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## M I C R O E N T E R P R I S E

*Laying the Foundation  
for Economic Development*

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# ECONOMIC PERSPECTIVES

## Microenterprise: Laying the Foundation for Economic Development

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Successful small businesses are the primary engines of economic development, income growth, and poverty reduction in much of the developing world. These businesses can also build foundations for stable communities, civil society, and gender equality. However, poor infrastructure, weak public services, inadequate mechanisms for dispute resolution, and lack of access to markets and formal financing remain major impediments to small business growth.

The United States, the multilateral development agencies, and many bilateral aid donors are working to improve this situation by developing new programs that help microenterprises — small, locally owned businesses with up to 10 employees — contribute to dynamic, competitive industries.

Over the past five years, America's average annual funding for microenterprise has been around \$155 million. This support has reached more than 3.7 million microenterprises worldwide — whose activities include producing goods for export, such as footwear, furniture, agricultural crops, and other foods; providing services ranging from equipment repair to information technology; marketing raw materials to manufacturers; and trading a wide variety of goods. As these businesses expand and integrate into the formal economies of their countries, they empower the world's poor, create higher incomes and more jobs, contribute to economic growth, and strengthen democratic societies.

I am proud of America's key role in promoting microenterprise. U.S. objectives are threefold: to improve access to financial services for the world's poor; to support access to business services that specifically address constraints felt by poorer entrepreneurs; and to improve the business climate through regulatory, legal, and policy reforms. Our efforts are global, from Mali in Africa and Jordan in the Near East to Azerbaijan in Europe and Peru in Latin America. Our successes will be universal, with the concerted efforts of the international community. I hope you will join us in taking action towards that goal.

In this issue of Economic Perspectives, you will find insights from key government officials and leading scholars in the field of microenterprise on access to finance and enterprise development and its societal implications. I believe that these issues are more important than ever in the 21st century because microenterprise provides hope and concrete tools for the world's poorest to improve their own lives and realize the basic dignity of self-sufficiency.

*Colin L. Powell*  
*U.S. Secretary of State*

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# ❏ CREATING AND BUILDING A SUCCESSFUL MICROFINANCE ORGANIZATION

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*By Gregory F. Casagrande, Founder and President of South Pacific Business Development Foundation*

*Small loans, often not more than a few hundred dollars, have helped improve income and employment growth for many Samoans and others in the independent Pacific island nations, says Gregory Casagrande, founder and president of the South Pacific Business Development Foundation (SPBD).*

*SPBD, an independent, not-for-profit, charitable microfinance institution, provides unsecured loans for the creation of simple and sustainable businesses such as sewing operations; various food processing businesses; pig, cow and chicken farms; trading businesses, and taxi and distribution services. The author outlines some of SPBD's loan strategies that have resulted in a nearly 100 percent repayment rate by its borrowers.*

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Despite decades of development initiatives, the economies of Samoa and the other independent Pacific island nations continue to generate few economic opportunities for the vast majorities of the local populations. It is clear that a new paradigm for development is critical to the region. The South Pacific Business Development Foundation (SPBD), an independent, not-for-profit, charitable microfinance institution (MFI), provides just such a paradigm. Though only a few years old, SPBD's efforts suggest that a well-conceived microenterprise scheme providing unsecured credit and entrepreneurial training and operated by local staff can have a significant impact on family and community income, living conditions, and education.

## **SOUTH PACIFIC BUSINESS DEVELOPMENT FOUNDATION**

SPBD was founded in the independent nation of Samoa in January 2000. My mission in creating the foundation was to empower poor families via the provision of training, unsecured credit, and ongoing guidance and motivation to help them create sustainable businesses that enable them to significantly improve their living conditions. Since our launch, SPBD has worked with over 2,600 poor families and has distributed over \$1.1 million in unsecured credit, mostly to women. In 2003, less than 1 percent of our creditors were one week or more in arrears. SPBD, while relatively small by international

standards, is now the largest and most successful microfinance organization in the Pacific island region and growing steadily.

## **PACIFIC ISLAND ECONOMIES**

Despite several previous failed attempts at microfinance in the region, there was significant need in Samoa and in the other independent Pacific island nations. According to the United Nations Development Programme (UNDP), Samoa is one of the world's 49 least developed countries and has a 48 percent rate of poverty. The economy is nascent, and most persons have little hope of finding formal wage employment. Lack of employment coupled with a lack of access to credit leaves most people with little meaningful opportunity. Most scratch out a subsistence living in rural villages and hope to get a family member to immigrate to New Zealand, Australia, or the United States. These ex-pat family members, often among the poorest in their new societies, are expected to send remittances home.

Typical living conditions of a family prior to joining SPBD include life in a grass-roofed hut with no walls and a pebble floor, remote access to clean running piped water, substandard outdoor sanitation, and limited access to electricity. Many children do not attend school since public schooling is not free. Families have meager incomes, usually generated by erratic sales of fish or produce and some casual labor for about \$0.50 per hour. Children frequently grow up in dilapidated homes that are often marred by domestic violence.

Prior to 2000, there had been two well-funded microenterprise initiatives and failures in Samoa and well over a dozen failures across the region. Many academics believed these failures were due to the very small size of the national economies and to a non-business oriented, traditional communal culture, which undermined capitalistic solutions. I believed that the previous failures were largely driven by weak management practices and decided to embark on SPBD despite lack of support from the major development players in the region (UNDP, South Pacific Commission, NZAID, AusAID, Asian

Development Bank). Several of these organizations had already suffered from failed microfinance initiatives in the region and were reluctant to support yet another.

## **PLANNING FOR SUCCESS**

From the start, SPBD needed a clear vision of what would constitute success. Our long-term goal was to create an "institution permanently dedicated to serving the financial needs of the poor." To achieve this goal, SPBD focuses on:

- Working exclusively with the most needy in Samoan society.
- Ensuring a positive measurable impact on the lives of our members and their families.
- Continually striving to achieve financial self-sufficiency.

The financial self-sufficiency objective is critical to serving massive numbers of poor on a permanent basis.

Once we defined success, we developed tools to measure whether we were achieving our three objectives.

We created a very simple, cost-effective "social metrics survey" to measure objectively the poverty level of all new SPBD applicants so as to ensure that the foundation works only with the needy. This quantitative tool measures the quality of the applicant's housing, sanitation, access to clean running piped water and electricity, and the quality of their children's education. This enables us to compare family poverty levels objectively and to specifically omit the non-poor from the program. Furthermore, by measuring each family once a year, we can determine whether the family is progressing and whether SPBD is making an impact.

Planning for financial self-sufficiency is not unlike business planning in a typical commercial business. SPBD follows the approach of establishing a target "Affordable Business Structure" (ABS). The ABS is our planned cost structure at break-even, in which interest revenues equal total costs. It is our financial guiding light. An ABS for microfinance institutions will vary from country to country depending upon local demographic and economic conditions.

Revenues vary with the number of clients served, the average loan size, and the interest rate charged. Costs can be broken into three broad categories: administrative, bad debt expenses, and financing costs. The ABS sets a target

level for each revenue and cost component. These targets, which we confirm against industry-wide, best-in-class benchmarks, must be internally consistent with one another and supported by an operating strategy to achieve them.

## **BUILDING MFI ORGANIZATIONAL CAPACITY**

Sustainable organizations require a team that is trained, empowered, and motivated to carry out the work. SPBD recruits and employs local workers at competitive local wages. We have not used expensive consultants but have benefited from the donated services of many U.S.-based volunteers. We recruit staff members that value our mission and are interested in growing with SPBD. We motivate staff by providing ongoing development opportunities, a good career path, and annual merit increases and quarterly bonus packages to high performers. All staff members have clear job descriptions and sign up to specific goals each year. Performance is regularly reviewed, and middle and senior management positions are subjected to annual reviews by all staff members.

Beyond our formal staff, SPBD has built a network of relationships. These relationships include the matai (chiefs) in each village in which we operate, leaders across Samoan society, and practitioners, funders, and leading thinkers in the global microfinance industry. SPBD actively works on all of these relationships to assist with our operations in the village, to attract funding and volunteers, and to keep us on the cutting edge of microfinance practices.

In our ongoing effort to build capacity, we have taken great care to document our own set of operating and financial processes in a set of manuals. These manuals, which are continually updated and refreshed, provide a basis for ongoing, controlled process improvement and for staff development.

SPBD's financial, human resource, and administrative processes are not much different from what you might see in a typical commercial bank. While not unique to an MFI, they are critical to the success of an MFI and should not be overlooked. Two specific areas of importance are management information systems (MIS) and internal control. A good MFI MIS system will have a specialized loan portfolio management system and a separate basic accounting package. These are worthwhile investments. A reliable internal control system is vital to detecting and, more importantly, preventing fraud.

Perhaps because we are a charitable, cash-intensive organization, some people viewed us as a soft target. We were tested many times, especially early on. Whenever we have detected fraud, we have acted swiftly and decisively, and because of these actions, fraud is no longer a significant issue for SPBD although we remain vigilant.

Our operating processes are unique to the field of microfinance and ensure that we maintain very high loan repayment rates and that our members are successful at operating their businesses. These processes include:

- SPBD provides all members with extensive upfront and ongoing training. The two weeks of upfront training includes an in-depth understanding of how the SPBD program works and the basics of small business management. The training is followed by a test on which the applicants must score 80 percent in order to become a member. This test weeds out people who are not fully committed to the program. Members who show a sincere interest in running a business but have not managed to pass the test are given additional training and an opportunity to retake the test. SPBD also provides ongoing mini-training sessions at regular weekly meetings held in each village.
- SPBD members form self-selected groups of four to seven members that self-guarantee each other's loans. Self-selection is critical since village people will know each other well and are best suited to judge the creditworthiness of one another.
- Loan products are specifically designed to be appropriate for the local market. Loan sizes, periodic repayment amounts, and repayment frequency are all important considerations. In Samoa, it is important to be aware that new members are likely to be pressured by their community to get as big a loan as possible – regardless of their ability to repay. Frequent payments, while administratively expensive, help members to develop new habits and keep the MFI and the member well connected. SPBD ensures that loan repayments do not exceed 30 percent of a member's expected total weekly income.
- Members must run successful businesses. This is at the heart of what we do. Our members create businesses around existing livelihood skills and provide simple services and products for which there is already a demonstrated demand. Their business plans must pass the scrutiny of their own self-guarantee groups, which have the power to reject loan applications.

- Loan utilization checks are performed to ensure that the loan has been used as stated on the loan application. Loan misuse often leads to failed businesses and is a stress on the system. When loan misutilization is detected at SPBD, the member is removed from the program.

- The rules governing subsequent loan sizes provide incentive to members to adhere strictly to all principles of the program. Most members are interested in further rounds of financing to expand their business or to improve their homes or children's education. At SPBD, maximum-sized subsequent loans are available only to members with perfect repayment records and perfect weekly meeting attendance and in groups with perfectly functioning group guarantees. There is a reduction in the size of the subsequent loan for each infraction committed. If the problems are too significant, the member may become ineligible for a subsequent loan.

There are many other considerations, but tackling the above is a good start.

SPBD's program has had a direct positive impact upon the lives of thousands of poor Samoans. By providing meaningful opportunity via credit and training, SPBD has helped women initiate simple and sustainable businesses such as sewing operations, bakeries, and various food processing businesses; village-based general stores; pig, cow, and chicken farms; vegetable gardens and small plantations; trading businesses; and taxi and distribution services, and countless others. These small businesses have generated significant additional cash flow for the families and have empowered our members to improve their lives in significant ways. We also provide unsecured credit to successful SPBD microentrepreneurs for housing improvements and childhood education. These products help ensure that the benefits of the business are directly translated into tangible benefits for the entire family. A less tangible but equally real benefit is the increase in self-esteem that accompanies a woman's success in business. It is true that success breeds success. Our members demonstrate it every day through their increased confidence and are actively passing this sense of vitality and optimism onto their children and throughout their village. The future is bright for SPBD members, their families, and their communities. □

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*Note: The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. Department of State.*