Pergamon

www.elsevier.com/locate/worlddev

World Development Vol. 30, No. 8, pp. 1341–1353, 2002
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Printed in Great Britain
0305-750X/02/$ - see front matter

PII: S0305-750X(02)00044-X

Microequity and Microfinance

MICHAEL PRETES *
Australian National University, Canberra, ACT, Australia

Summary. — This paper examines the work of the Village Enterprise Fund, an US nongovernmental organization, in East Africa as a case study in "equity" based microfinance in low-income countries. Many small businesses established in high-income countries rely on some form of equity capital to fund the startup phase and much of the growth of the business. The success of startup grants and equity financing in high-income countries suggests that this method might also be applicable in low-income countries. Using the work of the Village Enterprise Fund as an example, the paper argues that startup grants and equity finance are useful and appropriate in addition to the more common loan-based approaches.
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Key words — Africa, Kenya, microfinance, microenterprises, small business, poverty

1. INTRODUCTION

Many scholars have argued that microenterprise development can be an effective means of assisting the poor in developing countries (e.g., Bornstein, 1998; Johnson & Rogaly, 1997, p. 1; Zeller & Sharma, 2000, p. 144). Microenterprises have the potential to create employment, especially given that, in Africa, for example, the agricultural sector has a limited ability to absorb new job seekers (Mead, 1994, p. 1881). Within the past few decades there has been a dramatic increase in the number of programs that provide capital to the poor to start microenterprises. This capital has largely been provided in the form of loans, despite the need for a diverse array of financial services for the poor, including grants. As Eversole (2000, p. 48) notes:

> by continuing to offer only a limited range of microfinancial services, suitable to certain kinds of businesses, we ignore and perhaps even discourage the rich diversity of microenterprise activities.

This paper argues that "microequity" finance, in the form of small business startup grants, may in some cases be preferable to microcredit programs that provide small loans. The concern in this paper is with grants given by a microequity institution to entrepreneurs in developing countries, rather than grant support for the microfinance institutions themselves. [1] Many small businesses established in developed countries rely on some form of equity capital to fund the startup phase and much of the growth of the business. The success of startup grants and equity financing in developed countries suggests that this method of microenterprise finance might also be applicable in developing countries. Microequity is comparable to venture capital in that the decision-making process, about whom to fund, is similar in both cases. Both venture capitalists in the developed world and grant-giving agencies in developing countries aim to target their support to entrepreneurs who are most likely to succeed in business. Unlike venture capital, in which the financier receives a share of the enterprise's profits, "microequity" as used in this paper refers to the provision of grants by external

* I thank Brian Lehnen, Barbara Lamb Hall, Jackie Ajema Kikuyu, Richard Mazengo, and Michael Ewalu of the VEF, the volunteer field coordinators, and the many small business owners and villagers supported by the Fund, for the helpful information they provided during the writing of this paper and for their assistance during my fieldwork in Kenya and Uganda in September 2000. I also thank Julia Byford, Malcolm Cook, Lesley Crowe-Delaney, Peter van Diermen, and Gerard Ward for their useful comments on the paper. An earlier version of this paper was presented at the Institute of Australian Geographers and New Zealand Geographical Society Joint Conference, Dunedin, New Zealand, January 28–February 1 2001. Final revision accepted: 10 April 2002.

agencies to potential entrepreneurs in developing countries, without any expectation of a share in the ownership or profits of the business. Microequity providers seek to increase social equity—the social equity of the local community and its sustainability and independence from continued overseas aid. Social equity is concerned with addressing the gap between rich and poor, reducing social inequality, and promoting security and economic prosperity (Cambridge Sustainable City, 2001). By combining social equity and business, grant-making institutions are a kind of social enterprise (Dunford, 2000).

Most important, grant-based finance may be able to reach the very poor. [2] This paper examines the relative advantages of credit and grant-based approaches, and discusses the example of the Village Enterprise Fund (VEF), an NGO that makes small grants to entrepreneurs in Kenya, Uganda, and Tanzania.

2. MICROENTERPRISES

(a) *What do microenterprises need?*

Microenterprises are firms with fewer than five employees; they are typically unregistered and do not pay taxes. To be successful, microenterprise entrepreneurs must possess managerial skills, knowledge of markets and prices, and the technical ability to create their product. Simple vending businesses require general managerial skills but little technical ability, whereas manufacturing businesses such as furniture making require an additional knowledge of the craft. Furthermore, the entrepreneur must have sufficient capital to finance the startup costs of the business, plus access to additional capital to fund further growth: "it is the lack of capital that most frequently keeps a person from becoming self-employed" (Sonfield & Barbato, 1999, p. 3). Ability and capital are both necessary if the business is to be successful and is to provide an income for the entrepreneur and his or her family.

(b) *Financing microenterprises*

There are several possible sources of capital that the poor can theoretically access to fund a microenterprise. One is *self-financing*. In a self-financed business, the owner saves his or her own earnings or borrows from relatives. This is not always possible, however. The poor, living on a subsistence income, may be unable to save. This is especially true in times of natural disaster or social upheaval, when many people have lost all of their assets. Even among the poor who can afford to save, a lack of savings institutions makes savings difficult (Otero & Rhyne, 1994, p. 28). In his study of microenterprises in Madagascar, Zeller (1994, p. 1896) noted that friends and relatives may provide much short-term capital. This assumes, however, that friends and relatives have money to lend.

A second possible source of capital is local *moneylenders*. The poorest and most vulnerable borrowers often have little or no collateral to put up for a loan; this increases the risk to the lender. For this reason, moneylenders will often refuse to lend to the very poor. For example, Buckley (1997, p. 1084) observed that in Malawi "there was a general feeling that moneylenders would not lend to the poorest members of a community but only to those who could offer some form of surety such as a member of the family with a wage income or a particular asset." Moreover, moneylenders' interest rates are often prohibitively high, making them an undesirable source of credit for many. Sometimes these interest rates can be as high as 20% *per day*.

A third possible source is *commercial banks and other lending institutions*. These are problematic for the very poor. According to Zeller and his colleagues at the International Food Policy Research Institute, "the majority of the poor in developing countries lack access to formal credit" (Zeller, Schrieder, von Braun, & Heidhues, 1997, p. 62). There are three major reasons the poor cannot access formal credit: a scarcity of investment capital in developing countries, the need to be near a bank branch to access services, and the inability of the poor to assume the risk of repayment if the business venture fails. Commercial banking barely penetrates most rural areas (White & Killick, 2001, p. 69). Even if the poor own land, it is often not possible to use it as collateral, because of ambiguous or unrecorded traditional title or because of regulations prohibiting the use of land as collateral (Yaron & Benjamin, 1997). As Hulme and Mosley note in their major work, *Finance Against Poverty*, "the poor cannot afford to take risks, hence they avoid doing so as far as possible" (Hulme & Mosley, 1996, vol. 1, p. 182). Banks and other lending institutions

are therefore not the best source of capital for the very poor. [3]

A fourth form of finance is *microcredit institutions*, discussed in greater depth below. Some microcredit institutions are exogenous, and are established and maintained by external donor agencies. Others, like the Grameen Bank in Bangladesh, are indigenous institutions and are locally controlled and managed. Microcredit institutions will often make loans to clients rejected by commercial banks, and therefore there is normally little competition between microcredit institutions and banks (Zeller, 1994). The principal advantage of financing through microcredit programs is that these programs are willing to loan small amounts to first-time or less creditworthy borrowers, and sometimes to those lacking collateral. Subsidiary advantages include creating a credit history for the borrower and instilling a sense of responsibility through the need for repayment.

Large microcredit institutions exist in some countries and have generally been successful in assisting segments of the poor. Microcredit tends to work best for those borrowers with diverse income sources and who have a genuine ability to repay their loans (Schreiner & Colombet, 2001, p. 351). The Grameen Bank in Bangladesh, for example, makes small loans in rural areas through a large network of branches and alternative delivery services. Loans average $160 with an interest rate of about 16%, and no collateral is required. In Indonesia, the Bank Rakyat Indonesia's Unit Desa also makes small loans geared towards rural clients. These institutions are not necessarily self-sustaining. The Grameen Bank obtains most of its loanable funds on a commercial basis from the central bank, or from other financial institutions, money markets, and international aid organizations (Grameen Bank, 2001). Dependence on commercial financial markets can be problematic, given "an unstable macroeconomic environment, biased sectoral policies, excessive government intervention, and legal and regulatory barriers" (Yaron & Benjamin, 1997).

Despite their general success, microcredit programs face some problems. In particular, these institutions may not reach the very poor, given their need to sustainably finance themselves through cost recovery (White & Killick, 2001, p. 69). As Eversole observes, "credit for businesses seldom reaches the poorest" (2000, p. 48). The high interest rates, typically between 15–30% per annum, are often unacceptable to impoverished potential borrowers because they cannot assume the risk of repayment.

(c) *Is loan funding always best?*

The provision of microcredit in developing countries is based on several assumptions:

(i) That borrowers need to have a compelling feeling of obligation to repay a loan, otherwise the funds will not be valued and there will be little effort expended in making the business flourish;

(ii) That loans are the only financing mechanism available that can provide sufficient capital to meet the need for microenterprise finance;

(iii) That with the imposed discipline of loan repayment, the borrower will build a credit history that will allow him or her to access traditional capital markets in developing countries, such as banks or government lending institutions.

Though microcredit serves a useful function and is a necessary component of the wider provision of microfinance, there are a number of potential problems with exclusively loan-based programs. A serious problem is the potential for loan default if business income declines or if the business fails. Johnson and Rogaly (1997, pp. 11–12) and Hulme and Mosley (1996, pp. 120–122) note that the very poor have a limited ability to assume risk, and that very poor borrowers may become worse off because of business failure. In several well-documented cases concerning the Grameen Bank in Bangladesh (see Rahman, 1999; Goetz & Gupta, 1996), borrowers have had to refinance loans to make payments (often by borrowing from moneylenders), have had to sell household assets or their own food supplies to make payments, or have had to leave their home village for an urban area in order to find wage labor to repay their loan. As Simanowitz (1999, p. 177) notes in his study of South Africa:

> The fact that good credit discipline provides entitlement to further loans acts as a strong incentive for members to borrow money to repay the loan, in the knowledge that they will be able to pay off the credit with the next loan. In this situation, credit will serve to create indebtedness and dependency.

The system of collective peer pressure that has contributed to high repayment rates also has a darker side: some borrowers who have had difficulty in making payments have been

humiliated and stigmatized in their villages, becoming virtual outcasts. The pressure to make payments and repay the loan can create social tension, especially in small communities where everyone knows the borrower's situation. Sanctions may also apply against all members of a loan group, even though only one member defaults. Furthermore, women do not always benefit from microcredit programs aimed especially at them, because their husbands or other male relatives may force them to obtain loans, and then use the money themselves, leaving the women to find some way of making payments (see Rahman, 1999; Goetz & Gupta, 1996; Simanowitz, 1999).

Microcredit institutions may have difficulty in reaching the very poor because, especially in East Africa, most microcredit organizations conduct their work in urban areas, where loan clients are concentrated in close proximity, reducing the costs of monitoring and collecting loans. The rural poor often cannot access microcredit facilities due to distance. A high proportion of poverty in Africa is located in rural areas (White & Killick, 2001, p. 17). The cost of delivering financial services to remote rural areas is high, and often too high to make a microcredit institution operating on a cost-recovery basis viable. Equal access to financial services would also help to ensure fairness, because "unequal access may perpetuate unequal wealth" (Schreiner & Colombet, 2001, p. 340).

Another underlying problem with loan-based programs is the conflicting goals of the program. On the one hand these programs attempt to provide universal credit to the poor, but on the other hand they need to be profitable to continue their existence. Many loan programs attempt to avoid this conflict by making larger loans to creditworthy borrowers while denying credit to the very poor and unknown, a process known as "loan creep." Hulme and Mosley (1996) note that financial benefits disproportionately accrue to the middle poor and do not reach the very poor. As Schreiner and Colombet note from their study of microfinance in Argentina:

> The poor pay more for financial services because the poor cost more to serve. They demand small loans for short terms, but they are unable to signal and guarantee creditworthiness with constant income from a salaried job or with physical collateral (2001, p. 339).

The high repayment rates claimed by some agencies may be a reflection of this process. This self-congratulation may not always be warranted. Hulme observes that microcredit agencies:

> have created the myth that poor people always manage to repay their loans because of their ability to exploit business opportunities. This is nonsense ... [N]ot all microdebt produces favorable results, especially for poor people working in low-return activities in saturated markets that are poorly developed and where environmental and economic shocks are common (2000, p. 26).

In sum, microcredit's ability to help the very poor may be limited. Johnson and Rogaly (1997, p. 12) note microcredit programs' "appropriateness as a strategy for poverty reduction in the case of the poorest people is questionable." And Zeller and Sharma (2000, p. 144) observe that "outreach to the poorest is low." These conclusions suggest that other means are necessary to reach the very poor.

(d) *The role of "equity" financing*

Equity financing, in the form of grants, can successfully address some of the inherent problems of credit financing. Equity financing, which is a common source of capital for most enterprises in Western industrial countries, need not be the exclusive source of startup capital for a microenterprise. For example, innovative businesses in the United States, Europe, and Japan—especially those in the high-technology sector, where product innovation is essential—initially rely on equity financing, which is later supplemented with credit once the business becomes established. Most high-technology business startups have as little initial access to bank loans as do many of the poor in developing countries because they lack the same requirements, such as credit history and collateral. Therefore many business startups look to venture capitalists who agree to share the risks as well as the rewards. This is especially true of enterprises with untested products, untested markets, or where the entrepreneur is largely unknown.

Equity financing provides reduction of risk (by sharing it between the entrepreneur and the financier) and lower transaction costs. With shared risk, the poor can consider starting new enterprises or adopting innovations that might prove too risky if financed through borrowed capital. Transaction costs of small grants may also be lower than the transaction costs of small loans, because processing and collecting a

small loan takes a great deal of time but does not generate much revenue. The cost of incomplete information is higher for loans compared to grants. Lenders therefore tend to focus on larger loans, where the transaction costs as a percentage of the loan are smaller. The cost of processing and collecting a large loan is essentially the same as for a small loan, but the returns are much greater on a large loan. Equity grants avoid the cost of collection entirely and also minimize processing costs, because the recipient's credit history does not need to be thoroughly researched. A further benefit of equity financing is that it can create creditworthiness for the entrepreneur. An established business—after initially being started with a grant—stands a much better chance of qualifying for credit than does an unknown startup.

Equity-based grants are not handouts and do not necessarily instill a welfare mentality in the recipient. [4] As Eversole (2000, p. 50) notes, grants "equip beneficiaries' capacity for independent action." A welfare mentality can be avoided by making grants to small groups, where peer pressure acts to insure that the grants are used appropriately, and where misuse may impinge upon the ability to receive future grants. [5] Instead, an equity grant creates a partnership between the entrepreneur and the financier, both of whom have an interest in the success of the business. In the case of venture capital firms in developed countries, the interest of the financier is in showing a financial return on his or her investment. In the case of a grant-making agency in a developing country, the interest is in developing the community's "social equity"—the desired goals of sustainability, economic development, the generation of new products and services, and other community benefits. An increase in social equity ultimately reduces the recipient country's need for foreign aid—much of which is already in the form of grants and other forms of non-repayable assistance.

One of the few studies that directly compares the relative advantages of loans and grants is that of Sonfield and Barbato (1999). Their study, which focused on programs assisting displaced workers to become self-employed in developed countries, noted that:

> Equity assistance is preferable to credit assistance. Small start-up businesses generally have weak or poor cash flow situations for a period of time, often for more than a year. The difficulties and pressures facing a new business owner are always very formidable, and an obligatory and totally structured loan repayment schedule can often be a fatal factor. Thus, although obviously more difficult to fund, a self-employment development program which includes equity support rather than credit support is more likely to create a greater number of successful new start-up businesses. The issue of program funding then becomes a critical one (Sonfield & Barbato, 1999, p. 4).

Sonfield and Barbato's (1999) study describes a number of grant-based programs that provide assistance to the unemployed in North America and Europe. For example, a program in Washington State, in the United States, allows workers to receive unemployment benefits as a lump sum, provided they start a business with the capital. Similar programs in Great Britain and France have assisted over 700,000 persons since 1979. As they observe, "a self-employment development program which includes equity support rather than credit support is more likely to create a greater number of successful new start-up businesses."

A potential obstacle to grant-based microfinance is the long-term sustainability of the grant-making agencies. As these agencies do not recover the sums they transfer to microenterprises, they rely on a continual stream of donations from individuals in developed countries. Though the long-term existence of these agencies cannot be guaranteed, the continued ability of such programs as Trickle Up and the VEF (discussed below) to expand their programs suggests that they are able to sustain themselves through fundraising, new donations, and the establishment of endowments. Moreover, the enterprises created by equity finance are often themselves sustainable, providing employment and income for their proprietors. A final consideration is whether sustainability is an essential aspect of a successful microfinance program. Sustainability may not be necessary. As Dunford (2000, p. 43) notes:

> What is most important here? Is it to build social enterprises that can last long enough to bring about major improvement in the lives of very large numbers of people? Or is it to become certified as totally subsidy-free?

Though sustainability is certainly desirable, it is perhaps wise not to fetishize this concept if poverty is being reduced.

Equity-based grants fill a niche largely ignored by microcredit agencies by helping to mitigate the risk of startup businesses and by contributing to the social equity of a community. In filling this particular niche, equity

grants complement, rather than compete with, microcredit programs. Ideally, grant- and loan-based programs will work in tandem to offer a complete spectrum of financial services—geared to differing needs—to communities in developing countries.

3. THE VILLAGE ENTERPRISE FUND

The VEF is a microfinance nongovernmental organization (NGO) that makes small business grants, rather than loans. Its goal is to reach the very poor, or those who are too poor to undertake the risk of borrowing. VEF was founded in 1987 by Brian Lehnen and Joan Hestenes, and is based in Redwood City, a suburb of San Francisco, USA. In the 15 years of its operation VEF has worked in 12 countries. Today the Fund operates only in three: Kenya, Uganda, and Tanzania. Within these countries there is a specific regional focus on the Kakamega area in western Kenya, in eastern Uganda centered on Soroti, and in the Dodoma area of central Tanzania. Selection of these areas is partly based on levels of poverty and the need for employment, and partly on the local personnel available to assist the program. The focus on these three neighboring countries allows for consolidation of efforts and reduces administrative and travel expenses. The broadly similar culture, and the common languages of Swahili and English, also help facilitate the transferability of program information across the region.

(a) *Structure*

The function of VEF is to transfer wealth from donors in developed countries to entrepreneurs in developing ones. VEF is a nonprofit organization incorporated in California, and contributions to the Fund on the part of private donors are tax deductible. In order to reduce administrative expenses, VEF operates with a minimum of administration. Oversight of the Fund is the responsibility of a seven-member Board of Directors, who set general policy guidelines, undertake strategic planning, and assist with fundraising. Many of the Board members come from the high technology, commercial real estate, and investment sectors, providing many useful contacts with potential donors.

A three-member staff, all of whom work part-time, carries out direct administration of VEF. These are the executive director, the development director, and the operations administrator. The executive director's duties include managing day-to-day operations, making presentations to potential donors, reviewing grant applications, making semi-annual visits to the field, and handling any problems that may arise in the course of the Fund's activities. The other two positions are responsible for fundraising, processing grant applications, and record keeping.

Each of the three countries of operation has its own country director, who is a national of that country. Country directors generally hold full-time positions and are payed a salary that reflects the cost of living in their home community. Each country director has a salaried assistant. Country directors have been delegated a great deal of authority and can approve grant requests within their own countries, which speeds up the process of grant approval.

Each country director manages a network of volunteer field coordinators, about 25 in each country. Volunteer field coordinators are recruited by the country director, either through personal knowledge or referral. Country directors, with assistance from the US staff, assess the qualifications and abilities of the volunteer field coordinators. The coordinators are normally people known and respected in the local community, and are often teachers or pastors of local churches. Volunteer field coordinators identify potential grant recipients in their local communities, and assist these potential recipients with the grant process, which includes application, training, and monitoring. They themselves receive training from the country directors and US staff, and are responsible to them. They do not receive a salary but have some of their expenses reimbursed. Volunteer field coordinators attempt to identify the very poor within their community, and approach them regarding the possibility of establishing a small business.

The four levels of administration provide for an effective, rapid, and low-cost process of grant application and administration. The Kenya, Uganda, and Tanzania based country directors are able to make grant decisions without having to consult with the US headquarters. The responsibilities of the US office are primarily to raise the funds to be distributed and to manage overall operations.

VEF's income is derived from donations. In 2001, VEF had a total income of $333,574, [6] of which about 80% came from individual donations. The remaining 20% came from members of the Board of Directors, from churches and

church groups, and from outside funding institutions. Thirty-seven percent of VEF's expenditure was given out as grants. The remaining 53% of expenses included the costs of training programs for grant recipients and volunteer field coordinators, administration, and fund-raising and marketing.

(b) *Grant process*

Volunteer field coordinators identify potential grant recipients in their own communities, which are typically rural villages or small regional towns. Potential entrepreneurs also identify themselves to the volunteer field coordinators. The volunteer field coordinators seek to identify the very poor within their community, using their own local knowledge, and bring them together into groups. A minimum of five people may apply together as a group. The individuals in the group are not required to form a joint business, and may form five separate businesses if they wish. The purpose of the group grant is to consolidate the application and disbursement process, to provide the recipients with a network of similar applicants, and to provide some pressure on the recipients to use the grant appropriately. The coordinators make an initial determination as to the applicants' suitability for a grant, which includes an assessment of need and entrepreneurial potential. Assessment of need is based on a Standard of Living Index compiled by VEF and is a simple questionnaire determining existing income (if any), number of people in the household, diet, possessions including beds and clothing as well as land and animals, and condition of housing (see Appendix A). Entrepreneurial potential is more difficult to assess, but is based on knowledge of the person's working habits, skills, ability to learn, and so forth. The coordinator then assists the applicants in filling out a simple one-page form requesting a grant. This form is forwarded to the country director, who makes a decision. The number of applications that can be supported each year is limited by the funds available. The US headquarters gives country directors an indication of how many grants can be made during a given period and therefore how many applications can be submitted.

Grant applications require the names of the applicants and their expected duties in the business. Applicants with more limited entrepreneurial potential might have different responsibilities in the business, such as manufacturing a product, and be placed in a group with more entrepreneurial individuals. Applicants are required to describe their new business, including materials necessary for production, expected expenses, expected sales, and expected profits. The delegated project leader of the group signs the form, as does the volunteer field coordinator. The latter also gives his or her opinion as to the income level of the members of the group, identifying whether they fall into the poorest class in the local community. Volunteer field coordinators are generally able to do this accurately, given that they live in the same community and are familiar with local wages, standards of living, and costs. In their meetings with the applicants, volunteer field coordinators also have the chance to view the applicants' dwellings and material possessions.

Grant applications, once approved by the country director, are then forwarded to the US headquarters, which will only reject an application if the form is filled out incorrectly or if key data are missing. The US headquarters files the application and arranges for a check to be forwarded. The current process is for one transfer to be made to an account in the recipient country maintained by the country director, who then distributes these funds. Figure 1 gives a summary of the grant process.

Grants are for $100, though VEF is considering varying the grant amount based on the type of business to be established. The first installment of $50 is paid out when the country director and the US office approve the grant. The second installment of $50 is paid out after a six-month review and progress report is completed. This report indicates the profits made by the business and any problems that it may have had. The grant recipients describe their successes and problems, the number of people that they estimate have benefited from the business (such as other family members), a description of the enterprise itself, and financial information such as income, expenses, and profits. Record keeping by the business owner is required as part of the grant process and is explained during training sessions given by the volunteer field coordinator.

Business training is an important part of the grant process. Key training needs include general management, bookkeeping, and ways of continuing or growing the business. The country director contracts with a local trainer, usually someone from a local or international NGO. The training, which runs for one or two

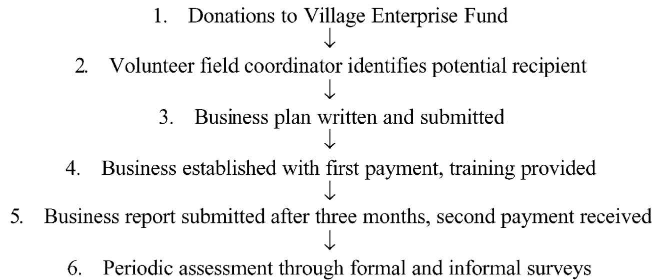

Figure 1. *VEF grant process.*

weeks, takes place at a site once or twice a year, with the country director and all volunteer field coordinators attending. The cost is borne by VEF. The training also gives an opportunity for the volunteer field coordinators to share their experiences as well as an opportunity for them to educate themselves in business methods. These skills are then passed on to the grant recipients. VEF is also experimenting with training sessions in which the grant recipients get together to share their experiences.

Grants fund a wide variety of businesses. These have included agriculture, bakeries, tailoring, fishing, vegetable oil, grocery retail, bicycle repairs, straw and wood articles, candles, shoe repair, roofing, pottery, and general retail trading. These enterprises fill a need by providing convenience, leaving customers time for other tasks, or by providing services or products otherwise unobtainable. Individuals will purchase goods and services if they are available locally, without the high costs of travel to obtain them in urban areas. VEF specifically does not fund such businesses as liquor sales or anything that they determine to be questionable or socially harmful.

Groups that have received their second payment are no longer officially monitored by VEF, though the volunteer field coordinators typically keep in touch with the recipients and are able to provide informal reports of their status as well as further advice as needed. Coordinators instead direct most of their efforts toward identifying potential new recipients.

(c) *Performance*

Performance assessment is essential in analyzing the impact that microfinance programs have in reducing poverty. As Simanowitz (1999, p. 177) notes:

> Measuring impact is important for poverty-alleviating programmes, since the people they deal with are very vulnerable. For members to fail is not acceptable since, if even a small percentage of people are made worse off as a result of the programme, it is a serious problem when these people are already among the poorest.

Assessment may be less critical with respect to microequity programs, as, unlike in the case of loans, grant recipients cannot be made worse off because they have no obligation to repay even if the business fails. For this reason, VEF does not regularly assess the performance of each enterprise beyond the second installment of the grant. It is also difficult to compare the performance of credit versus grant based approaches to microfinance because, for most microcredit institutions, performance is usually judged by the performance of the microcredit institution itself, through repayment and loan recovery rates. Zeller (1994, p. 1895) observes that "the performance of group lending, which is most often only measured by its repayment rate, has been mixed." Sinha (1998, pp. 2–5) notes that measuring the impact of microcredit on both poverty reduction and empowerment is extremely difficult.

VEF does not officially monitor businesses beyond the six-month or one-year mark. But, field visits by volunteer field coordinators, country directors, and US headquarters staff provide informal assessments of enterprise progress and development. From such data, as well as from comprehensive surveys carried out by the Fund in 1996 and 2001, VEF is able to estimate that approximately 88% of enterprises remain in business for more than one year, while about 77% survive for more than three years (see Table 1). After the initial $100 grant, many of these enterprises become self-sustaining and often expand by accessing microcredit services, using loans to expand.

Table 1. *VEF business longevity*

Survey year	Length of business operation			
	>1 year	>2 years	>3 years	>4 years
2001[a]	88%	78%	77%	NA
1996[b]	80%	NA	NA	50%

Source: VEF surveys, 2001 and 1996.
[a] $N = 960$.
[b] $N = 507$.

VEF also assesses performance based on changes in the grant recipients' standard of living. VEF conducted a survey in 2001, using the same Standard of Living Index as that for determining grant eligibility, to assess changes six months after an enterprise was established. The results, shown in Table 2, suggest some improvements in the general standard of living. For example, the average number of meals eaten per day by grant recipients and their families increased from 1.6 to 2.1. A greater number of individuals also owned household items such as mattresses and blankets six months after starting their business. This data indicate that grants are indeed assisting some of the very poor in rural East Africa.

Grant recipients have responded positively to VEF's grant program. The following quotes from recipients indicate the uses to which business profits have been put, as well as general perceptions of the overall impact of the program (all quotes from VEF files, 2000–2001):

— The project fund has sponsored one child to school through small business (Kulwa Halima, Tanzania).

Table 2. *VEF standard of living changes*

Standard	Before grant[a]	Six months after grant[b]
Average # of meals per day	1.6	2.1
Average meat/fish per week	0.9	1.9
% owning a bed	42%	54%
% owning a mattress	51%	70%
% owning blankets	48%	76%
% owning bed sheets	58%	73%
Average quality of clothing (5 point scale)[c]	1.7	2.7
% of children in school	62%	71%

Source: VEF survey, 2001.
[a] $N = 780$.
[b] $N = 348$.
[c] Assessment by Volunteer Field Coordinators.

— We have a job and our future is made bright (Egau Girado, Uganda).

— This grant came at the right time to enable our family to run this business; we realized good profit and we can now buy meat, sugar, clothes, and school uniform for our children (Muron Emmanuel, Uganda).

— There is no longer persistent sickness in our family since we are able now to buy medicine; the family is now healthy (Akorimo Godfrey, Uganda).

To date, VEF has funded over 6,500 businesses, distributing over $650,000 to fledgling entrepreneurs in developing countries (Table 3). Many if not most of these recipients had no access to formal credit markets and would not have qualified for even microcredit services. As VEF is a grant-based program, there are no repayment rates that can be used as measures of success. Likewise, the lack of continuous monitoring makes assessment difficult. Nevertheless, random sampling of the businesses established in the three East African countries where VEF currently operates suggests that the program has been of great benefit to the communities.

Not all enterprises have succeeded, however. In the 1996 survey, the top three reasons given for business failure were people problems (26%), crop problems (13%), and product problems (13%). People problems were defined in the survey as "the business members or leader had conflict, or moved away, or found other work, or got sick. Or business members split up and each took part of the business." Crop problems were defined as "failure due to pests, or disease, or drought. Or business could not pay for seed, land, water, fertilizer, or pesticide." Product problems were defined as "materials or tools needed not available or too expensive. Location or storage or transportation unavailable or too expensive. Materials or tools needed [were] spoiled or broken. Business member did not have skills to produce products."

Table 3. *VEF results 2001, and cumulative 1987–2001*

Period	# of businesses	Volunteer field coordinators	# Entrepreneurs
2001	1,366	75	6830[a]
1987–2001	6,508	156	32,540[a]

Source: Village Enterprise Fund, *Annual report*, 2001.
[a] Estimate.

Table 4. *Trickle Up Program results 2000, and cumulative 1979–2000*

Period	# of Businesses started	# of Coordinating agencies	# Entrepreneurs	% Female	Main source of income[a]	Average three-month profit
2000	12,940	275	39,129	58%	86%	$117
1979–2000	95,484	1,541	426,660	61%	78%	$169

Source: Trickle Up Program, *Annual report*, 2000.
[a] Percentage of persons for which grant-sponsored business is main source of income.

From this survey, as well as from the semi-annual field visits of VEF staff and from reports made by volunteer field coordinators, VEF has determined that there is a substantial need for training, especially at the early stages of establishing the business. In particular, the need for training is greatest just after the first grant installment is received. Moreover, greater contact between the volunteer field coordinator and the business members decreased the rate of failure. Since 1996, VEF has attempted to provide more comprehensive business training at the early stages and to increase the site visits on the part of volunteer field coordinators.

(d) *Other microequity institutions: the trickle Up Program*

The VEF is not alone in choosing to make small business grants, rather than loans, to the very poor. An older and larger organization, the Trickle Up Program, has been making startup grants to microenterprises since 1979. The VEF is largely modeled on the Trickle Up Program, and the grant process, as well as the size of the grants ($100), is similar in both cases. Because of these similarities, the Trickle Up Program will not be discussed in depth here (see Eversole, 2000; and Trickle Up Program, 2000, for further details). A few differences however are worth noting.

The Trickle Up Program was founded in 1979 and is based in New York; its first grant was to an entrepreneur in Dominica. Like VEF, Trickle Up seeks to help the very poor. A much larger organization, Trickle Up currently works in 32 countries on four continents (including the United States, where several $700 grants are given to help business startups). To date, Trickle Up has financed 95,484 businesses, benefiting 426,660 people (Trickle Up Program, 2000). Rather than using its own volunteer field coordinators, the program uses independent coordinating agencies, which are typically other NGOs but may also include church groups, national government institutions, and United Nations agencies. These coordinating agencies usually have their own programs, often involving microcredit, but will identify potential grant recipients (commonly those not qualifying for microloans) to Trickle Up and will assist with the grant process.

Trickle Up does not assess its performance based on business longevity, but it does collect more data about business success than does VEF. It also collects additional information about its clients (Table 4). For example, Trickle Up collects profit data, and is able to report that the average three-month profit for its funded enterprises was $117 in 2000. The program is also able to provide data on the percentage of its grant recipients for which the funded business was the principal source of income; this was 86% in 2000 (Trickle Up Program, 2000). Trickle Up, as a larger organization, is able to collect and process more data about its funded enterprises, but its example may suggest some ways in which the VEF could assess its own performance.

4. CONCLUSIONS

In most business ventures a variety of financial services is needed to cover different stages and needs of the business at any given time. In developing countries, loans—especially for very poor residents—may not be the most appropriate source of financing for new or innovative microenterprises. Loans may instead be suitable in cases where a microenterprise is already profitable and can afford the risk of a loan for business expansion. Equity grants therefore fill a real need in assisting microenterprise startups, especially in new and innovative programs where risk is greater. Grant-based programs also have the best chance of reaching the very poor. White and Killick (2001, p. 117) note that if aid could be targeted to the extreme poor, then extreme poverty

would be greatly reduced. The example of the VEF in Kenya, Uganda, and Tanzania demonstrates how a microequity institution can succeed in reaching many of the rural poor.

Microenterprises in developing countries need *both* grants and loans. Partnerships should be developed between grant and loan programs to provide a portfolio of financial services to microenterprises. These partnership opportunities have great promise in meeting the mutual needs of microenterprise entrepreneurs in the developing world. As Johnson and Rogaly (1997, p. 12) note, "Although microfinance provision appears to be evolving towards greater sustainability, relevance, and usefulness, there are few certainties and the search for better practice continues." Microfinance scholars and practitioners should give greater consideration to grant-based microequity programs as part of this search.

NOTES

1. For a discussion of the role of grant support to microfinance NGOs, see McNamara and Morse (1998).

2. It is important to bear in mind that poverty is not merely defined as low income, but also includes various kinds of deprivation, insecurity, and vulnerability—especially the ability to respond to crisis situations (Rakodi, 1999, pp. 315–316). It is also important to consider that the *poorest* in a society may consist of the mentally and physically disabled, the elderly, and street children (Hulme, 2000, p. 27), groups that may be beyond the reach of microfinance.

3. Commercial banks and other formal lending institutions may be an especially poor source of capital for small business startups. A 1993 study of sources of startup capital for minority-owned small businesses in the United States noted that "the problem is that banks do not normally provide financing for start-up businesses" and that "banks are not the source for start-up capital because it is not [their] market to be out there lending to start-up businesses. That's more the venture capital system" (Barriers to Bank Lending, 1993). This study was conducted in a developed country; the problems of microenterprise startup in developing countries are even more extreme.

4. It should also be borne in mind that many academic scholars receive research and travel grants, but they do not usually see these as "handouts" or "charity." Rather, they are a form of "equity" funding that provides a community or societal benefit extending beyond the recipient.

5. Grants to small groups also help to avoid the potential for moral hazard.

6. All figures are in US dollars.

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APPENDIX A. VILLAGE ENTERPRISE FUND STANDARD OF LIVING INDEX

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APPENDIX

Village Enterprise Fund Standard of Living Index

VFC: ________________Grant Code:______Name of Bus:______________________Date:_______
Person being interviewed: __________________ Gender: M F Age: _______
Physical address: ____
Number of dependents: ________ How many meals can you afford per day? ___________
What is your common food per week?

How many times per week do you eat: meat or fish? _____ sugar in tea? ______

Do you have:			
	a bed?	Y	N
	a mattress?	Y	N
	a blanket?	Y	N
	bed sheets?	Y	N

Coordinator assessment of their clothing: 1 2 3 4 5
very poor average very good

# of school aged children: _______ # of school aged children in school: _______
Are you employed?: Yes No What is your daily wage when you work?: _____________
How many days do you work each month? _________________
Are others in your household employed?: Yes No
List the names of those employed and their daily wage when they work:

List how many days each one works each month:

<u>How many animals do you keep?</u>

cattle ________________	each valued at __________	total ____________
goats ________________	each valued at __________	total ____________
sheep ________________	each valued at __________	total ____________
pigs ________________	each valued at __________	total ____________
turkeys ________________	each valued at __________	total ____________
chickens ________________	each valued at __________	total ____________
other ________________	each valued at __________	total ____________

Do you own any land? Y N How many acres? ______________

How much of your land is under cultivation? ________ What do you use to plow? _________

<u>Do you have:</u>			
	a bath shelter?	Y	N
	a latrine?	Y	N
	a kitchen?	Y	N

<u>Total value of assets</u>

land:	___________
animals:	___________
household items:	___________
Total:	___________

<u>Roof of house:</u>		Walls:		<u>Floor:</u>	
iron sheets	____	cemented bricks	____	cement	____
tiles	____	mud	____	mud	____
grass thatch	____	other (explain)	____	other (explain)	____
other (explain)	____				

Do you have any other comments about your family or home life? (use the back of this sheet if you need more space)