Sustainable Microentrepreneurship:

The Roles of Microfinance, Entrepreneurship and Sustainability in Reducing Poverty in Developing Countries

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CONTENTS

1. INTRODUCTION

About 90 percent of the people in developing countries lack access to financial services from institutions, either for credit or savings[1], which further fuels the "Vicious Cycle of Poverty" (refer to Fig. 1). If the people of LDCs have a limited capacity to invest in capital, productivity is restricted, incomes are inhibited, domestic savings remain low, and again, any increases in productivity are prevented. A lack of access to financial institutions also hinders the ability for entrepreneurs in LDCs to engage in new business ventures, inhibiting economic growth, and often, the sources and consequences of entrepreneurial activities are neither financially nor environmentally sustainable (existing for continuing future use). Microfinance serves as a means to empower the poor, and provides a valuable tool to assist the economic development process. However, unavoidably, various barriers and obstacles limit the roles of microfinance, entrepreneurship and sustainability in reducing poverty in LDCs around the world.

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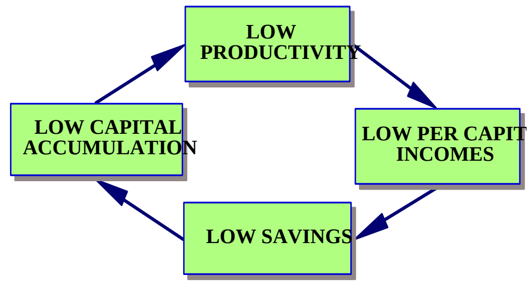
[1] Robinson, Marguerite S., 2002, *"The Microfinance Revolution: Sustainable Finance for the Poor"*

In addressing this issue, two key questions arise:

(1) To what extend does microfinance empower entrepreneurship in LDCs, and are these processes economically and environmentally sustainable?

(2) To what extend do real-world case studies suggest that these processes reduce poverty in LDCs regarding the economic development process?

Fig 1. The Vicious Cycle of Poverty



It is impossible to evaluate a development process without criteria to be addressed. Thus, economic development can be defined as "the process of improving the quality of all human lives", (Todaro, 1994), which incorporates three equally important aspects: raising incomes and consumption; fostering self-esteem through institutions that promote human dignity and respect; and increasing people's freedoms. This criterion has a distinct application to this particular development process. Robinson (2002: pp. 39-41), contends that "the first thing that many poor families do when their incomes rise is improve their nutrition, and send their children to school." This is fundamental to economic development, but also, "Because financial services help the poor expand their economic activities and increase their incomes and assets, their self-confidence grows simultaneously." And finally, "Large-scale sustainable microfinance helps create an enabling environment for the growth of political participation and democracy." Thus, the economics of microenterprise make it a compelling anti-poverty strategy (Rubinstein, 1993). With a loan of $100, in a poor country one can start a small business; repay the loan in a year, while still owning the productive assets. Over time, a poor person can earn enough to escape poverty.

The concept of "Sustainable MicroEntrepreneurship" is neither formal, nor derived, but rather a development process combining the three aspects of microfinance, entrepreneurship and sustainability. It refers to the specific practice of "social-conscious-driven entrepreneurship"[2], perpetuated by a sustainable access to credit, and without bearing undesirable externalities on people or environment. Sustainable MicroEntrepreneurship is a small-scale, self-sustaining active development process initiated by the poor to help themselves break free from their poverty.

2. THE RELATIONSHIPS BETWEEN MICROFINANCE, ENTREPRENEURSHIP AND SUSTAINABILITY IN REDUCING POVERTY IN LESS-DEVELOPED COUNTRIES

The extent to which microfinance, entrepreneurship and sustainability are interrelated is dependent on the extent to which it addresses the economic development process. Yunus (1994), claims, "If we are looking for one single action which will enable the poor to overcome their poverty, I would go for credit. Money is power." Credit invested in an income-generating enterprise as working capital or for productive assets leads to establishment of a new enterprise or growth of an existing one. Profit from the enterprise provides income, and a general strengthening

[2] Yunus, Muhammad, 1994, Extracts from the keynote address delivered at 85th Rotary International Convention help in Taipei, Taiwan, on June 12, 1994

of income sources.[3] A variety of financial institutions, worldwide, have found ways to make lending to the poor sustainable and to build on the fact that even the poor self-employed repay their loans and seek savings opportunities. The challenge is to build capacity in the financial sector drawing on lessons from international best practices in micro, small enterprises and rural finance.[4] However, ensuring environmental sustainability is equally important as sustaining microenterprises financially. The Sustainable Financial Markets Facility (SFMF, 2004) recognises the importance of promoting "environmentally and socially responsible lending and investment in emerging markets, thus stimulating sustainable markets/sustainable private sector activity[5] and enhancing other sustainable initiatives in the developing world. Thus, the interrelated nature of microfinance, entrepreneurship and sustainable development is evident.

The extent to which microfinance, entrepreneurship and sustainability are interdependent is becoming increasingly recognised by experts in their respective fields of work, associated with economic development. Over 500 million poor people around the world run profitable microenterprises and often cite credit as the primary constraint to business growth (IFC, 2002) thus, credit is essential for poor entrepreneurs in LDCs. Additionally, firms supplying the finance to these entrepreneurs are equally dependent on them for business, and to expand their services to more villages or urban areas. However, this dependency belies the assumption that microfinance can be profitable in LDCs. Robinson (2002), a prominent expert in the field of microfinance, notes that "The formal sector has begun to realise that financing the poor can be both economically and socially profitable." The dependency of environmentally sustainable initiatives, however, can be slightly more controversial. The Environmental Business Finance Program (EBFB) suggests that, "Private sector support is crucial to help solve the world's environmental problems", however, "incremental costs deter the private sector from pursuing many environmental business opportunities."[6] This is particularly true among small enterprises due to a lack of access to finance.

The interrelationships and interdependency of microfinance, entrepreneurship and sustainability in LDCs further exemplify the informal practice of "sustainable microentrepreneurship" among the world's poor. But although interrelated and interdependent, each of the aspects must be further explored individually to gain a greater understanding of the complexities of the connection between them. This will also aid in evaluating the case of sustainable microentrepreneurship in reducing poverty in LDCs.

2.1. THE ROLE OF MICROFINANCE IN REDUCING POVERTY IN LDCS

> *Imagine you are a poor woman in Bangladesh. You work hard almost every day weaving mats. In five days you can finish a mat that sells for less than a dollar. When your children get sick, there is no money for medicine. How much would it change your life, if you could borrow $65 to buy a sewing machine?*

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[3] Daley-Harris, Sam, 2002, Pathways Out of Poverty: Innovations in Microfinance for the Poorest Families; *"Microfinance Impacts Directly and Significantly on Economic Poverty"* pp. 22, 2002, Bloomfield, CT: Kumarian Presss

[4] Financial Sector of the World Bank Group, 2002, *"Rural and Microfinance SMEs"*, www.worldbank.org (accessed 4 September, 2004)

[5] International Finance Corporation, 2004, Sustainable Financial Markets Facility, www.ifc.org (accessed 4 September, 2004)

[6] EBFB, 2004, *Why focus on environmental SMEs?"* www.ifc.org (accessed 4 September, 2004)

The above example[7] is real. Joygon Begum was a poor mat weaver in Bangladesh. Joygon used her $65 loan from the Grameen Bank to buy a second-hand sewing machine, and started a small business making clothes, which her husband sells in the village market. Before her first loan, Joygon and her family frequently went hungry, and never had money for family medical care. She could not afford even the very small education fees for her children. Now, the family eats three healthy meals a day, with a diet including vegetables, grains, and a small amount of meat and fish. Her children attend school, and she has money saved up for emergencies (Rubinstein, 1993). Small examples such as this are a reflection of an emerging international industry.

In the last 20 years, the "microfinance industry" has emerged. During the 1980's and 1990's, particularly in Asia, Africa, and Latin America, thousands of microfinance NGOs (Non-Government Organisations) were established to provide microloans, using individual and group lending methodologies. In the 1990's, while many of the NGOs failed to reach scale or financial sustainability, others led the way in demonstrating that:

-Poor people, particularly poor women, are excellent borrowers, when provided with efficient, responsive loan services at commercial rates.

-Microfinance institutions can provide microloans to poor people in an efficient and financially sustainable way, once the numbers of clients reaches reasonable scale – 10 000 to 20 000 borrowers in most settings.

-Microfinance-lending savings, and other financial services to poor people – is an effective way to help poor people help themselves build income and assets, manage risk, and work their way out of poverty.[8]

Loans in LDCs are made for a variety of purposes. Loans are made for housing, and for "start up" loans so farmers can buy inputs to agricultural production: rice seeds, fertilizers and agricultural tools. But loans might also be used for a variety of non-crop activities such as: dairy cow raising, cattle fattening, poultry farming, weaving, basket making, leasing farm and other capital machinery and woodworking.[9] Of course, funds may be used for a number of other activities, such as crop and animal trading, cloth trading and pottery manufacture. Credit is also issued to groups consisting of a number of borrowers for collective enterprises, such as: irrigation pumps, building sanitary latrines, power looms, leasing markets or leasing land for cooperative farming. The potential for loan uses are virtually endless, and differ between villages and countries. And due to the fact that there is no such thing as a 'typical' developing country, loans provide a source of income for diverse activities chosen specifically by the borrower, to create their *own* life.
Strategies to promote the capability and capacity of microfinance to reach the world's poor are a primary objective of the World Bank Group. They have announced a "strategy to increase access to financial services and low-income households", which addresses three principal areas:

-Fundamental framework: the policy, legal and regulatory frameworks that allow innovative financial institutions to develop and operate effectively.

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[7] Rubinstein, Joel, 1993, *Micocredit:"A poverty eradication strategy that works"* www.action.org/microjoel.html (accessed 4 September, 2004)

[8] Daley-Harris, Sam, 2002, Pathways Out of Poverty: Innovations in Microfinance for the Poorest Families; *"Improving the Social and Empowerment Impact of Microfinance"*, pp.264-5, 2002, Bloomfield, CT: Kumarian Presss

[9] Yunus, Muhammad, 1994: Grameen Bank, *"Major Uses of Loan Funds"*, Bangladesh (1994)

-Institution building: exposure to and training in best practices that banks and microfinance organizations need to expand their outreach and develop sustainable operations, along with performance-based support for capacity building; and

-Innovative approaches: leasing, lending and other products to increase access of small- and medium-size enterprises to financial services.[10]

Despite the apparent benefits of microfinance in reducing poverty, inevitable controversy exists. Microfinance has its critics. In a Research and Impact Assessment by the Department for International Development (DFID), it was noted that, "International microfinance experience indicates that microcredit is not a suitable tool to assist the chronically poor", suggesting instead, "savings, can assist them to ride out crises by strengthening their economic security."[11] Hickson (2001) claims "Most MFIs [MicroFinance Institutions] have far to go in finding ways of reaching extremely poor households…This possible belies a lack of understanding of the dynamics of poverty and the opportunities that exist for the provision of financial services to the extremely poor."[12] Opponents of microfinance have pointed out that valuable aid money from fatigued donor agencies has been diverted to untested and non-viable microfinance programmes - away from vital programmes on health, education etc. that are in dire need of such money.[13] Additional barriers to microfinance included the perceived 'myths' surrounding the industry, such as that poor people are bad borrowers, especially women; or that microfinance is not profitable. However, in the 80s and 90s, microfinance programs bucked conventional wisdom and showed that poor people, especially women, had excellent repayment rates, sometimes better than formal banks in most developing countries. Experience has also shown that the poor are willing and able to pay interest rates that allow microfinance institutions to cover their costs.[14] Thus, conflicting views exist regarding microfinance, and its effectiveness at reducing poverty in LDCs.

2.2. THE ROLE OF ENTREPRENEURSHIP IN REDUCING POVERTY IN LDCS

Entrepreneurship is the active process of recognising an economic demand in an economy, and supplying the factors of production (land, labour and capital) to satisfy that demand, usually to generate a profit. High levels of poverty combined with slow economic growth in the formal sector have forced a large part of the developing world's population into self-employment and informal activities.[15] But this is not necessarily negative; microenterprises contribute significantly to economic growth, social stability and equity. The sector is one of the most important vehicles through which low-income people can escape poverty. With limited skills and education to compete for formal sector jobs, these men and women find economic opportunities in microenterprises as business owners and employees.[16] If successful, entrepreneurship is likely to result in a small- to medium-enterprise (SME). They include a variety of firms – village

[10] World Bank Group, 2001, *"Microfinance and Small- and Medium-Size Enterprises"* www.worldbank.org/wbi/banking/microfinance/ (accessed 4 September, 2004)
[11] DFID, 2001, *"Maximising the Outreach of Microfinance in Russia"*, Research and Impact Assessment; Terms of Reference for FORA (London: DFID, 2001).
[12] Hickson, Robert, 2001, *"Financial Services for the Very Poor – Thinking Outside the Box"*, Small Enterprise Development 12, no. 2 (2001)
[13] Srinivas, Hari, *"Microfinance is not Enough…"* www.gdrc.org/icm/not-enough.html (accessed 4 September, 2004)
[14] World Bank, 2004, *"Afghanistan: Pioneering Donor Coordination for Microfinance"*, February 4, 2004, www.worldbank.org (accessed 4 September, 2004)
[15] Financial Sector of the World Bank Group, 2000, *"Rural and Microfinance/SMEs"* www.worldbank.org
[16] The IDB and Microenterprise: Promoting Growth with Equity, *"What is a microenterprise?"* www.gdrc.org/icm/micro/what-is.html (accessed 4 September, 2004)

handicrafts makers, small machine shops, restaurants, and computer software firms – that possess a wide range of sophistication and skills, and operate in very different markets and social environments. In most developing countries, microenterprises and small-scale enterprises account for the majority of firms and a large share of employment (refer to Fig. 1). In Ecuador, for example, firms with fewer than 50 employees accounted for 99 percent of firms and 55 percent of firms in 1980; in Bangladesh, enterprises with fewer than 100 workers accounted for 99 percent of enterprises and 58 percent of employment in 1986.[17] Finally, it has been noted that, "SMEs constitute the most dynamic segment of many transition and developing economies. They are more innovative, faster growing, and possibly more profitable as compared to larger-sized enterprises."[18] Hence, the role of entrepreneurship in reducing poverty in LDCs is promising.

It has already been identified that entrepreneurship is a major contributing factor to economic growth, however, entrepreneurial ability and leadership tend to be relatively lacking in LDCs. Collier and Batty (pp. 491/492) have identified five primary reasons for the shortage of entrepreneurs in LDCs. Firstly, this includes the limited profit opportunities which exist in LDCs as a result of lower per capita incomes and limited markets. Secondly, poorly developed capital markets make it difficult for potential entrepreneurs to borrow the funds needed to establish new businesses and take advantage of new investment opportunities. This ties in closely with the role of microfinance in empowering entrepreneurship. Thirdly, poorly developed infrastructures hinder the development of new commodity and resource markets as well as inhibiting the efficient operation of existing ones. Fourthly, sometimes social, cultural and religious beliefs and attitudes attach little importance to monetary gain, restrict economic and social mobility, or assign very low status to entrepreneurs. And fifthly, an unfavourable economic and political climate might discourage the development of entrepreneurial talent and initiative. It is often argued that in light of these barriers, governments hold the key in opening doors to aspiring entrepreneurs in LDCs.

The governments of LDCs can play an important role in improving the quantity and quality of entrepreneurs in a number of ways. Collier and Batty (pp. 534/535) suggest a number of policies to reduce the shortage of entrepreneurs in LDCs, such as the establishment of specialist educational institutions offering courses in business management and administration, and the establishment of specialist government agencies and departments to provide advice and assistance to local entrepreneurs about to take up a business venture are likely to aid the process. Additionally, tax relief, subsidies, investment allowances and other incentives may encourage entrepreneurial activities, similarly, the provision of credit facilities to finance appropriate new business ventures might help. And finally, the attempted maintenance of an economic, social and political climate, which is favourable to entrepreneurs, is essential. It has also been suggested that official policies often make business difficult for microentrepreneurs. Improved business regulations, tax regimes, licensing requirements, financial sector reform and bank supervision will promote better conditions for microenterprise development.[19] A final optimistic suggestion, according to economic theory, implies that the income expenditure multiplier effect may also help to create chain reactions through developing economies, thus helping to break the cycle of poverty.

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[17] Hallberg, Kristin, *"A Market-Oriented Strategy for Small- and Medium-Scale Enterprises"*, World Bank Washington D.C., International Finance Corporation Discussion Paper Number 40

[18] The World Bank Group, 2001, *"Microfinance and Small- and Medium-Sized Enterprises"* www.worldbank.org/wbi/banking/microfinance/ (accessed 4 September, 2004)

[19] The IDB and Microenterprise: Promoting Growth with Equity, *"What is a microenterprise?"* www.gdrc.org/icm/micro/what-is.html (accessed 4 September, 2004)

2.3. THE ROLE OF SUSTAINABILITY IN REDUCING POVERTY IN LDCS

The concept of sustainability is difficult to define, and its precise definition varies within differing contexts. However, regarding the development process, two primary aspects of sustainability emerge: economic and environmental sustainability. Both tie in with the notion of sustainable microentrepreneurship; economic sustainability refers to a continual supply of finance to meet a person/community's needs, usually in the form of secure and accessible loans from a microfinance institution; and environmental sustainability is the aim to preserve environmental resources for use by future generations. Littlefield (2004) claims, "If you're going to provide financial services permanently to people, they've got to be sustainable, and that means charging interest rates that cover your costs."[20] Similarly, the IFC (2004) notes, "Well-managed microfinance institutions…have convincingly demonstrated that they can become profitable and sustainable institutions while making major contributions to poverty reduction by increasing economic opportunities and employment." This is core to sustainable microentrepreneurship.

Sustainable development bears relevance to the developing world, primarily due to the role of the private sector in reducing poverty (such as microfinance institutions, business organisations and multinational corporations). This affects them because the growing public awareness of corporate governance and of environmental and social issues is driving changes in consumer behaviour, investment, and policy or regulatory adjustments. All signs point to continued pressure on the private sector to demonstrate that economic growth and sustainability are compatible.[21] In an examination of 'ordinary' businesses in LDCs, who have strategically integrated sustainability into their operations, it was noted that, "the evidence confirms that there are compelling commercial reasons to take action, despite a common assumption that sustainability is a luxury which emerging markets cannot afford."[22] Thus, economic and environmental goals may be pursued simultaneously, and it is now becoming apparent that this may be in firms' interests.

Strategies exist to promote sustainable development in LDCs all over the world. However, it is argued that, "Sustainable development will only be achieved by ensuring that the economic, social, cultural and environmental dimensions of development be addressed in an integrated and balanced manner. This requires breaking down institutional and mental barriers between different sectors of society…"[23], and in forging close cooperation between the sectors of LDCs.

However, there are challenges as well as opportunities in putting a greater emphasis on sustainability in emerging markets. Some may argue that the business case for sustainability does not apply in markets where incomes are low and mostly spent on basic needs, but also firms might not see benefits from improving environmental or social performance. However, others argue that businesses resisting sustainable practices, may put themselves at a long-term competitive disadvantage by missing opportunities, such as economically efficient and environmentally sound production methods that allow new market entrants to produce for less. Such businesses may also face greater downside exposure to changes in the competitive environment and consumer behavior. [24] Whereas non-sustainable operations were in the commercial interests of firms in the past, this may not be the case in the future, especially in the developing world, where efficiency and cleanliness are vital to the development process.

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[20] Littlefield, Elizabeth, 2004, *"Afghanistan: Pioneering Donor Coordination for Microfinance"*, (2/4/04)
[21] IFC, 2004, *"Investing in a Sustainable Private Sector"* www.ifc.org/sustainability/ (accessed 5/9/04)
[22] SustainAbility, 2004, *"The Business Case in Emerging Markets"* www.sustainability.com (accessed 5 September, 2004)
[23] UN, 2001, *"Mobilizing Minds: UNESCO's Environmental and Sustianble Development Activities"*
[24] IFC, 2004, *"Investing in a Sustainable Private Sector"* www.ifc.org/sustainability/ (accessed 5/9.04)

3. SUCCESSFUL CASE STUDIES OF MICROFINANCE, ENTREPRENEURSHIP AND MICROFINANCE IN REDUCING POVERTY IN LDCS

Most of the growth in the microfinance industry over the last ten years has taken place in the absence of specific financial sector policies for microfinance. Today, about 40 million low-income entrepreneurs, mainly in the developing countries, have access to microfinance.[25]

In Bangladesh, where about one third of the world's estimated 30-40 million microborrowers reside, the growth has come from specialised microfinance NGO's and Grameen Bank. What began with a few small grants and loans from international donors, has now provided over 100 million dollars in loans. The most distinctive feature of the credit delivery system is the absence of middle men between the credit supplier and end user. The bank's cumulative recovery rate is an astounding 98 percent.[26] Grameen Bank has its own special legal structure, and does not fall under regulatory oversight of the central bank. The bank also aims to raise health and environmental consciousness. Each of its members must plant at least one sapling a year as part of an afforestation programme. Grameen is perhaps the only bank in the world that encourages birth control, sanitation and a clean environment as part of its lending policy (Yunus, 2001).

In Bolivia the microfinance revolution emerged in the 1990's. Large-scale commercial credit is provided there by BancoSol, a privately owned bank for microentrepreneurs, and by a number of competitors following hotly on BancoSol's heels (and profits). By 1997 BancoSol, financed by a combination of domestic and international commercial debt and investment and locally mobilized voluntary savings, provided loans profitably to more than one quarter of Bolivia's clients.[27] The Wall Street Journal (15 July, 1997) notes, "The real measure of its success is that BancoSol has spawned a slew of competitions."

In India, despite the large size and depth of its financial system, the majority of the rural poor do not have access to formal finance and financial services. For this reason, innovative microfinance initiatives pioneered by nongovernmental organizations strove to create links between commercial banks, NGOs, and informal local groups to create the "SHG Bank Linkage".[28] The success of SHG Bank Linkage has been largely attributed to good policy and strong leadership, in conjunction with facilitating government policy and legal framework. India's approach to microfinance – making it profitable and so widely available – helped the country reduce the incidence of poverty from about 40 percent of the population in the mid-1970's to about 11 percent in 1996 (Robinson, 2002). Members of SHG recognise that "several challenges lie ahead," but still believe it has "the right ingredients to be scaled-up into offering mass access to finance for the rural poor while improving sustainability." (World Bank, 2003)

5. CONCLUSION

The economic benefits of sustainable microentrepreneurship in LDCs are compelling, and its potential effects on the development process are equally promising. In terms of development and social impact, the microfinance industry allows significant improvements in quality of life for the microentrepreneurs of LDCs around the world. They can now stabilise the cash flow of their economic activity, bringing security to the enterprise. This allows them to better manage

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[25] Development Gateway, 2004, *"Microcredit and Microbusiness Development"*, July 8, 2004, www.developmentgateway.org/microfinance (accessed 5 September 2004)
[26] Yunus, Muhammad, 2004, Grameen Bank, www.grameen-info.org
[27] Robinson, Marguerite S., 2002, *"The Microfinance Revolution: Sustainable Finance for the Poor"*, pp.34
[28] World Bank, 2003, *"India: Scaling-up Access to Finance for the Rural Poor"* (accessed 5/9/04)

spending, which often generates savings; and this provides better standards of living to their family, and dependents in terms of housing, nutrition, health and education. Finally, an access to banking and increased security promotes a sense of entrepreneurship, and thus their self-esteem and reputation increase. The initial small loan of usually less than $100 can eventually reintegrate these entrepreneurs into formal networks of the economy and foster the structural and sustainable development of local communities. Furthermore, estimates indicate that today only 5% of the micro-credit demand is fulfilled[29], thus, the microfinance industry is expected to grow significantly in coming years. Despite several challenges ahead, this emerging industry, and the process of sustainable microentrepreneurship combine to offer a potential alleviation solution to the poverty crisis of the 21st century, and into a sustainable future.

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Snodgrass and Biggs, 1996, p.53 Based on industrial census data from 14 countries, mainly in the 1960s and 1970s. GDP per capita in real terms. 1985-88; firm size based on the number of employees

Srinivas, Hari, *"Microfinance is not Enough…"* www.gdrc.org/icm/not-enough.html (accessed 4 September, 2004)
[1] World Bank, 2004, *"Afghanistan: Pioneering Donor Coordination for Microfinance"*, February 4, 2004, www.worldbank.org (accessed 4 September, 2004)

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[29] BlueOrchard, 2004: *"Micro-enterprises"*, www.blueorchard.ch (accessed 21/9/04)

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