Almost all direct World Bank support for microenterprises is delivered through loans aimed at reducing poverty. A review of the microenterprise programs—most still in the early stages—shows that although they involve only very small amounts, the effort by Bank staff to make them work has been enormous. This large up-front effort will pay off only if these small initiatives are understood as pilot programs from which to draw lessons for future programs that can reach large numbers of people. Thus, they should be monitored carefully and ineffective approaches quickly discarded. If these small but numerous programs are lost in the shuffle as more urgent components in the poverty reduction loans demand scarce staff time, a valuable opportunity to learn more about enterprise development among the working poor will be lost. This Note reviews the design of the Bank’s microenterprise loans, describes the lessons learned, and suggests options for growing the portfolio.

Design lessons
The review raised four key design questions. First, is the strategy of promoting and supporting microenterprise development a sound approach to poverty reduction generally and to employment creation among the poor specifically? Second, are these components packaged correctly by the Bank—that is, is it appropriate and effective to roll microenterprise support programs into poverty reduction operations? Third, are the institutional arrangements used in these operations well-suited to achieving the objectives? And fourth, are the terms and conditions of credit provision in these components in line with international best practice in micro-credit delivery?

Strategy—micro-finance can reduce poverty
Evidence suggests that access to savings services and micro-loans can raise and stabilize the incomes of the poor. The best programs—best in terms of having substantial impact and attaining an acceptable level of financial viability—are a small number of large micro-credit operations. Most well-known among these are the Grameen Bank of Bangladesh (1.5 million borrowers), Indonesia’s BRI/Kupedes program (2 million borrowers and 10 million savers), Banco Solidario in Bolivia, ADEMI in the Dominican Republic, and the Kenya Rural Enterprise Program (15,000 borrowers). All have reached a significant number of microenterprises, primarily
Microenterprise portfolio

Almost all Bank-financed microenterprise programs are components of poverty-related loans. The search for loans containing microenterprise components yielded twenty-one with approval dates after June 30, 1988. Total project cost of the twenty-one loans is US$1.64 billion, of which World Bank loans have financed US$705 million (43 percent). Of the total Bank loan amount, US$924 million (46 percent) is devoted to microenterprise development components: US$97 million in micro-credit programs, US$289 million in technical assistance, and US$419 million in general funds to finance both credit and technical assistance programs.

Three loans—Egypt’s Social Fund, with US$63.6 million in microenterprise-development components; Sri Lanka’s Poverty Alleviation Project, with US$320.0 million; and Mexico’s Labor Market and Productivity Enhancement Project, with US$154.8 million—account for more than 75 percent of the total. In the remaining eighteen operations, over the five-year period, only US$83.7 million was lent for microenterprise development, and in none was more than US$10.4 million allocated for that purpose.

Performance review

Of the twenty-one projects reviewed, three became effective in fiscal 1989, four in fiscal 1990, five in fiscal 1991, four in fiscal 1992, and five in fiscal 1993. None has been completed, and most have started up very slowly.

Micro-credit programs. Of the seventeen loans with micro-credit programs, all but three have begun to make subloans. Of the fourteen active credit programs, seven faced substantial problems at start-up, and at least three continue to struggle with implementation.

Two credit programs are outstanding and merit careful monitoring: Honduras’s Social Investment Fund and Albania’s Rural Poverty Alleviation Project. Both have highly successful credit components, due in part to meticulous planning regarding delivery mechanisms, targeted beneficiaries, and the terms for micro-loans. Between 1990 and 1993 in the Honduran project, intermediary NGOs have on-lent funds to more than 3,000 microentrepreneurs, who have repaid their loans at a rate of 95 percent. In addition, the fund has paid for a 36-hour training program for well over a thousand NGO staff members.

In the Albanian project, Bank and government representatives met repeatedly with villagers who were the intended borrowers to determine the most efficient and effective method of providing credit. At these meetings emerged the unique and highly successful Village Credit Committee design. By March 31, 1994, forty village credit funds had been established in five districts, and 1,300 subloans had been disbursed. The average loan is US$287. Loan repayment began in November 1993, and the loan recovery rate has been 100 percent.

Technical assistance programs. Many technical assistance programs appear to be stalled, mainly because of problems in securing counterpart funds and in clarifying terms of reference and staffing of the implementing institutions. The most successful technical assistance programs have been job training and placement programs, in part because the implementing agencies are already in place and the logistics of such programs is relatively simple, and the programs to develop women’s skills, largely because of the dedication of those involved, from Bank staff to field workers.

Notwithstanding the incomplete picture, one Bank-supported technical assistance program, the Capacitación Industrial de la Mano de Obra program in Mexico’s Labor Market and Productivity Enhancement Project, is clearly exceptional.

with financial services and limited technical assistance, typically in loan application and follow-up.

Packaging—risk of mixed messages

Are poverty-related loans (which also contain public welfare services) the proper place for these microenterprise programs? The answer may be that in principle microenterprise development projects should fit well into comprehensive poverty reduction programs, but in practice it has proved extremely difficult to marry the two, for a number of reasons.

Terms. Mixing public welfare and financial services for the working poor is difficult, in part because the terms under which these services are offered differ fundamentally. Experience shows that financial services need to be provided in a businesslike way if programs are to be sustainable. Micro-credit borrowers must pass merit tests by demonstrating their qualifications to operate small enterprises and to undertake the responsibility of a loan. The message gets blurred when credit programs are mixed with such welfare services as health, nutrition, and sanitation services, education, and basic infrastructure. For these services there is no merit test—it is understood that most costs will be underwritten by the government and donors.

Time horizons. Many programs in poverty-related loans, particularly among the social action funds,
are designed as emergency assistance for situations verging on crises—famines or unacceptable poverty levels resulting from large structural economic shifts. Experience suggests that establishing a makeshift micro-credit program as part of what is essentially a relief effort will have little impact beyond the few individuals reached; will likely end in collapse when funds are reduced or withdrawn; and may undercut the development of a credit rather than a grant culture. The preferable approach might be to acknowledge that building viable micro-credit systems takes several years under the best of circumstances and to assemble just as quickly as possible the necessary ingredients to build such a system. In the interim, where emergency efforts are needed for the desperately poor, a relief effort that involves clearly labeled grants might be in order.

**Delivery—competent institutions matter**

**Project management.** At the most aggregate level, are the types of institutions selected to headquarter poverty-related loans appropriate locations from which to oversee enterprise components? The Bank’s projects are evenly split between those that locate project management units in government ministries (typically ministries of social welfare, rural development, or agriculture) and those that establish new, independent units (mostly the social funds). Surprisingly, neither structure involves use of financial institutions or personnel to oversee credit components.

**Intermediaries.** The competence of intermediaries is predictive of a program’s success. So selection criteria are important. The survey shows that the main intermediaries for microenterprise programs (and all other project components) are NGOs—because they are generally well-situated to reach the poor, can mobilize local resources and populations, and can deliver basic services at low cost. Most programs delegate full lending authority to intermediary NGOs; others restrict NGOs’ role to that of a bridge between borrower and lender. But the selection of intermediary NGOs raises two questions. Are there enough NGOs in the country to administer a microenterprise program? And do the NGOs have the necessary institutional capacity and technical skills? Evidence from the survey suggests that even when the number of available NGOs is not a constraint, their capacity to intermediate microenterprise programs often is—because of weaknesses in institutional depth to manage a program and in specialized financial skills to appraise loan proposals and monitor project implementation.

**Terms and conditions—sustainability a key issue**

Besides selecting delivery mechanisms, designing a micro-credit program requires answering four basic questions: Who are the targeted borrowers? What type of financing is to be provided? How will loans be priced? And what mechanisms will be used to ensure repayment?

**Borrowers.** Loan designs make it clear that the intended beneficiaries of most micro-credit programs reviewed are the very poor in Africa and Latin America—mostly those in rural areas. The survey suggests that this may be one of the hardest groups to serve effectively with micro-credit programs, for the following reasons:

- The most successful micro-credit programs target a mix of borrowers drawn from the working poor and the very poor. None have succeeded by targeting only the very poor.
- Most successful micro-credit programs have operated in urban or rural areas with a population density high enough to generate the volume of loans needed to earn required revenues.
- Existing enterprises, not new start-ups, are the main borrowers (and repayers) in most strong programs—a discrimination that is not apparent in the programs reviewed.

**Type of finance.** The Bank’s micro-credit programs provide mostly working capital, in keeping with the evidence that this is the main need of microenterprises.

**Interest rates.** Pricing micro-loans is a controversial issue. Early models assumed that micro-credit services fall within the arena of charity, and, accordingly, the first donor-financed programs subsidized interest rates at levels insufficient to cover the high transaction costs, loan losses, and expensive accompanying services. The results: poor repayment rates, limited scope, credit rationing, negligible mobilization of
domestic resources, lax program management, erosion of loan funds, and discontinued loan services when grant funds dried up. Almost all donor-financed micro-credit programs of the 1980s failed, in large part because they were not conceived of as business services that had to be at least partially self-financing.

The emergence of a small number of highly successful micro-credit programs over the past decade demonstrates that such programs can reach a large number of borrowers on a sustainable basis. The key to success has been to see micro-finance services as business services and, accordingly, to structure programs in a businesslike way; most important is to price services based on their costs. Also key to these programs’ success has been their work to develop financial systems that include savings mobilization, rather than remaining credit-only programs. In sum, their goal is to develop indigenous, sustainable financial systems that can serve the working poor.

In contrast, while this review showed that many Bank-financed micro-credit programs charge commercial interest rates, there is little evidence that intermediation costs have been taken into account when setting interest rates. Without attention to covering costs, these programs can be expected to go the way of their predecessors.

Repayment. Achieving high repayment rates clearly is key to establishing viable micro-credit programs. Yet, although most managers acknowledge that provisions should be made to encourage high repayment rates, relatively little of substance has been built into the projects. With the exception of an Albanian program that disqualifies the entire village from further loans when a single loan is unpaid, most programs simply put the responsibility for loan collection on the intermediary without creating specific mechanisms or incentives. Surprisingly few Bank-financed programs lend to groups of borrowers, a technique widely used in other micro-credit programs to achieve high repayment rates. Given the poor repayment records of many micro-credit programs, early attention to ensuring repayment is advisable.

Expanding the portfolio
With virtually all microenterprise components still in the early stages of implementation, only tentative conclusions can be drawn at this point. The financial support for microenterprises in these projects is surprisingly limited, and the impact necessarily will be small. A primary justification for the small sums is the limited absorptive capacity of participating intermediaries—not limited demand for micro-credit among borrowers. The impact will increase if the volume of lending increases. Several alternatives could be pursued. First, Bank operations could support successful non-Bank programs, as was done in the case of the BRI/Kupedes program in Indonesia. Second, the Bank could contribute to the capitalization of microenterprise programs with strong track records to accelerate their growth and thus their impact—if mechanisms for doing so could be found. Candidates for capitalization might include network NGOs such as Acción Internacional or Women’s World Banking and the small but growing numbers of NGOs that are moving toward becoming specialized financial institutions. Third, the Bank could strengthen existing indigenous financial systems that have good potential to offer broadly based services to microenterprises, as it is now attempting to do in a small number of countries through projects that seek to rehabilitate rural credit and savings banks.


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