I discuss innovation in a more conventional sense—especially innovation of new products and systems. Nonprofit organizations in general tend not to prioritize innovation in the way that for-profit firms do. Yet, given that customer bases shift and needs change, it is important that nonprofits think hard about innovation, particularly given the generally tight funding environment in which they operate.

Expansion of product lines. To both approach sustainability and do a better job of serving their target markets, U.S. microenterprise programs must continually experiment with, test, and introduce new products. Ratliff et al. (2003) present case studies from both the private for-profit and nonprofit sectors to illustrate the stages through which an idea or set of institutions must move to achieve scale. Moving through these stages takes considerable time and is more likely to happen in organizations that have capacity to devote sufficient research and development dollars, staff time, and expertise to the process. According to Wright (n.d), “The design of new products should reflect as closely as is feasible the needs expressed by the clients and the opportunities offered by the market while still ensuring that they also meet the [MDO’s] organizational and financial requirements.”³⁴

Some organizations have begun to experiment with new products. For example, ACCION USA is currently piloting a credit builder loan that is available to anyone who lacks a credit rating. Bethex has created its own version of a payday loan, called Cash in a Flash. Some MDOs are experimenting with equity investments in client businesses. Cascadia Revolving Loan Fund, for example, has a quasi-equity fund, and the Montana Community Development Corporation

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(CDC) has a patient capital fund. Other programs have begun to offer savings vehicles such as individual development accounts. Individual development accounts encourage savings by matching participant savings; generally, accounts must be used for one of three purposes: home ownership, education, or business. The business option clearly works well with the micro programs' missions.

Employment of technology. In business, innovative deployment of technology is often the key to greater efficiency and systemic innovation. In the financial services industry, one of the greatest innovations involving technology in recent years is credit scoring.³⁵ Credit scoring, which is generally automated, lets a financial institution know almost immediately whether a potential borrower fits the institution's risk profile. Charles Tansey of Neighbor Works has proposed an idea that builds on mainstream financial institutions' current use of credit scoring. In Tansey's automated sourcing scheme, mainstream financial institutions would identify loan requests that do not meet their own risk requirements but do fall into the range deemed acceptable by MDOs. The banks would refer these clients to MDOs, potentially increasing the deal flow to MDOs substantially. Count Me In, the nation's first online microlender, employs a unique credit scoring system to make loans of \$500 to \$10,000 available to women across the United States. Many in the community development finance field cringe at the thought of using credit scoring. Count Me In's chief credit officer explains, "Credit scoring is so often seen as evil, when really it's just a tool that can be used well or poorly" (personal communication, September 2004). ACCION USA is also working on a rapid decision matrix that will enable lending via the internet.

Both Count Me In and Circle Lending are experimenting with the automation of some training aspects of microenterprise development by moving materials online. MicroMentor, an online mentoring system that matches microentrepreneurs with mentors, is also attempting to use technology to extend the technical assistance and support available to microentrepreneurs. In all three of these cases, it remains to be seen whether online support and materials are effective for the populations U.S. MDOs tend to target.

Standardize and Accredit

To begin to approach sustainability, the U.S. microenterprise development field must develop specific standards and adopt an accreditation strategy. Without pushing ahead on these issues, the field will neither have the ability to demonstrate results nor establish the legitimacy it requires to secure more consistent streams of funding and create the kind of innovative partnerships that will move the field forward. The nonprofit field in general has, in recent years, increasingly developed and implemented performance standards—initiated by both organizations and industries.³⁶ Admittedly, standardization and accreditation are difficult in a field in which there is such a wide variety of organizations operating under the microenterprise umbrella. It is likely that more than one set of standards and more than one set of accreditation criteria will have to be crafted to be fair to the field.

Standardization. It will be impossible to achieve scale without greater standardization than currently characterizes the field (Bhatt & Tang, 2001; Ratliff et al., 2003). The first area in which movement toward standardization should be made is data collection. As discussed earlier, the MicroTest initiative and CDP represent important steps in this direction. However, participation in these efforts is currently much too low. As one interviewee put it, "Until we get a majority of organizations counting beans the same way, we can't have scale." Rather than making it easier for programs to participate in these efforts by lowering the bar, funders, intermediaries, and the trade associations must become involved. For example, trade associations could deny accreditation to programs that do not collect data in one of these formats. Funders could make funding contingent on data collection. These kinds of strong messages alone will create the kind of incentive environment for programs to devote the resources necessary to take the important step of collecting reliable data.

Standardization in other areas could potentially also assist the field. Such standardization could occur in the areas of loan documentation, screening procedures, aspects of curriculum, and pretesting and posttesting of areas in which the field claims to effect positive change, such as self-esteem. Moy and Okagaki (2001) concisely lay out the tradeoffs involved between standardization and customization:

The problem with standardization for CDFIs is that it flies in the face of customization and, more broadly, the CDFI model of autonomous, self-contained, vertically integrated, institutions. This industry structure, combined with the value most CDFIs place on their “localness”, mitigates against standardization or outsourcing specialized functions. One could argue that CDFIs have overemphasized customization, as it does not always lead to greater added value. (p. 19)

Although it may not be possible to have universal standards in all of these areas given the important differences among programs, there are certainly broad categories of programs for which standardized approaches in some of these areas would be appropriate.

Accreditation. The argument for accreditation is that the U.S. microenterprise development field has now matured to a point that we have a solid sense of what reasonable performance standards look like. In addition, endorsing an accreditation framework is one step that could move the field to industry status. Writing more generally about the CDFI industry of which microlending organizations are a part, Moy and Okagaki (2001) argue that the field should continue to “professionalize itself as an industry with the mainstream financial services industry as a model . . . copy[ing] specific tools and techniques from the mainstream capital markets to access larger amounts of capital” (p. 16). AEO’s current plan is for members to vote on its proposed standards and accreditation strategy. If adopted, a third party would be engaged to ensure compliance with the standards and grant the accreditation. One interviewee who thought the trade association should take a stronger stand, expressed concern that the standards and accreditation were “getting watered down by the membership.” AEO must be careful not to compromise standards so much that they do not hold up to outside scrutiny.

CONCLUSIONS

In all of the examples cited earlier, programs have innovated in ways that make good business sense and allow them to better fulfill their missions. Additionally, many of the innovations discussed earlier challenge assumptions in the field, such as the need for training and the belief that check cashing operations are all taking advantage of a vulnerable market. Too often, business and social goals are set up dichotomously, as though programs had to choose between one and the other. This is simply not necessary. Rather, programs—and the larger field—must look for “both/and” solutions.

The extent to which funders, intermediaries, and trade associations will need to play a role in moving these ideas forward cannot be overstated. These entities must engage the field’s leadership and work to ensure that program executive directors have the appropriate mix of skills to move programs forward. They must also establish the appropriate incentive environment for such changes to take place. The vast majority of programs have neither the incentive nor the capacity to initiate these ideas on their own. Funders, for example, can choose not to fund programs that are not accredited or do not collect data in a particular way. Trade associations can play a role in mergers by both providing training and workshops on the benefits and how-tos of merging and meeting with organizations for which mergers make sense. NCCA has begun to do this. Both NCCA and AEO have begun to push more strongly for performance standards (AEO, 2002; Lehr, 1998).

The issues currently facing the U.S. microenterprise field are not unique to this field. They are shared by many nonprofits, particularly those in the community development finance field.

Unfortunately, however, each group has confronted these issues largely in its own silo.³⁷ Much could be gained from a joint conversation, particularly given that many of these entities are targeting the same group with different products and services. There is clearly room for greater coordination within the community development finance field.

If undertaken, many of the suggestions made here will lead to a winnowing of the field, in which weaker and less efficient programs close their doors and stronger ones survive. It is time for this kind of reorganization to take place in the field so it can redirect dollars to more efficient and effective programs. The field will be smaller but stronger as a result, and this small, strong base can be the foundation from which a truly effective industry can emerge.

NOTES

1. For example, Iowa-based Institute for Social and Economic Development has closed three offices; San Francisco-based Women's Initiative laid off staff and relocated to a smaller office.

2. Community development financial institutions (CDFIs) data project (CDP) data are available for purchase from the National Community Capital Association (NCCA).

3. MicroTest is an effort spearheaded by the Aspen Institute's Fund for Innovation, Evaluation, Learning and Dissemination (FIELD) to standardize data collection among U.S. microenterprise programs. Details of the MicroTest effort are supplied later in the text.

4. Mohammed Yunus created the Grameen Bank in Bangladesh in 1979. This and other international programs, such as BancoSol, FINCA, and ACCION, have grown very large. However, there are critical differences between the context in which these programs operate and that in which U.S. programs operate. For more on this, see Servon (1999).

5. For a more complete history of the development of the U.S. microenterprise field, see Else (2001).

6. These numbers are not strictly comparable to the number of programs in 2002 because the *U.S. Directory of Microenterprise Programs* (Walker & Blair, 2002) reported on only those programs that replied to surveys, rather than all programs, until 2002.

7. We know that the directory numbers are an undercount because many organizations engage in microenterprise activities but do not identify as being part of the field. For example, in the CDP data set, only 23 organizations identified themselves strictly as microenterprise lenders, but 86 other CDFIs had made at least one microloan. Of these organizations, 79% are loan funds (including two multibank community development corporations, which the CDP report groups under loan funds), 19% are credit unions, 1% are venture capital firms, and 1% are banks. To obtain a more accurate representation of microenterprise development activity in the United States, it would be necessary to determine the number of people served—for training and lending—across all types of programs. It would also be necessary to determine the total loan volume across all types of programs.

8. State microenterprise associations (SMAs) are statewide associations of microenterprise development organizations (MDOs) that both provide assistance to member organizations and convey a united voice to state actors about microenterprise activities in the state. They can provide data collection, reporting, and technical assistance services; many lobby policy makers for change and leverage the collective data from member programs to increase funding dollars. State microenterprise intermediaries (SMIs) are statewide associations of MDOs that leverage funding for members and distribute this funding. They therefore have fiduciary responsibilities. As the term *intermediary* implies, SMIs raise funds and redistribute them to member agencies.

9. Formerly known as the Corporation for Enterprise Development.

10. Many of these initiatives are housed under FIELD. Go to <http://fieldus.org> for more information on FIELD.

11. Edgcomb (2002) explores the issue of scale in much greater detail.

12. To arrive at this figure, Edgcomb and Klein (2005) aggregate data from a variety of sources on a range of categories (e.g., microenterprises with difficulty accessing bank financing, women-owned microenterprises, business owners with personal incomes less than \$10,000), which are not mutually exclusive. Therefore, this 10 million figure is likely an overcount. However, the point remains that there is likely a large gap between the number of people who could benefit from MDO services and the number of people currently served by MDOs.

13. The *U.S. Directory of Microenterprise Programs* (Walker & Blair, 2002) categorizes individuals who received any level of service from the program as *participants*. However, only those individuals who receive a significant level of service (typically individuals with an active loan or who receive at least 10 hours of training) are categorized as *clients*.

14. The contribution of microenterprises to local economies has been widely debated (see Bates, 1996; Lichtenstein & Lyons, 2001; Raheim, 1997; Rowe, Haynes, & Stafford, 1999; Servon, 1997; Servon & Doshna, 2000).

15. There have been continued debates about the effectiveness of microenterprise development as a poverty alleviation strategy (see especially Bates, 1995; Clark, Kays, Zandniapour, Soto, & Doyle, 1999; Klein, Alisultanov, & Blair, 2003; Raheim & Alter, 1995; Schreiner, 1998; Servon & Bates, 1998; Spalter-Roth, Soto, & Zandniapour, 1994).

16. Eleven programs that are not listed as doing any individual lending or group lending (which is how we have counted the number of programs doing any lending) are listed as having disbursed some loans. We have not included these programs in the total of 167 respondents.

17. This statistic is based on 158 respondents out of those who said they engaged in individual or group lending. Twenty two programs provided data for number of borrowers but were not categorized as engaging in any lending.

18. Corporate America has lessons here for the nonprofit sector, as we have witnessed the evolution of many industries from using a Fordist mode of production to one more greatly characterized by flexible specialization (Piore & Sabel, 1986). Technology, which is insufficiently used by U.S. microenterprise programs, has aided this evolution.

19. 2003 was the 1st year for which outcomes data were collected.

20. For those programs that collected outcomes data, the overall response rate from clients was 54%. Although MicroTest has been collecting performance data for several years, this is the 1st year for which outcomes data have been collected (see Black et al., 2002, and Black, Edgcomb & Klein, 2005, for more complete reports on the MicroTest data).

21. Twenty-one programs actually submitted data; 4 of these programs were excluded because they did not meet one or both of the following criteria: They had to draw a random sample of their overall client base, and MicroTest analysis had to show that there was no significant bias in terms of those who responded.

22. Although 61 programs submitted data, 12 were not included in the *2002 Directory of U.S. Microenterprise Programs* (Walker & Blair, 2002). Therefore, this analysis is based on the 49 programs that submitted MicroTest data and were included in the directory. Furthermore, only those organizations that provided data for the specified fields in the attached tables were used while comparing the two data sets (see the column labeled "Count" to note the number of organizations that provided data for any particular field).

23. In Black et al. (2003), a report on MicroTest data, the authors claim that theirs is "a large and representative sample of U.S. microenterprise programs" (p. 6). Even the subtitle of this publication, which is "Performance of the US Microenterprise Industry," implies that the findings within are representative of the field. Other publications have made similar leaps. For example, in Clark et al. (1999), a publication based on Self-Employment Learning Project (SELP) data, they say, "While the field of microenterprise programs has grown exponentially since SELP's inception to more than 200 programs today, we believe that the [seven] SELP programs are representative of the field of microenterprise assistance as a whole" (p. 9). However, they have not conducted the basic comparative analysis such as that done in this article to verify this assertion.

24. Participating organizations for the 2001 data collection effort were the Aspen Institute, NCCA, the Community Development Venture Capital Alliance, the Corporation for Enterprise Development, the National Federation of Community Development Credit Unions, and the National Community Investment Fund.

25. "Numerical standards are based on median performance data from organizations participating in the MicroTest project. Behavioral standards represent ideal actions, activities, and conduct that are necessary for the effective operation of a microenterprise development program" (AEO).

26. This language was also used by many participants at an April 2004 meeting on scale held at the Aspen Institute in Washington, D.C.

27. Bethex identifies primarily as a credit union but currently has 80 small business loans in its portfolio, most of these in the range of \$50,000 to \$75,000.

28. See McVay and Hirschland (2000) for a case study of the Appalachian Center for Economic Networks, which provides another example of innovative partnering.

29. This idea originally came from an interview with an AEO staff member, September 10, 2004.

30. Lichtenstein and Lyons (2001) present some ideas for how entrepreneurial training could be expanded and enhanced.

31. An AEO staff member also suggests that organizations specializing in training increase their breadth by providing financial education training and offering free tax preparation and other services to increase the economic security of low-income people. Training-oriented programs can also go deeper by teaching e-commerce skills, offering specialized industry consultants, and the like.

32. Cook, Belliveau, and VonSeggern (2001) provide recommendations for how microenterprise programs can improve their curricula.

33. If, in fact, one of the primary outcomes of MDOs is making people more employable, then it should be sold as a workforce development strategy, and a key question would be whether investment in microenterprise development is more cost effective than investment in other kinds of workforce development. One interviewee, who has a long history in the field, said that the microenterprise strategy has "fallen way short of expectations with respect to the number of borrowers, making it more of a training initiative, which begs the question of whether microenterprise is the most effective workforce development intervention."

34. Wright's paper, which studies institutions in the developing world, uses the acronym MFI, which stands for MicroFinance Institutions.

35. Credit scoring is a technique used by creditors to determine to whom they should give credit. Information about a potential borrower's credit history is entered into a statistical program that compares this information with the credit performance of consumers with similar profiles. A total number of points (the credit score) helps to predict the likelihood that the borrower can make payments on time and repay the loan.

36. Abzug and Watson (2003) point to at least four factors contributing to the increase in concern about nonprofit program performance: (a) the comparative growth of the sector, (b) the demands of funders, (c) demands for transparency resulting directly from the Red Cross and charitable fraud scandals, and (d) legal and regulatory pressure.

37. There are some important exceptions to this statement. For example, the CDP is led by the NCCA and enjoys the participation of the microenterprise field along with other key actors in the community development finance field.

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