Moving Microenterprises beyond a Subsistence Plateau

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ABSTRACT: Enthusiasm for microcredit programs has increased during the past decade. The attention these programs have drawn stems philosophically from progress in cultivating self-sufficiency among those in abject poverty, and practically from the viability and high loan repayment rates of many microfinance institutions. The programs assume that lack of capital is the main barrier to the economic progress of the poor. The lack of entrepreneur business management experience and training, however, may create a barrier equally powerful and limit the growth potential of microenterprises. Microcredit programs could foster even greater economic progress by ensuring that clients receive appropriate human capital development. Without adequate training of microentrepreneurs, microloans may allow the poor to move from abject poverty to subsistence income levels, but limited skills leave the opportunity for substantial firm growth untapped. The potential of these firms to employ others also remains unfulfilled. This paper reviews relevant microcredit and microenterprise literature, and then argues for increased microentrepreneur training based on the case of a Manila microentrepreneur.

Microcredit is hailed as a means of helping individuals in developing countries lift themselves out of poverty, putting the poor in greater con-
control of their financial futures. Evidence for the impact of microcredit programs is mounting. Concerns are also emerging, however. In particular, the lack of business management experience and understanding among microentrepreneurs may limit the growth potential of their enterprises. Microloans for seed capital may allow the poor to move from abject poverty to subsistence income levels, but limited skills may cause microentrepreneurs to plateau at this improved yet low standard of living. The potential for substantial firm growth remains untapped. This untapped potential could lift these entrepreneurs completely out of poverty and, through growth of the enterprises, provide employment opportunities for others.

Issues in the Microcredit Literature

The primary objective of MFIs in developing countries is to alleviate poverty. The relevant literature cites numerous contributions of microcredit programs in achieving this objective. Perhaps the most fundamental benefit is that microcredit programs have been successful in allowing microentrepreneurs to increase both output and income. These improvements in physical living standards, though small, often make the difference between abject poverty and independent subsistence.

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Microcredit fosters self-reliance and dignity (De Gent, 1999). Beyond increased household income, these programs engender self-confidence and move the poor away from a dependence mentality or low self-esteem. Personal growth is fostered beyond physical economic progress. Microcredit programs also may empower the poor, not only individually, but as a population who once felt powerless (Johnson, 1998). This collective impact can be significant.

Microfinance institutions have sponsored many successful lending programs. Though overhead costs are high relative to loan value, many of the programs have become increasingly efficient, and repayment rates are high (Woolcock, 1999; Stallings, 1999).

In spite of evident advantages in the microcredit movement, concerns are emerging. Some programs have struggled. Woolcock (1999) points out that success is not automatic, inevitable, or guaranteed. Accordingly, microcredit challenges are noted in the literature. Most microenterprises are profitable, but progress is slow, often resulting only in small marginal changes that affect the lives and household income levels of the poor (Fairley, 1998).

There is little evidence to suggest significant and sustainable increase in income levels or firm growth. Buckley (1997) explains that certain challenges to microenterprise creation and growth—for example, structural or socioeconomic conditions—cannot be tackled solely by capital injections. Incomes may bump up slightly, but without attention to structural and socioeconomic barriers, they may then stagnate. Limited educational background of microentrepreneurs may also contribute to the lack of ongoing enterprise growth. Smith and Metzger (1998) found that education of small entrepreneurs enhanced earnings after controlling for capital investment.
The labor market implications of microenterprise activity in developing countries are not entirely favorable. When microenterprises remain small, an underclass of self-employed, overworked, and undercompensated business owners forms (Johnson, 1998). With growing numbers of microenterprises (each seeking to provide a relatively low-skill, low-technology product or service), it is likely that the number of firms providing similar goods and services will rise. Competition between these firms will increase, intensifying the challenges to individual firm growth and profitability.

**Microenterprise Growth and Training Issues**

Microcredit programs in developing countries are designed to alleviate poverty, and there is clear evidence that microcredit programs are helping to boost incomes to, or slightly above, subsistence level. But the literature indicates that microcredit programs may not be effective in alleviating poverty in an environment of continuous improvement and growth. Though subsistence is preferable to abject poverty, complacency with slight progress may conflict with the goal of continued economic growth for the poor. Rather than accepting subsistence plateaus, we need to examine alternatives aimed at increasing the likelihood of ongoing microenterprise progress.

Significantly different factors may influence an MFI’s financial viability, the sustained viability of funded microenterprises, and the potential for continual microenterprise growth. To the extent that the microcredit literature focuses on any of these, the viability of MFIs appears to receive the most attention (Schmidt, 1997; Woller et al., 1999). Certainly microenterprise viability and growth become moot issues if the lenders disappear. However, as increasing numbers of MFIs and microenterprises remain profitable and stable, a primary focus on the viability of lenders and microenterprises ignores a greater potential
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for the alleviation of poverty. If designed to provide increased incentive for and probability of continual firm growth, microcredit programs could have more impact on poverty reduction. Instead of stagnating, microenterprises may grow to become significant employers. This could enhance household incomes beyond the families of the microentrepreneurs.

Barriers to continual microenterprise growth identified in the literature include structural and socioeconomic conditions, increasing competition, and the lack of microentrepreneur business skills and understanding. Of these barriers, it may be easiest for MFIs to provide training to enhance the probability of continuous growth in funded microenterprises. Many MFIs provide, or even require, training in basic management skills prior to the issuance of loans or during repayment (“A dream,” 1997; “India,” 1998; Kole, 1999; Platt, 1998; “Small loans,” 1997; Stanley, 1999; “We need,” 1998). Nevertheless, there is not complete agreement on the need for microentrepreneur training. Initially, Mohammed Yunus, founder of the Grameen Bank focused on the lack of seed capital as the main barrier to economic progress among the poor; he asserted that the poor are both creative and competent. To this end, his program originally deemed training unimportant (Singh, 1997). More current information on Grameen guidelines, however, indicates support for client training programs (Foote, 1997).

Even though a lack of capital funding is universally recognized as a significant barrier, there is no consensus that it is the only barrier. Some observers focus on lack of training as another significant barrier (Stallings, 1999). Frequently the poor are unskilled; they lack the educational opportunities necessary to develop many basic and higher-level skills needed for greater productivity.

The human capital economic literature documents that returns to investments in human capital are positive (Romer and Barro, 1990) and are often at least as high as the returns to investments in physical capital.
Returns to human capital investment in developing countries tend to exceed those in developed countries (Funkhouser, 1998), and human capital investments are recognized as a key factor in the economic development of poor countries (Thomas, 1991; Maital, 1992; Tallman and Wang, 1992; Dougherty and Jorgenson, 1996; Mather, 1999). Thus, investments in human capital should be at least as desirable for alleviating poverty (even at a micro level) as investments in physical capital. There is still an unsettled debate concerning the desirability of general versus vocational education as the focus of human capital investment in developing countries’ schools. At an individual level, however, entrepreneur education does seem to affect the probability of the success of new businesses (Robinson and Sexton, 1994). In some cases, the extremely poor, due to their lack of skills, may not be in a position to start businesses even if physical capital funding were readily available (“The power,” 1999). In other cases the poor may be able to start a viable firm with little or no training, but the growth potential of the firm may remain untapped for lack of owner skills and understanding. Whether the main priority of a microcredit program is social welfare or economic or employment progress, training programs can be vital to the achievement of both foci (Johnson, 1998).

Many organizations do seek to ensure microenterprise success by coupling investments in human and physical capital. However, the duration, focus, and instructional method of training provided by these institutions vary a great deal. Some programs require training either as a precondition for a loan or as a requirement during a loan repayment; other programs simply make the opportunity available to borrowers. Alternatively, community-based training programs are available in some areas. Some train in classes or groups; others train through individual consultations. The content of the training differs across programs, but
often includes skills in such areas as literacy ("Study confirms," 1999), small and basic business skills (Aziz, 1997; Fairley, 1998; Johnson, 1998), basic skills (Platt, 1998), savings (Fairley, 1998), costing, pricing, insurance, lease terminology, and human resources management (Stanley, 1999).

When the skills of beginning microentrepreneurs are minimal, training in fundamental business areas may be critical to the initial start-up of the enterprise. Once the enterprise is up and running, microentrepreneurs will learn from experience. More could be learned from experience, however, if it were intertwined with additional, more sophisticated training. This could be the key to fostering more rapid and continual growth of microenterprises, eliminating the plateau to which many microenterprises ascend but which they fail to exceed.

Many MFIs offer gradually increasing loan amounts. This suggests the need for incremental training over time as a business grows. Larger loans allow a microenterprise to explore more complex investment opportunities. The need for higher-level tactical and strategic planning grows. Without increasing the depth of training, microentrepreneurs may be able once again to lift themselves to a subsistence-level income without fully tapping the potential toward eradicating poverty. These microentrepreneurs unwittingly be in positions to make only profit-satisfying decisions, rather than decisions that consciously maximize profits or enhance competitive advantages. Microcredit programs that do not ensure that borrowers of increasingly larger loans have the requisite skills for appropriate analysis may cause their clients to increase risk and fixed costs through higher debt ratios without improving their abilities to leverage this debt into an improved strategic position and greater profitability. Microentrepreneurs need increasingly sophisticated training to accompany expanding loan amounts. The case of Victoria Bermillo in the Manila area illustrates her need for increasing depth in training.
Victoria Bermillo’s Situation

Victoria Bermillo (pseudonym), a forty-four-year-old mother of three daughters, sells a variety of goods from a street-side booth near an open market in Pasig City, Philippines. Pillowcases produce the majority of her revenue, but she also sells other items. Victoria began her business many years ago, selling goods in a building on the market. Seven years ago that building burned down. She has since moved her business to a street location where foot traffic is much heavier. The new location has resulted in greater sales than experienced at her previous location.

Victoria keeps her goods in a large wooden box behind her stand. The box was purchased with a microloan that has been repaid. She must pay thirty-five pesos a day to hire a man to protect the goods each night. The land where her stand sits is the property of the city of Manila. One of Victoria’s greatest concerns is that the city will evict her and other vendors off the land, as they have occasionally threatened to do. For now, Victoria pays the city twenty pesos a day for rent. This money allows her to stay there temporarily, but she could be asked to vacate the property at any time.

Victoria’s pillowcases are always obtained from the same supplier, from whom she purchases 60 to 100 units per week. Other vendors in the area also sell the same style of pillowcases, purchased from Victoria’s supplier.

Victoria has a small bank account. At one time she kept detailed records of her business transactions, but she stopped keeping any records as record keeping became a burden. At the present time, she has no formal way of recording her finances. Table 1 is a weekly income statement based on information provided by Victoria. Due to the lack of formal records, the data contained in the statement are based on estimates. This income statement is for a typical week with average sales.
Victoria’s total revenue from the sale of all goods is approximately 12,000 pesos per week. Approximately 75% of the total revenue, or 9,000 pesos, is generated by pillowcase sales. The approximate cost of all items she sells is 75% of the sales price. Sales are always highest during the Christmas season and school vacations.

The business seems to be profitable, but the majority of the profits are used to pay for her children’s schooling and other necessities. Victoria wishes she could have more merchandise in her booth at one time, but the needs of her family do not permit the cash flow that would be needed to purchase more goods at one time from her suppliers.

Victoria has considered another alternative to increase her income: buying an electric sewing machine for 6000 pesos and manufacturing her own pillowcases. She currently has electricity at her home. Victoria estimates that materials for homemade pillowcases would cost about half the price she currently pays her supplier. Victoria thinks she could make all pillowcases.

**Table 1: Weekly Income Statement (in Filipino pesos)**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount (in pesos)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>12,000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>9,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>3,000</td>
</tr>
<tr>
<td>Other Costs</td>
<td></td>
</tr>
<tr>
<td>Transportation (30/day x 7 days)</td>
<td>210</td>
</tr>
<tr>
<td>Owner’s Labor (56/day x 7 days)</td>
<td>392</td>
</tr>
<tr>
<td>Opportunity Cost*</td>
<td></td>
</tr>
<tr>
<td>Security (35/day x 7 days)</td>
<td>245</td>
</tr>
<tr>
<td>Rent (20/day x 7 days)</td>
<td>140</td>
</tr>
<tr>
<td>Total Other Costs</td>
<td>987</td>
</tr>
<tr>
<td>Net Profit</td>
<td>2,013</td>
</tr>
</tbody>
</table>

*Costs estimated by authors
the cases she would need for the next day by sewing about three hours each night. Alternatively, Victoria could hire someone to do the sewing for 7 pesos per hour. The extra electricity used in sewing the pillowcases would cost about 20 pesos per day.

**Helping Victoria Understand Her Situation**

At least three levels of training can help Victoria grow her enterprise beyond its current level of profitability:

- Training in record-keeping to verify estimates of expenses and revenues,
- Training in analytical skills to determine the most profitable alternatives, and
- Training in strategic understanding, in order to earn above-average profits in her area.

Managers in extremely small enterprises may not see the value of record keeping. Tracking costs, revenue, and other data can be time-consuming and stressful, especially when skills in this area are not well developed. When profit and cash flow calculations are quite simple, microentrepreneurs may not be motivated to invest the time and effort required to go beyond these calculations and keep detailed records. They need to understand the role of accurate information in decision-making before the value of records becomes evident.

Once accurate data are available, microentrepreneurs can conduct cost-benefit analyses by examining and evaluating new options that have potential to help grow their businesses. Some training is required to identify relevant cost items, to determine prior costs, and to reasonably estimate future costs and revenues.

Microentrepreneurial profits can be threatened as increasing numbers of enterprises open in nondifferentiated markets. Victoria already has many competitors who sell pillowcases produced by her supplier. She
also faces the threat of additional sellers of the same pillowcases entering her market, which would place pressure on her to lower prices. Strategic understanding of operations in a nondifferentiated environment, or training in methods of differentiation, can provide microentrepreneurs the knowledge they need to earn above average profits and to carve out a competitive advantage in difficult and increasingly competitive markets.

Since Victoria previously kept records, she has probably received some training in that area. Now she needs to understand that basing decisions on more accurate information increases the likelihood that her decisions will lead to the anticipated outcomes. Experience and training in decision analysis may motivate Victoria to track essential costs and revenues diligently.

Table 2 presents two analyses of Victoria’s profit potential from pillowcase sales, calculated from her memory-based estimates of costs and revenues. The first scenario assumes a continuation of her current purchase of pillowcases from a supplier (cost of goods sold). The second scenario assumes that she produces her own pillowcases (cost of goods manufactured).

Focusing on pillowcases alone, Victoria currently generates 9,000 pesos (75% of total revenue) from pillowcase sales weekly. With costs averaging 75% of revenue, her pillowcase costs would be 6,750 pesos (9000 x .75). If she spends the extra three hours each night making her own pillowcases, she will save approximately half of the 6,750 pesos she normally pays her supplier, or 3,375 pesos. However, she would need to pay for her sewing machine and an increase in her electric bill, and sew three hours each night in addition to working at the booth each day (or hire someone to sew for her). In addition to these added expenses, Victoria would have extra transportation costs in obtaining the materials. If Victoria were able to purchase the sewing machine through a microloan, she would need to pay interest with her weekly payments.
Assuming a simple interest rate of 50% on a one year loan of 6000 pesos paid in weekly installments, Victoria would have loan payments of 173 pesos per week. Her weekly profitability for pillow case sales only would more than double, rising from 2,250 to 5,060 pesos per week if she could obtain a loan for a sewing machine. Even if the interest rate were higher or the loan repayment time were shortened, Victoria’s business would still be more profitable if she chose to make rather than buy her pillowcases.

Table 2: Make vs. Buy Analysis
(weekly amounts, in Filipino pesos)

<table>
<thead>
<tr>
<th></th>
<th>Buying From a Supplier</th>
<th>Producing Pillowcases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>6,750</td>
<td>3,375</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>2,250</td>
<td>5,625</td>
</tr>
<tr>
<td>Other Relevant Costs (pillow cases)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity(20/day x 7)*</td>
<td>0</td>
<td>140</td>
</tr>
<tr>
<td>Labor(21/day x 7)</td>
<td>0</td>
<td>147</td>
</tr>
<tr>
<td>Transportation(15 x 7)*</td>
<td>0</td>
<td>105</td>
</tr>
<tr>
<td>Loan Payment**</td>
<td>0</td>
<td>173</td>
</tr>
<tr>
<td>Total Other Relevant Costs</td>
<td></td>
<td>565</td>
</tr>
<tr>
<td>Net Profit</td>
<td>2,250</td>
<td>5,060</td>
</tr>
</tbody>
</table>

*Costs estimated by authors
**Weekly profits to increase by this amount when loan matures
Victoria needs the skills to do this type of analysis if she is to make
profit-maximizing decisions. Alternatively, she at least needs to consult
with someone who can help her understand these things. Since basic
record keeping is confusing to Victoria, it is doubtful that she could
undertake this more sophisticated analysis of her costs and revenues on
her own with her present level of understanding. This depth of under-
standing was not critical to her firm’s initial development. In fact, this
level of analysis would likely overwhelm many beginning microentre-
prendeurs. Victoria’s firm is profitable, but it has reached a plateau at a
level commensurate with her business skills. If Victoria gains additional
record keeping and cost-benefit analysis skills, she will be able to make
decisions to substantially increase her family’s income with much more
confidence that her expectations are realistic. As her business grows,
necessitating the hiring of additional workers, she may be able to con-
tribute to the alleviation of poverty in her community.

Victoria’s development of cost-benefit analysis skills is certainly
important, but over time, her business will likely stagnate at a new
plateau. Strategic training could make an even greater difference in her
long-run profits. When many in a locality are selling the same items, it
can be difficult to sustain a competitive advantage. Product differentia-
tion is one strategy that can lead to a long-term competitive advantage,
especially in a market of effectively homogeneous goods. Differentiating
her products would give Victoria the opportunity to earn the boon of a
successful differentiator, which is an above-average income (relative to
other pillowcase vendors) generated by a premium price (Porter, 1985).
With her own sewing machine, Victoria would be able to make slightly,
or even boldly, different pillowcases than those sold by other vendors.
She could begin to make and sell complementary products, such as table
cloths, to go with her pillowcases. She might even enlist other microen-
entrepreneurs to sell her products, thereby increasing her profits and providing business opportunities for others.

Without purchasing the sewing machine, Victoria is subject to her suppliers for her main tangible product. The only alternative way she can currently differentiate her business is to create a competitive advantage through superior service or superior location.

Purchasing a sewing machine could increase—more than double—the income for this struggling microentrepreneur. But this is not clear to Victoria because of her current lack of analytical skills. Furthermore, with appropriate training, the purchase could become the means of business growth over several years. A pillowcase production business can also alleviate Victoria’s fear of losing her retail location. If such a loss occurred, her entire business would not be destroyed. Victoria would achieve a higher level of self-sufficiency, gaining more control over her own destiny.

Microentrepreneurs often lack the skills to visualize competitive opportunities through differentiation. A microentrepreneur such as Victoria, who receives training allowing her to successfully gain a competitive advantage and carve out a market niche, is more likely to expand the enterprise (and income) beyond the poverty level. This enterprise growth also provides the best opportunity for the eventual employment of additional workers, benefiting local economic development even more.

Conclusion

Victoria’s case is not isolated. Many microentrepreneurs, especially those in developing countries, would move forward, either in small increments or large leaps, if knowledge and skills were developed alongside expansions in capital funding. Investments in human capital need to be cou-
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pled with seed capital funding if these firms are to fulfill their potential toward poverty eradication. With increasing loan amounts, it is important to provide insights into cost-benefit analysis—based on accurate records—so that sound business decisions can be made.

As businesses grow beyond the subsistence level, training in simple strategic principles can empower many microentrepreneurs to change their lives radically by lifting themselves out of and well beyond poverty. Associated with this growth, microenterprises will employ additional workers, allowing more individuals to move out of abject poverty. To alleviate poverty through microcredit programs, programs must emphasize expansion and provide the training necessary to achieve it.

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