Microenterprise in the First and Third Worlds

Mark Schreiner

June 2001

Microfinance Risk Management
6070 Chippewa St. #1W, St. Louis, MO 63109-3060, U.S.A.
Telephone: (314) 481-9788, http://www.microfinance.com
and
Center for Social Development
Washington University in St. Louis
Campus Box 1196, One Brookings Drive, St. Louis, MO 63130-4899, U.S.A.

Key words: Microenterprise, microfinance, entrepreneurship, community development, technology transfer, non-government organizations

Acknowledgements

A later version of this paper is published in *World Development*, Vol. 31, No. 9, pp. 1567-1580. This research was supported by the Division of Asset Building and Community Development of the Ford Foundation. I am thankful for comments from Cynthia Sanders, Michael Sherraden, and participants in seminars at Ohio State University, West Virginia University, and Washington University in St. Louis.

Author's Note

Mark Schreiner is Research Director at the Center for Social Development, Washington University in St. Louis. He studies ways to help the poor to build assets through savings and loans in the first and third worlds.

Microenterprise in the First and Third Worlds

Abstract

Sparked by examples from the third world, hundreds of microenterprise programmes have been started in the first world. Will they be successful? This paper reviews the evidence and concludes that microenterprise development is more difficult in the first world. For example, the microenterprise sector in the first world is smaller because most people can get wage jobs and because of the public safety net. Unlike third-world entrepreneurs, first-world entrepreneurs are more often constrained by lack of savings rather than a lack of credit. Most microenterprise programmes, however, can do little to facilitate savings. Because many first-world entrepreneurs also lack skills, most first-world programmes focus on training. The cost-revenue structure of this training, however, is not sustainable. The paper offers several suggestions for how to address the challenges of microenterprise development in the first world.

Microenterprise in the First and Third Worlds

1. Introduction

Microenterprises are tiny businesses; most have one employee, the owner. Microenterprise-development programmes make loans and/or give classes to poor people to help them to start or to strengthen their businesses. In the past 15 years in the United States, the number of microenterprise programmes has grown to more than 340 (Langer, Orwick, and Kays 1999). Growth has also been rapid in the United Kingdom (Rogaly, Fisher, and Mayo, 1999; Rogaly and Roche, 1998).

Some scholars believe that microenterprise is a promising way to help the working poor, the unemployed, and those who receive public assistance (Raheim and Alter, 1998; Clinton, 1997; Soloman, 1992; Balkin, 1989; Friedman, 1988). This hope stems from a few programmes in the third world[1] that serve massive numbers of people at a low cost to the fisc. The best-known examples are Grameen Bank in Bangladesh (Khandker, 1998; Hossain, 1988), BancoSol in Bolivia (Gonzalez-Vega et al., 1997; Hulme and Mosley, 1996), and the unit desa system of Bank Rakyat Indonesia (Charitonenko, Patten, and Yaron, 1998).

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[1] Although the Cold War has faded, this paper uses first world and third world to refer rich industrialized nations and poor pre-industrial nations, excluding countries in transition from communism.

The success of the transfer of microenterprise promotion depends on the context (Taub, 1998; Bhatt and Tang, 1998; Hulme, 1990). Can microenterprise programmes work as well in the first world as in the third? This paper reviews evidence of the effects of the context. It argues that microenterprise for the poor is more difficult in the first world than in the third. Microenterprise is a good choice for a few extraordinary poor people, but wage jobs, additional education, and job training are still the most common paths out of poverty (Bhatt, Painter, and Tang, 2001; Servon, 1999; Dennis, 1998; Bates, 1997; Novogratz, 1992; Mokry, 1988; Bendick and Egan, 1987).

Access to microenterprise programmes may double the rate of movement to self-employment from unemployment or from public assistance (Friedman, Grossman, and Sahay, 1995; Benus *et al.*, 1995). The absolute increase in the number of people who would start small firms if they had access to microenterprise programmes, however, is probably about 1 per 100 for the unemployed and about one per 1,000 for those on public assistance (Schreiner, 1999). Few poor people will use self-employment to escape working poverty (Sherraden, Sanders, and Sherraden, 1998; Servon, 1996).

In the first world, access to wage jobs and an effective public safety net decrease the push to self-employment. Most microenterprise programmes in the third world make loans to the poor through groups, but groups in the first world tend to fall apart because of lack of social capital and because individuals with a good credit record can get loans on their own from private lenders. The two most important constraints on self-employment in the first world are a lack of savings and/or a lack of skills, but microenterprise programmes are limited in how they can facilitate savings, and it is difficult and costly to build the human capital required for entrepreneurship.

This following sections describe how aspects of the economic and socio-cultural context in the first world hinder the promotion of self-employment for the poor. Most of these factors are positive features with side effects that dampen the push toward self-employment. This is not necessarily a bad thing. For example, poor people may be better off with a strong safety net and low incentives for entrepreneurship than with a weak safety net but strong incentives for self-employment. The paper also offers recommendations for how to improve microenterprise development in the first world. Most important, funders—whether public or private—should structure support so as to strengthen the incentives for microenterprise programmes to experiment to find innovations that decrease the cost of services and/or increase the worth of services.

2. Differences in typical microenterprises

The microenterprise sector in the first world differs from that of Bangladesh, Bolivia, or Indonesia. ‘Self-employment is not as easily pursued in the United States as it is in international contexts’ (Edgcomb, Klein, and Clark, p. 59, 1996).

Table 1 lists examples of types of microenterprises in the first and third worlds. Most first-world microenterprises produce non-traded services such as child care, haircuts, retail sales, transport, or home, car, or office maintenance. What little manufacturing there is involves custom work such as cabinets, crafts, or clothes. Some illegal microenterprises distribute drugs. The average person in the first world does not spend a large share of his or her budget on purchases from microenterprises.

Third-world microenterprises produce both services and manufactured goods. Most of these small firms are subsistence farms. Many sell cooked food from the sidewalk or food staples from a small store. The average person in the third world does spend a large share of his or her budget on purchases from microenterprises.

Most microenterprise programmes the world over target the working poor. They do not promote the high-demand, fast-growth small firms that may account for a large share of new jobs in the first world. Such ‘gazelles’ are usually started by people such as consultants, architects, or computer programmers who have high human capital. Microenterprise programmes typically have little to offer these growth microenterprises.

Instead, microenterprise programmes focus on low-demand, slow-growth firms. This is sensible because poor, low-skill people are more likely to succeed in such survival-and-maintenance activities. These simple businesses require low levels of financial and human capital, but they also have low returns.

3. Loans to groups of borrowers

The success of microenterprise development in the third world rests mostly on the innovative use of joint-liability groups to make loans to people without traditional collateral (Morduch, 1999). Each group member is liable for the debts of the others; if one does not repay, the others must pay, or else all will lose access to future loans.

Groups can decrease social costs if they tap into existing social capital and use it to shift screening, monitoring, and contract enforcement from the lender to the group. Total costs decrease if the social capital was built in the past. In the third world, this is often the case because group members live or work in the same place or already run informal savings clubs among themselves (Adams and Fitchett, 1992).

Group loans may increase social benefits if their financial intermediation relaxes financial constraints or if their social intermediation relaxes non-financial constraints. For example, weekly meetings of groups in the Grameen Bank not only provide access to loans but also—as a by-product—break down the constraints of *purdah*, giving women a socially acceptable excuse to walk in public, to meet women from outside their compound, and to hear their first names spoken with respect (Larance, 1998).

Microenterprise programmes often prefer group loans to individual loans because they value social capital, because they aim for community-level outcomes, and because, as inexperienced lenders, groups shift many tasks to borrowers. Furthermore, group loans can reach poorer borrowers than individual loans (Conning, 1998). For example, in 1999 the average individual loan in the United States was $10,630, but the average group loan (per member) was $1,802 (Langer, Orwick, and Kays, 1999).

Groups in the first world, however, have been a disappointment (Ashe, 2000; Taub, 1998). Most of the first programmes copied the group concept as conceived in Bangladesh, but most have since switched to focus on training and/or individual loans. Less than one-sixth of US microenterprise programmes make loans to groups (Langer, Orwick, and Kays, 1999). ‘Group-lending approaches in the United States do not carry with them the efficiencies anticipated by the performance of peer programmes in the developing world’ (Edgcomb, Klein, and Clark, p. 41, 1996).

Group lending in the first world have struggled for four reasons. First, social capital among the poor is weak. In the market, most trades are one-shot and impersonal. Unlike the third world, the first world lacks concentrated, personalized markets where the same buyers haggle over each price with the same sellers each day or each week. The faceless, nameless trades with set prices that characterize first-world markets do decrease transaction costs because they do not require buyers and sellers to invest in reputations. As a side effect, however, they stunt the growth of the social capital that would nourish joint-liability lending. In the household, people get their livelihoods from wage jobs or from public assistance and thus are not forced to form many multi-stranded, long-term economic and social relationships beyond the family. Furthermore, social capital is an asset that evaporates to some extent with each move, and people in the first world move often. Without constant contact to build trust, joint-liability groups lack the necessary social capital (Woolcock, 1999).

The second reason that groups have struggled is that the first-world poor are diverse. In theory, joint liability works best with homogenous members because then all members face the same risks. In practice, this can happen in Bangladesh or Bolivia because many entrepreneurs are farmers or petty traders and because every village has scores of people who want to raise chickens or peddle soap. Small towns in the first world, however, may not support more than a couple beauty salons or résumé services. Furthermore, few poor people in the first world can find four friends who also want to start a small business. The mix of cultures and ethnicities in the first world may also decrease social capital if people tend to avoid others who differ in these ways.

Third, groups in the first world often fail because microenterprise programmes do not enforce joint liability (Hung, 2001; Bhatt, 2000). It is not nice to make an honest borrower pay the debt of a defaulter, but forgiveness sets an example that unleashes an avalanche of arrears because group members no longer have selfish reasons to select trustworthy peers, to watch them, and to pressure them to pay.

Fourth, groups break down because even poor people in the first world—if they have a clean credit record—can get individual loans through credit cards. Revealed preference suggests that most borrowers would prefer to avoid groups and thus to avoid the high transaction costs needed to maintain friendships, coax and cajole delinquent partners, and mete out punishments.

Joint liability also means that honest borrowers must sometimes pay the debts of defaulters. This can spark a domino effect in which borrowers who would have paid their own debts choose instead to stop payment, both their own debts and those of defaulters (Besley and Coate, 1995). Groups also break down because the fortunes of members diverge through time. Some members have more luck, skill, or effort and so want bigger loans, but poorer members cannot afford to be saddled with big debts should their less-poor partners default, so the group breaks up.

Joint-liability groups are the main innovation in microenterprise development in the third world, but they do not work well in the first world. First-world programmes should recognize this and move on to look for innovations appropriate to their context.

4. Size of the microenterprise sector

The first-world microenterprise sector is small. Microenterprise accounts for 60–80 percent of jobs in the third world but only about 8–20 percent in the United States (Edgcomb, Klein, and Clark, 1996). Alternatives to self-employment—wage jobs and public assistance—reduce the size of the sector and the pool of entrepreneurs.

First-world economies are large and well-integrated with global markets. While this increases overall well-being, it also precludes the three types of self-employment most common in the third world. First, few manufacturing microenterprises in the first world can compete against factories. Second, few small retailers can compete against chain stores. Third, few very small farms can survive on their own in the first world.

The alternative to microenterprise in the third world might be starvation. Wage jobs are scarce, and there is no public safety net. In contrast, the first world not only has abundant wage jobs but also a safety net for the jobless.

4.1 Self-employment and the safety net

A safety net reduces the number of microenterprises in five ways. First, it prevents starvation and thus decreases the push toward self-employment. Second, the receipt of public assistance requires less effort (and implies less risk) than self-employment. Third, income tests on public assistance reduce the rewards to the risk and effort of self-employment because assistance decreases as business profits increase. A fourth and related point is that asset tests discourage saving (Powers, 1998;

Hubbard, Skinner, and Zeldes, 1995). Without savings, there is no self-employment; nothing else can finance pre-venture capital and living expenses until the business turns a profit. The problem is less that limits on income and assets reduce public assistance and more that the limits kick in before a small firm can support its owner. Fifth, the safety net may decrease entrepreneurship because people who receive transfers may not think of self-employment as an alternative (Friedman, 1988).

In the first world, the safety net places a floor on economic well-being, and this makes microenterprise development more difficult. Of course, the safety net should not be loosened just to push people toward microenterprises. But first-world programmes should recognize that their job is more difficult than in the third world.

4.2 Wage jobs and the pool of microentrepreneurs

The pool of low-income entrepreneurs in the first world is shallow. Entrepreneurship requires all the effort and skill of a wage job, but it has higher risk. People able to be self-employed can usually earn more in wage jobs (Spalter-Roth, Hartmann, and Shaw, 1993). Thus many of the self-employed either have a special vocation for self-employment or have failed at wage jobs.

Income from microenterprise is often low because most poor entrepreneurs start with low levels of investment and go enter sectors with low barriers (Bates, 1997). Thus, they have low productivity and face high competition. Small firms in depressed areas may face low demand if they sell things that customers could do for themselves or could do without. All of this leads to high effort, high risk, and low profits.

The main impact of microenterprise programmes—in both the first and third worlds—is not to increase income but rather to smooth income in the face of shocks (Taub; 1998; Sherraden, Sanders, and Sherraden, 1998; Morduch, 1998). Self-employment income also buffers wage income. Owners of small firms can work more in the business when household expenses spike or when there is slack time in a wage job.

The pool of poor entrepreneurs in the third world is not as picked-over as in the first world, where most people who can get wage jobs already have wage jobs. In the third world, wage jobs are so scarce that even people with high skills and oomph may not find wage jobs. Thus, the average unemployed person in the third world probably has almost average luck, skills, and oomph, but the average unemployed person in the first world probably has below-average luck, skill, or oomph (Novogratz, 1992).

Of course, there are exceptions. Some people start small firms to do work that they love, to be their own boss and to set their own hours, to bequeath a business and an example to their children, or to feel the pride of achievement (Himes and Servon, 1998; Sherraden, Sanders, and Sherraden, 1998). Self-employment may also shelter women and minorities from discrimination. Finally, self-employment may provide the flexibility that parents—especially mothers—require as they raise children.

5. Entrepreneurs as decathletes

In the first world, entrepreneurship is complex. Like decathletes who sprint, jump, and throw in ten events, owners of small firms must excel in many tasks. They not only provide a service or manufacture a good, but they also pay taxes, comply with regulations, supervise employees, maintain a locale, attract customers, and find suppliers. Entrepreneurs must wear many hats, and some of them may not fit well. In contrast, wage workers need to excel at fewer tasks.

Self-employment in the third world is less complex. Employees, if any, are usually children or relatives who are simple to monitor. Most customers are neighbours, and many small firms can simply ignore regulations and taxes.

Like wage workers in the first world, owners of small firms in third world ar required to excel at only a few tasks. For example, a woman in Bangladesh can husk rice if she can get paddy from a less-poor neighbour, remove the chaff, and then pick out dirt and rocks. It is a tough job, but anyone can do it. Likewise, raising a milch cow requires only land and time. In the Dominican Republic, a woman can buy 100-pound sacks of brown sugar wholesale and sell retail to neighbours from her house. In India, a woman can clean, refill, and sell used ballpoint pens.

The first world has small markets for husked rice, fresh milk, cups of brown sugar, and recycled ballpoint pens. Even if there were demand for simple, small-scale enterprises, owners in the first world would still have to pay taxes and meet codes, maintain a locale, and deal with many suppliers and customers. In the first world, even a simple microenterprise can be complex.

6. Government and formalization

More than third-world governments, first-world governments do what they are supposed to do. Sometimes, this increases the cost of microenterprise. For example, two-thirds of the new businesses in the United States in 1995 were run from the home (Dennis, 1998). Working from home allows the owner to care for children, to get help from family, to work during slack times of the day, and to utilize the illiquid investment in the home. Working from home also avoids the need to commute. Zoning laws, however, may prohibit home-based firms, and child-labor laws may forbid that children help their parents. In the third world, these laws may be on the books, but they are seldom enforced as in the first world.

First-world entrepreneurs face significant red tape (Dennis, 1998). Taxes and compliance with regulation have implicit non-cash transaction and opportunity costs that may swamp their explicit cash costs. Furthermore, the quasi-fixed nature of these costs impinges regressively on small firms.

Of course, red tape in the third world can make red tape in the first world look like gift wrap (de Soto, 1989). Formal microenterprises in the first world must pay taxes and comply with codes, but they also benefit from police and contract enforcement by the courts, from credit bureaus, and, in some places, from waivers on means tests for public assistance. To note that effective government may not always facilitate microenterprise is not to indict effective government, because formalization has its benefits. For example, informal microenterprises—such as the drug trade—may need to resort violence to enforce contracts. They may also hide income and assets to keep public assistance, and they cannot easily prove their creditworthiness. Also, zoning laws protect neighbours from noise and pollution, and child-labour laws protect children from abuse. Even without microenterprise, the first-world poor would be better off than the third-world poor, and much of this is due to better government.

Some first-world laws may impede self-employment needlessly. Usury caps, for example, might make sense if lenders held a monopoly and if borrowers had no choice but to borrow. This is not usually the case in the first world. In fact, usury laws probably decrease access to formal loans for microenterprise in two ways. First, they do not let lenders recoup the (mostly fixed) costs of small, short loans to high-risk borrowers without traditional collateral. Second, usury laws give high interest rates a bad name. Even if lenders could raise rates enough to make a profit on microenterprise loans, they might choose not to do so for fear of being called usurers.

7. Access to financial services

Financial services include loans, deposits, insurance, and payment services. Access implies supply at a price that covers the long-term costs of an efficient supplier and that is less than the value of the service to the user. Lack of access is not problematic unless the cost of supply is higher than it needs to be or if markets are imperfect. Financial markets are imperfect, but not all interventions are improvements.

Access to financial services in general—and to loans in particular—constrain entrepreneurship in the third world more than in the first world. This means that first-world microenterprise programmes must help the poor to build savings or to build human capital. This is more difficult than making loans.

7.1 Access to financial services in the third world

In the third world, lack of access to financial services constrains many microenterprises. For example, the fixed-cost structures of banks lead them to discourage small, frequent deposits from the poor. Also, their branches are far from the poor (physically and culturally), and they stay open for just a few hours a day.

The poor in the third world do save, and they respond to greater access to deposit services (Rutherford, 2000; Robinson, 1994). They save because their income does not always coincide with their expenses and because they do not have public assistance or formal insurance to buffer catastrophic risks. They do not, however, save much in financial deposits. Instead, they store wealth as cinder blocks, lengths of barbed wire, gold nose-rings, sacks of grain, pots, livestock, bottles of rum, petticoats, favours for neighbours, and children. These stores of wealth, however, have some disadvantages compared with financial deposits. They are less liquid and can rust, run away, be consumed, or otherwise lose value through time. Of course, financial deposits can also lose value to inflation and/or devaluation, especially in the third world.

The best microenterprise programmes in the third world find innovative ways to reduce the fixed costs of deposit services for the poor. For example, the unit desa system of Bank Rakyat Indonesia has small, plain branches. Simple procedures allow low-skilled—and thus low-wage—employees to manage without computers. Before the Asian meltdown, the system had about 18 million depositors and 2 million borrowers, and aggregate deposit balances were twice aggregate loan balances (Yaron, Benjamin, and Piprek, 1997). After the meltdown, the number of depositors increased.

Few poor entrepreneurs in the third world have checking accounts, and other payment services (except wire transfers from migrant workers in the first world) are not well-developed. If deposits are the forgotten half of development finance (Vogel, 1984), then payment services are the forgotten third, and loans are the remembered sixth. Insurance has also been undeservedly ignored (Zeller and Sharma, 2000).

Most banks in the third world make loans only to those with wage jobs or with mortgage collateral. This creates a vacuum for microenterprise programmes in a niche with a broad pool of creditworthy entrepreneurs.

7.2 Access to financial services in the first world

Some studies find that first-world entrepreneurs are constrained by a lack of access to loans (Holtz-Eakin, Joulfaian, and Rosen, 1994). If loans do constrain, then it is usually because they require assets as collateral, and assets require saving.

First-world microenterprises usually do have access to loans to some degree. For example, one-fourth of the clients of a large network of US programmes had had defaults or bankruptcies, and more than half of all clients used their loans to consolidate debt from other sources (Himes and Servon, 1998). Almost anyone in the first world with a wage job and a clean credit record can get a credit card. Most microentrepreneurs or their spouses have wage jobs (Spalter-Roth, Hartmann, and Shaw, 1993), and credit cards probably meet most demand for microenterprise loans (Bates and Servon, 1998). Although credit-card debt is high priced, it has low transaction costs and very low total costs. Likewise, loans from the so-called fringe banks—pawn shops, check-cashing outlets, and hire/purchase stores—have high prices but low total costs (Caskey, 1994). Competition has pushed non-bank financial intermediaries—if not banks—closer to the poor.

Poor people in the first world also have access to savings and payment services. Existing microenterprises must have had some savings when they started, and some of these savings may have been held as financial deposits. Half the low-income people and microenterprises surveyed in a Hispanic neighbourhood of Chicago had deposits in banks (Bond and Townsend, 1996). Even banks, pressed to do something to reduce financial exclusion, have begun to look down-market (Merton and Bodie, 1995).

Poor people in the first world also have access to a wide range of payment services. Post offices, check-cashing outlets, and grocery stores sell money orders and cash checks. Automatic-teller machines provide some payment services, although many are unsafe or distant from the poor.

Broad access to financial services in the first world is good for microenterprises but bad for microenterprise programmes. In the third world, the best programmes can turn a profit from lending. In the first world, microenterprise programmes cannot compete with for-profit lenders. Although savings may be more useful than loans for self-employment, the role for microenterprise programmes in savings is probably small.

7.3 Savings services and microenterprise programmes

Most microenterprises are financed not with debt but with savings (Dennis, 1998; Bates, 1996; Bond and Townsend, 1996). If they do get a loan, it is usually linked to the purchase of a physical asset such as a barber chair or a lawnmower. During gestation, the entrepreneur cannot get a loan for research expenses nor for living expenses, so without savings, most new firms will fold before they fledge.

For new microenterprises, savings has some advantages over loans. Savings screen for skills and oomph where information is the least asymmetric—the self. Often entrepreneurs start small, part-time, and with savings to test their skill and the market.

This lets them cut their losses if the venture fails. Firms that use savings also avoid fixed repayment obligations that could cause bankruptcy if cash inflows vary.

The dilemma is that most microenterprises need savings more than loans, but microenterprise programmes have no clear role to facilitate savings. Programmes can attract borrowers, especially if they make large, uncollateralized, low-interest-rate loans. They can also subsidize the development of business plans and thus indirectly reduce the need for savings. But programmes cannot, by law, take deposits. Also, deposits, unlike loans, do not directly generate revenue for the programme.

Individual Development Accounts (IDAs) are one option (Sherraden, 1991). Deposits by poor people in an IDA in a bank are matched if used to purchase a home, post-secondary education, or microenterprise assets. The number of IDA programmes has exploded in the United States, and the United Kingdom has proposed IDA-like accounts (HM Treasury, 2001). Still, a microenterprise programme does little more than raise funds for the match, provide entrepreneurship training, and monitor the use of withdrawals. Banks do the rest, and there is no technological reason why banks could not do it all at a lower cost.

First-world microenterprises, unlike third-world microenterprises, are probably constrained less by lack of loans than by lack of savings. Unfortunately, microenterprise programmes cannot provide saving services directly. Thus, efforts to relax financial constraints on first-world microenterprises should focus on banks.

8. Classes for skills and oomph

With competition for loans and little role in savings, first-world microenterprise programmes have focussed on training. More than 90 percent of US programmes offer training (Langer, Orwick, and Kays, 1999). It is more difficult, however, to impart skills and oomph than to make loans.

The earliest third-world programmes started with training, but now most focus on loans. In contrast, the earliest first-world programmes started with loans, but now most focus on training.

Human and financial capital are complements, but first-world programmes have three other reasons to bundle classes with loans. First, training may help inexperienced lenders to screen potential borrowers. People who can pass a class—often with a business plan as its capstone—are more likely to be able to repay their loans. Second, class attendance is a way to vet self-employment for waivers on means tests for public assistance. Third, funders prefer to pay for loans rather than training, so some training programmes make loans in order to get funds for their true mission (Servon, 2001).

The record in the third world suggests that loans and training do not mix well. For example, the World Bank tried without much success to use subsidized loans to induce subsistence farmers to adopt new technologies (Von Pischke, 1991; Adams, Graham, and Von Pischke, 1984).

Third-world microenterprise programmes that mixed loans and training found that good teachers were not always good lenders and vice versa. Borrowers were confused when training was a gift but cash was a loan. Furthermore, some programmes felt it was unfair to dun defaulters whose ventures failed in spite of their training.

Perhaps the most important lesson from the third world is that programmes should build a firewall between their lending and training activities (Helms, 1998). This improves transparency and sharpens incentives to decrease costs and to increase value.

8.1 Skills

The two prerequisites for entrepreneurial success are human and financial capital. Loans matter only when skills and savings are present. Wealth is the biggest constraint on debt (Berger and Udell, 1998), and, according to Bates (1997, p. 4), 'no serious studies have demonstrated that small amounts of debt can overcome human-capital deficiencies that otherwise minimize chances for business success.'

Both in the first world and the third, most training covers general business skills. Rather than tell a cook how to cater, a gardener how to cut grass, or a cobbler how to fix shoes, they focus on skills used in all businesses such as bookkeeping, financial management, spreadsheets and word processing, marketing, insurance, and taxes. 'The objective is to provide the practical knowledge to do the myriad of little things it takes to start and sustain an enterprise' (Balkin, 1992, p. 141).

There is some experimental evidence that on-call advice has a greater impact than up-front classes (Schreiner, 1999). Furthermore, sector-specific training for regulated sectors such as child care and food preparation have helped poor entrepreneurs to comply with regulation and get licenses. Successful private-sector examples include truck-driving schools and schools of cosmetology.

In general, however, it is difficult to transfer human capital in short courses. Entrepreneurship training is more difficult than job training because the ‘goal is not merely to provide business skills, but to help develop a new and viable organization’ (Drury, Walsh, and Strong, 1994, p. xiii). More resources are required to train decathletes than to train specialists. Furthermore, program staff may not be experienced in adult education, or they may lack entrepreneurship experience. In the end, microenterprise classes may have greater impacts on self-esteem more than on skills or income (Raheim and Alter, 1998; Spalter-Roth, Soto, and Zandniapour, 1994).

Training in the first world drains programme budgets for two reasons. First, it requires a lot of staff time, and skilled labour in the first world is expensive. Second, most programmes do not charge for training (Langer, Orwick, and Kays, 1999).

Free training ignores two of the most important lessons from the third world. First, fees produce feedback that improves the quality of training: students will not pay more than what the class is worth to them. Even a nominal fee is better than no fee. Second, microenterprise training will probably never be profitable. In general, loan-led programmes in the United States lose less money than training-led programmes (Edgcomb, Klein, and Clark, 1996). Profitability matters if funders may one day lose interest in microenterprise development.

Of course, there may be a market failure if training produces more social gains than social costs even though it does not produce more private gains than private costs for either programmes or students. Lessons from the third world can point to ways to structure subsidies so as resolve the market failure and still preserve incentives for quality and efficiency. For example, a programme in Paraguay gives entrepreneurs vouchers for part of the price of self-employment training (Schor and Alberti, 1999). Entrepreneurs can receive vouchers whether or not they also receive loans. They combine the voucher with their own funds to pay the trainer of their choice. Professional training institutes teach general skills, and private entrepreneurs transfer hands-on their own specific skills as bakers, seamstresses, or mechanics.

8.2. Entrepreneurship

Even with observed traits constant, people are not the same. The difference is *entrepreneurship*, the oomph that drives sacrifice in the present in the hope of a better future. Oomph matters because self-employment requires unsupervised work with high risks and low rewards (Dennis, 1998). Unfortunately, oomph is difficult to teach.

Taub (1998) speculates that poor people in the first world may have low average oomph because they are not used to self-employment and because their peers do not expect them to take risks in a new venture. Other evidence, however, suggests that at least some poor people are entrepreneurial. In 1995, 2.6 percent of families with incomes below $10,000 in the United States started new ventures (US Bureau of the Census, 1997). An unknown number of additional low-income people do informal work that is not reported as self-employment because it is illegal, paid in cash or in kind, or is too small or infrequent to be thought of as a business.

9. Conclusion and recommendations

First-world microenterprise-development programmes face challenges unknown in the third world. Abundant wage jobs and a safety net weaken the push toward self-employment. Even small ventures are complex and must comply with regulations, pay taxes, and compete in global markets. Group loans do not work well, and private lenders take the best individual borrowers. Poor entrepreneurs need to build human and financial capital, but training decathletes—especially for entrepreneurial oomph—is costly, and microenterprise programmes can do little to facilitate savings services. Microenterprise development is much more difficult in the first world than in the third world. The rest of this paper recommends ways to address the challenge.

9.1 Structures of incentives for innovation

Microenterprise development in the third world reduced costs through innovative joint-liability loans. Microenterprise development in the first world requires structures of incentives to prompt the search for similar innovations. The incentives of funders determine the incentives of programmes (Schreiner and Morduch, 2001).

Experiments and change are difficult, and public and private donors can sometimes be the smothers of invention. After all, most experiments, like most small firms, fail, and administrators who fund failures are not promoted. Furthermore, short-term electoral cycles may reward those who can claim quick results or who can disburse a lot of money. This leads to too much focus on current 'best practices' and concentrates funds in a few programmes widely recognized as being among the best, whether or not these programmes have ceased to innovate (Hulme, 2000). First-world microenterprise programmes are still in the stage of research and development, and funders should restrict assistance to those with concrete plans to try something new to decrease the costs of supply and/or to increase value to users.

The incentives faced by microenterprise programmes derive from the incentives faced by the people who work in public and private donor organizations. These structures change at a glacial pace, but a first step might be to measure the output of administrators not as funds disbursed but rather as the number of microenterprises served per unit of resources disbursed. The intent is to reward funders who seek out programmes that make an effort to control costs.

9.2 Costs and outputs

Microenterprise programmes can cut costs by cutting output, but would defeat the purpose. Thus, a simple first step toward better incentives is to measure both costs and outputs. In the third world, such measurement has helped to push programmes to innovate (Schmidt and Zeitinger, 1996). Even without credible estimates of programme benefits, estimates of costs and outputs can help to ensure that scarce development funds are spent well (Devarajan, Squire, and Suthiwart-Narueput, 1997).

Many microenterprise programmes in the first world are quick to relate anecdotes of successful entrepreneurs, but most are slower to publish cost studies.

Exceptions include a cost analysis of the largest IDA programme (Schreiner, 2000), rough estimates that put costs for a large sample of US programmes at about $2,000 per client in 1996 and about $1,300 per client in 1999 (Schreiner and Morduch, 2001), and an excellent study of outputs and costs by Edgcomb, Klein, and Clark (1996) which implies that the cost per dollar-year of borrowed purchasing power in the seven oldest and best-known US microenterprise programmes was about $1.50. Whether these costs are high or low compared with output is not the point; what matters is that the mere measurement of costs and benefits creates incentives to improve.

9.3 The safety net

Public managers must remember that although the context of the first world often mitigates against microenterprise, it is probably better to have many wage jobs, an effective safety net, a good government, global trade, and taxes and regulations with teeth. After all, the goal is not more microenterprise but rather improved well-being for people, and microenterprise may or may not be the most effective means to that end.

9.4 Savings and debt

The low-income self-employed in the first world are likely constrained more by lack of savings than by lack of loans. Although low-income communities often lack the social capital to make borrowing groups work, individuals with decent credit records can get small individual loans, through credit cards if nothing else. Larger loans, however, require collateral. Collateral requires assets, and assets require saving.

How can microenterprise programmes promote saving? IDAs are one way. Programmes might also require not only a business plan but also some minimum savings to cover operating and living expenses as a new venture gets off the ground, somewhat like the escrow accounts for emergencies required of low-income home buyers.

9.5 Modest claims

In the first world, microenterprise is not a panacea but a vitamin. Advocates should seek not to promote but to improve, being 'careful not to overstate benefits' (Raheim and Alter, 1998, p. 59). Microenterprise is 'clearly not the answer to the urban poverty problem' (Servon, 1997, p. 175), and self-employment alone 'will not result in the alleviation of poverty in the long run' (Raheim, 1997, p. 51).

The need to attract funds may sometimes tempt advocates to hype potential and to hide problems. A more sober view can only help to push programmes to try harder to seek for welfare-improving innovations.

9.6 Hire expertise

Good leaders of not-for-profits do not always make good trainers or good bankers. Although anyone with money can make a loan, a good lender gets repaid and does not make loans that end up harming borrowers. Former entrepreneurs often make the best trainers, but few employees in not-for-profits have this experience. Just as an agricultural-extension project should hire agronomists, a microenterprise programme should hire former entrepreneurs, professional loan officers, and teachers.

9.7 Training and loans

First-world microenterprise programmes focus on training and loans. But what kinds of classes should they give? And who should they target? Some evidence suggests that long-term, on-call advice is better than general, up-front classes. The risks and problems faced by small businesses are too diverse to predict and address beforehand.

In the third world, few microenterprise programmes make loans to start-ups, but in the first world, most microenterprise programmes focus on start-ups. Bendick and Egan (1987) suggest that scarce development funds would be better spent to strengthen existing small firms.

9.8 Monitor self-employment

Microenterprise practitioners should search for ways to monitor effort toward self-employment that do not require attendance at classes or indebtedness. Means tests on public-assistance programmes are meant to prevent the abuse of public assistance, but lawmakers have been willing to waive the limits if they believe that the waivers are short-term and that the waivers can help someone to escape from poverty for good.

It is difficult, however, to monitor self-employment effort. With wage jobs, the employer monitors effort (Dennis, 1998). With job training or post-secondary education, the educational institution monitors effort. But self-employment has no natural monitor. Pleas to raise or to waive means tests to get rid of their side effects on self-employment will not be heard unless alternatives can be found to serve the original purposes of the means tests. Class attendance or loan repayment might be good proxies for self-employment effort, but some poor entrepreneurs do not want or need training or debt. Microenterprise programmes may want to develop direct monitoring techniques such as having business counsellors visit clients once a week at their place of work.

9.9 Wage jobs and education

Microenterprise programmes should search for ways beyond self-employment to connect people to the workforce. Even if access to microenterprise assistance doubles the number of poor people who start small firms, more than 99 percent of the poor will not be affected (Schreiner, 1999). The one matters, but not more than the ninety-nine.

A good microenterprise programme will often discourage self-employment in favour of more education or job training. Self-employment may help a few extraordinary poor people—those with high human capital and/or oomph—to leave poverty, but most of the poor will reach the middle class through education and wage jobs. Programmes with the best interests of the poor in mind seek first to help them get more education and skills, then to search for a wage job, and only last to attempt self-employment (Balkin, 1989).

9.10 Banks and financial exclusion

Some banks fulfill some of their obligations to address financial exclusion through grants to microenterprise programmes who then make loans to microentrepreneurs. Policy should insist that banks make the loans themselves. If banks could not farm-out microenterprise loans, then they would put more pressure on themselves to develop products attractive to many poor people that yet are profitable or at least minimize cost. The hope is that banks might learn to serve this niche for their own self-interested reasons. As it is, banks do not learn whether their perceptions of losses in this niche are true nor whether innovation could produce profits.

The dilemma is that the not-for-profits that run microenterprise programmes want grants from banks to bolster their budgets. Moreover, they to do not trust banks to do a good job in this niche. As for banks, many are content with business-as-usual; a foray into microenterprise would only increase workloads and decrease profits. Regulators could correct this awkward incentive structure if they refused to consider grants to not-for-profits as a fulfilment of obligations to combat financial exclusion if the not-for-profit uses the grant to do lending, a main business activity of banks.

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Table 1: Example microenterprises in the first and third worlds

First world	Third world
• Care for children or pets	• Plant crops and fatten livestock
• Cut hair or polish nails	• Do odd jobs, especially on farms
• Cook food and sell drinks at festivals	• Cook food and sell drinks on the street
• Sell Avon, Amway, or Mary Kay	• Petty trade in food, clothes, or toiletries
• Clean homes, cars, or offices	• Take in laundry
• Trade and/or repair clothes or cars	• Make and/or repair clothes or cars
• Paint or repair houses	• Build or repair houses
• Cut grass or trim branches	• Collect and sell wood, charcoal, or water
• Kill pests	• Carry loads or messages
• Repossess cars	• Drive a bus or truck
• Work with wood	• Work with wood or metal
• Rent video tapes	• Show movies from video tapes
• Deejay parties	• Play in a band
• Drive cabs	• Run a rickshaw
• Quilt or knit blankets	• Husk rice or shell peanuts
• Sling newspapers or brochures	• Sell newspapers or lottery tickets
• Make and sell arts and crafts	• Scavenge for things to recycle
• Make and sell fake jewelry	• Make and sell baskets or rope
• Buy and sell drugs	• Shine or repair shoes