

A close-up photograph of a person's hands and feet working on a fishing net. The person is sitting on a wooden bench, and their feet are positioned to hold the net taut while they use a small wooden tool to mend it. The net is made of fine, light-colored mesh. The background is slightly blurred, showing green foliage and a wooden fence.

MICRO AND SMALL ENTERPRISE (MSE) FINANCE

Examining the Impact Narrative

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Executive Summary

Micro and small enterprises (MSEs) are a vital part of the livelihoods and resilience strategies of poor households across emerging markets. There is evidence that lack of access to finance is one of the several binding constraints that limit MSEs' potential. Even so, the impacts of MSE finance are not comprehensively understood. This deck reviews existing impact literature and identifies key knowledge gaps.

Today's evidence base shows that the impacts of finance on MSEs are often small and inconclusive

Evidence suggests that finance only has modest effects on the average borrower. It does not meaningfully increase their business profits, household incomes or consumption; or help poor people escape poverty.

Borrower mindset, gender and loan characteristics influence impacts of finance

However, finance has large impacts on borrowers with previous MSE experience and an entrepreneurial (growth) mindset.

Although many MSE finance programs target women, it is unclear whether these programs help women expand their businesses or increase their profits. This is likely because women tend to invest their financing in the enterprises of men in the household and often work in sectors with low growth potential, but much of the gender gap in MSE profitability remains unexplained.

Loan characteristics like repayment holidays, flexible repayment schedules, individual liability lending, and digital channels of delivery increase the positive impact of MSE finance and encourage high-potential borrowers who might otherwise not have sought financing.

Executive Summary (Cont.)

But impacts may be hiding between the many gaps in today's evidence base

MSE finance comes in many forms around the world. However, existing research consists largely of a single type of study -- the *randomized control trial*. It mostly focuses on a single model of MSE finance -- *group lending programs of microcredit* – delivered to a single type of MSE – *the one-person microenterprise*. And it is concentrated in three regions -- *South Asia, South East Asia and East Africa*. This review identifies at least five dimensions for future research that may provide a more comprehensive assessment of MSE finance's impact:

- **Evaluations of a broad range of MSE finance instruments** such as individual liability MFI loans, working capital loans, invoice discounting and digital sources like merchant payments, digital credit, e-factoring etc.
- **Firm level impact studies**, especially on MSEs with

fewer than twenty employees, which contribute to nearly half of global job creation in emerging markets.

- **Going beyond RCTs** and employing a broad range of qualitative and mixed-method research to determine impact
- **Examining understudied geographies**, especially Latin America and the Caribbean (LAC)
- **Rethinking the goals of MSE finance** by going beyond poverty reduction and enterprise growth, and considering more modest but comprehensive outcomes like income stability, diversification, resilience, sense of purpose in community etc.

Researchers and funders have an important role to play in updating the impact narrative of MSE finance by recalibrating our theory of change and producing more evidence.

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SECTION I

Micro and Small Enterprises (MSEs)

What Are They?



What is an MSE? A taxonomy of small businesses

Small businesses are classified into micro, small and medium enterprises, usually based on some combination of number of employees, gross revenue, loan size or assets, with thresholds differing across countries

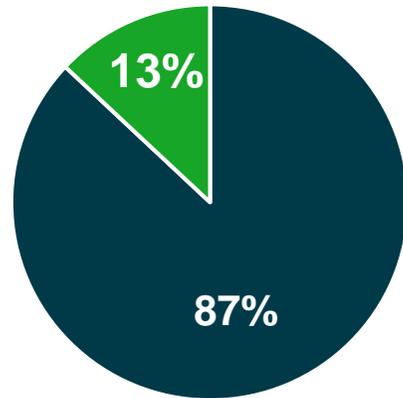
CGAP adopts a taxonomy based on the number of employees and average loan size of a business:



Estimates suggest there are 162 million MSMEs across 132 developing countries, and most of them are microenterprises

The actual number is likely much higher, around 400 million, because estimates exclude informal sector firms and firms with less than five employees

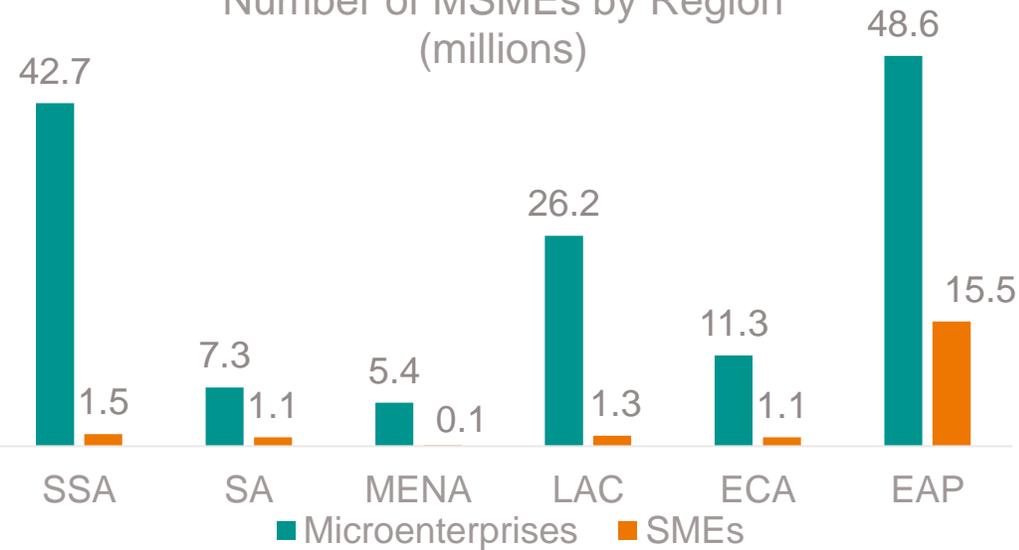
MSMEs in developing countries by Size



■ Microenterprises (5-10 employees)

N=132
IFC (2017)

Number of MSMEs by Region (millions)



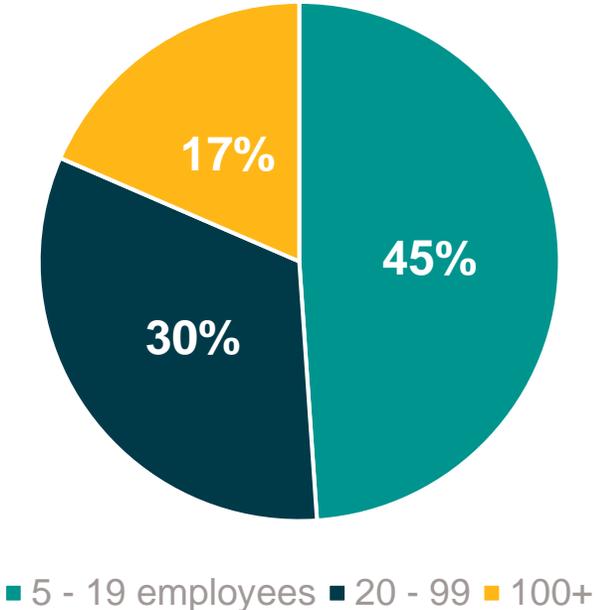
N=132
IFC (2017)

Note:

EAP = East Asia and Pacific;
ECA = Europe and Central Asia;
LAC = Latin America and the Caribbean;
MENA = Middle East and North Africa;
SA = South Asia;
and SSA = Sub-Saharan Africa.

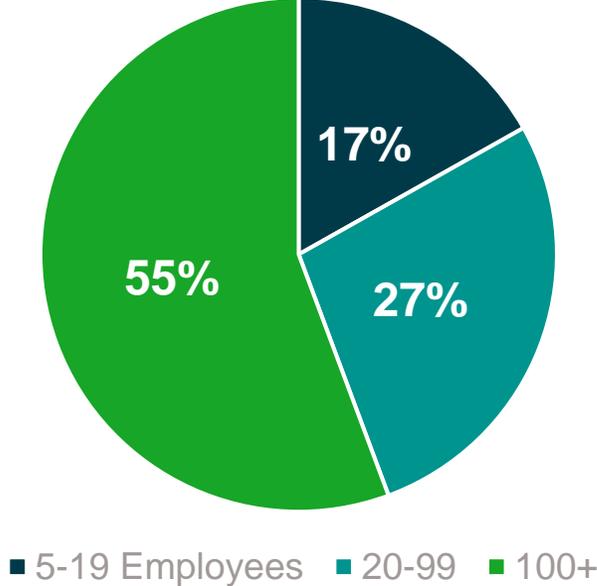
MSEs with 5 - 19 employees contribute to nearly half of all jobs created and a fifth of all employment in developing countries

Share of Job Creation Across Firm Size



N = 85 countries
Ayyagari et al (2014)

Share of Median Net Employment Across Firm Size



N = 104 countries
Ayyagari et al (2014)

Note: Ayyagari et al (2014) use World Bank Enterprise Survey data which excludes firms < 5 employees

SECTION II

MSEs and Livelihoods of the Poor

Why Do MSEs Matter?

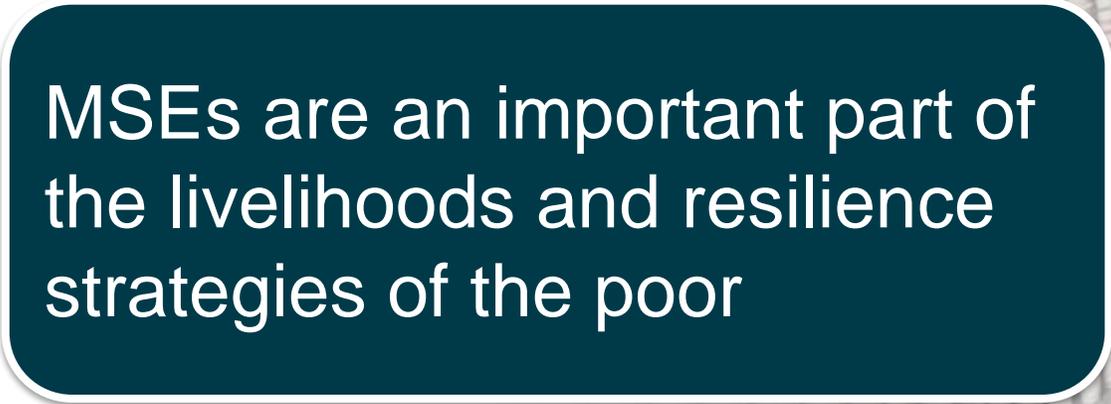




Micro Enterprises
As Owners/ Operators



Small Enterprises
As Employees



MSEs are an important part of
the livelihoods and resilience
strategies of the poor



Photo Credit: Sudipta Dutta Chowdhury, CGAP Photo Contest 2016

Most MSEs are created out of necessity, and remain small throughout their lifetime

Poor people often take up enterprise:

- Because they cannot find wage employment
- To sustain and smooth incomes until they find wage jobs
- To cope with health shocks that prevent them from seeking wage jobs
- At times, to finance their agricultural activities

Sources: Poschke (2013), Donovan et al (2019), Adhvaryu & Nyshadham (2017), Adjognon et al (2017)

MSEs face several interconnected, binding constraints that inhibit their productivity, profitability and expansion

- Lack of access to finance
- Lack of a growth mindset
- Lack of access to skilled labor
- Lack of advisory services like mentoring and training
- Electricity outages and other utility related constraints
- Exogenous factors like crime, security concerns, and economic shocks

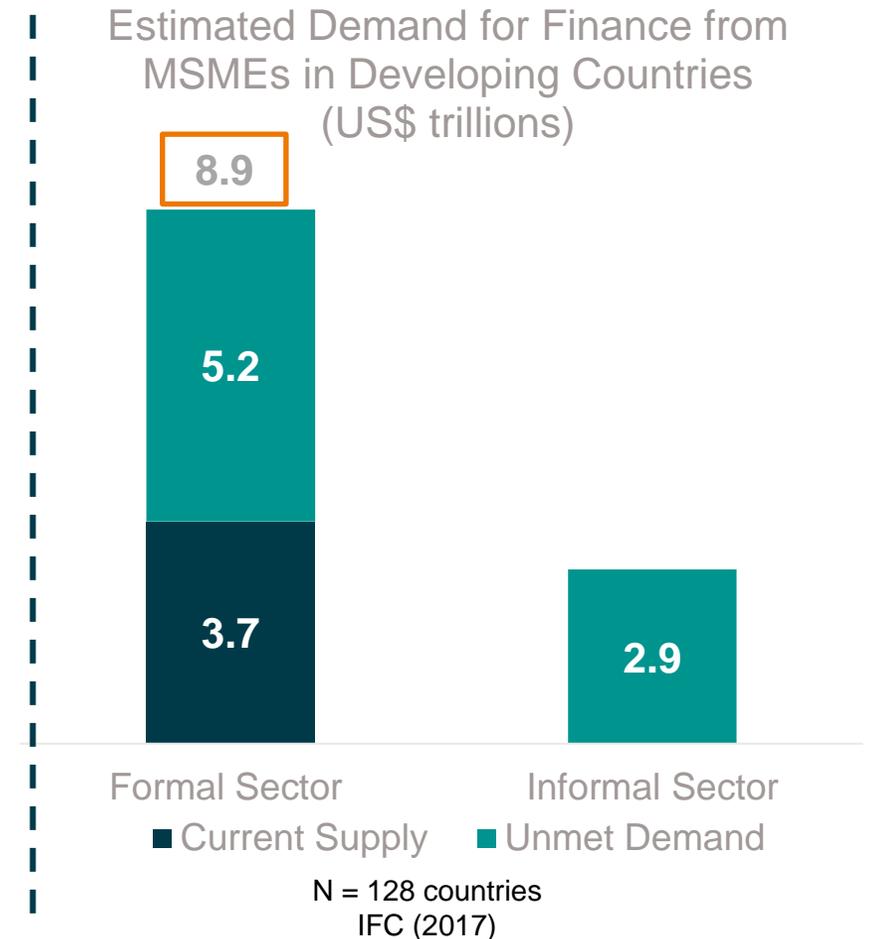
Sources: Poschke (2013), Donovan et al (2019), Adhvaryu & Nyshadham (2017), Adjognon et al (2017), Beegle & Christiaensen (2019), Blattman & Dercon (2018), Wang (2016), Emmanuel et al (2019), Hardy and McCasland (2015), Falentina & Resosudarmo (2019) Nagler & Naudé (2017), Ayyagari et al (2008)

Access to finance has received outsized attention from the international development community, yet it remains a sticky problem



IFC (2017)

There have been several efforts to quantify aggregate demand for finance, but **global estimates often exclude or underrepresent MSEs**, and the 'finance gap' mostly reflects the needs of larger and formal SMEs.



Consequently, there is much to be understood about micro and small enterprises, including:

- Their unique financial and nonfinancial needs
- The barriers they face in accessing finance
- The impacts of access to finance on MSEs and the livelihoods attached to them

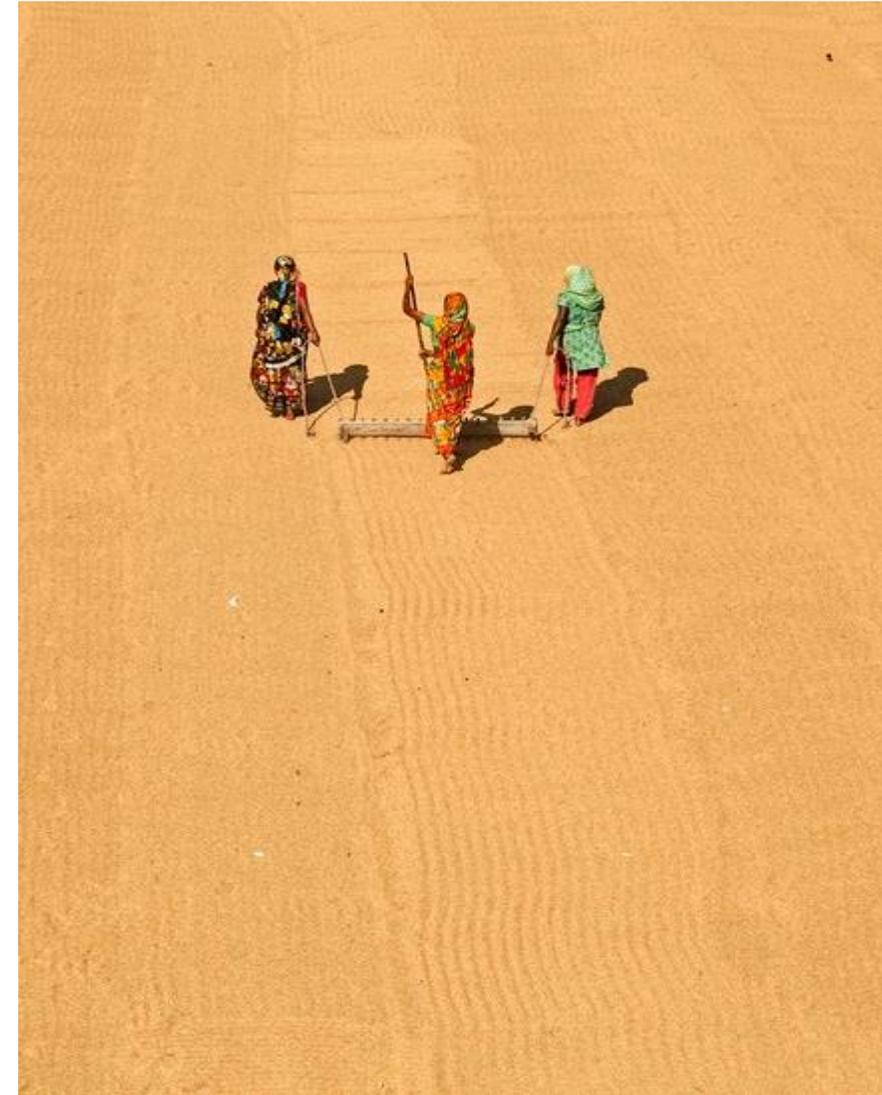
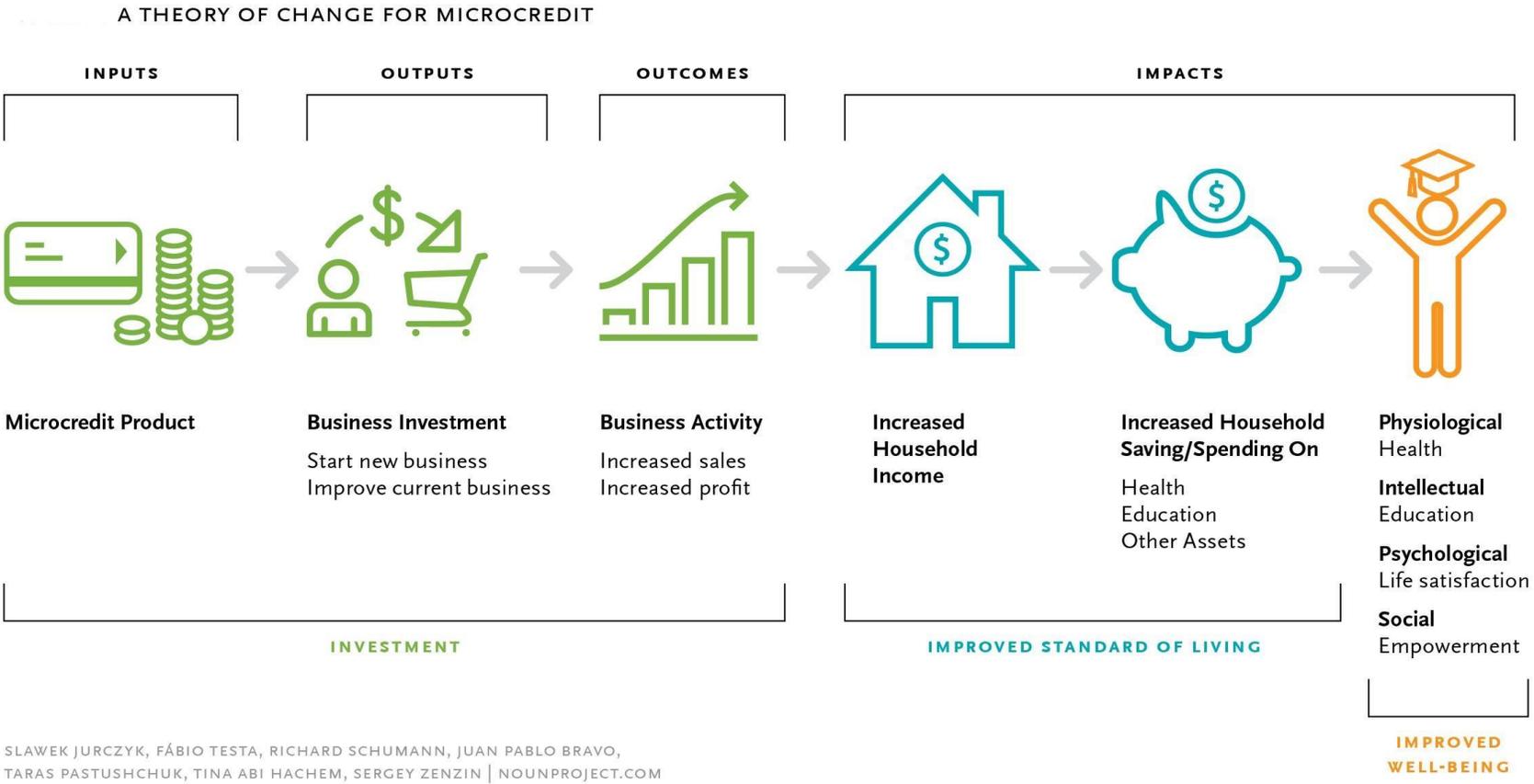


Photo Credit: Zakir Chowdhury, CGAP Photo Contest 2014

The historical narrative of MSE finance centered on the group lending model of **microcredit**, and envisioned an escape from poverty through microenterprise



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But the experience of practitioners and several impact evaluations have repeatedly shown how this theory of change has not played out in practice



SECTION III

Evidence of Impact

High-Level Insights
From a Literature Review

Photo Credit: Froi Rivera, CGAP Photo Contest 2017



What do we know about the impacts of access to finance for MSEs?

“Access to credit is not a silver bullet to transform most microenterprises into thriving, fast-growing businesses. Microcredit helps some microenterprises, but it often has modest and mixed impacts, and is not transformative.”

Source: Jayachandran (2020)



Microcredit has modest impacts on the **average** borrower

Microcredit helps some low-income borrowers:

- Expand the scale of their business operations, including the number of hours worked, enterprise revenue and expenses;
- Increase their investments in consumer durables like motorcycles, cellphones, TVs, fridges, rickshaws etc.; and
- Often keep their businesses running instead of becoming wage earners or unemployed.

Sources: Augsburg et al (2015), Attanasio et al (2015), Angelucci et al (2015), Crépon (2011), Banerjee et al (2015a), Bruhn & Love (2014)

However, microcredit **does not** meaningfully increase enterprise profits, household consumption, promote entry into new businesses or fuel an escape from poverty

Sources: Banerjee et al (2015), Tarozzi et al (2015), Buera et al (2017), Van Rooyen et al (2012)

The impacts of microcredit are greater for some borrowers more than others

- The impacts of microcredit differ on the lines of individual characteristics like **gender** and **entrepreneurial mindset** of the borrower.
- An entrepreneurial mindset refers to the **intention to grow and succeed in enterprise**, demonstrated through a large target business size, growth goals, extensive social networks and use of informal credit facilities from other households, and making full use of credit facilities when extended.

Source: Banerjee et al (2017)

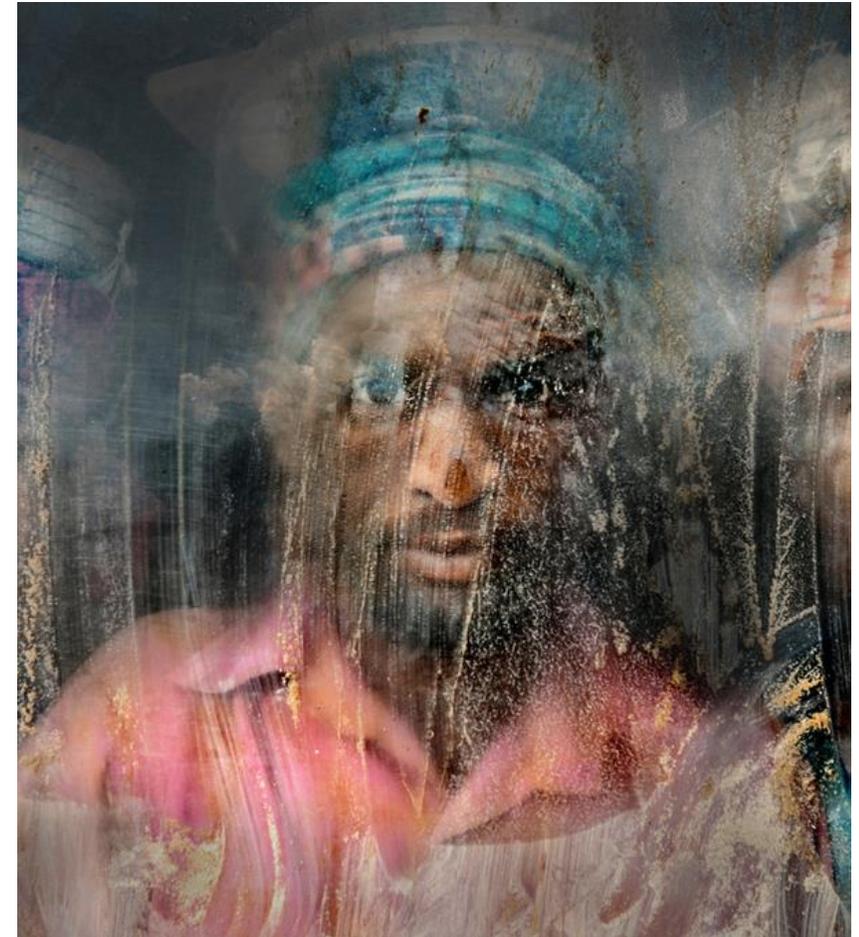


Photo Credit: Faisal Azim, CGAP Photo Contest, 2015

Microcredit is most impactful for borrowers with an entrepreneurial mindset

‘Strivers/ Gung-Ho entrepreneurs’ or borrowers with a growth mindset who had enterprises even before they gained access to finance **accrue large and enduring benefits from microcredit**, compared to ‘reluctant entrepreneurs’ or borrowers who start a microenterprise for sustenance only after they gained access to microcredit.

- Enterprise revenue doubled
- Enterprise expenses up by 80%
- Value of enterprise assets up by 35-40%
- Number of hours worked on enterprise up by 20%
- Increased access to formal sources of finance
- Impacts persisted six years after first access to finance

Sources: Banerjee et al (2017), Banerjee et al (2019)

Nobody is born a ‘striver’, people can be trained to be one

Recent evidence also suggests that there’s nothing innate about entrepreneurial mindset, and that it can be cultivated among borrowers through low-cost, psychology based personal initiative training approaches, which have shown to improve enterprise outcomes.

Source: Campos et al (2017)

Despite the focus of group lending models on women, microcredit does little to improve their microenterprises, but not for of a lack of effort or aptitude on the part of women

- Generally, microcredit helps women expand or take up new businesses in the short run, but it does not improve their enterprise outcomes like sales or profits.
- Some of this is explained by the fact that women tend to work in low growth potential sectors, **but much of the gender gap in enterprise profitability remains unexplained.**

Source: Said et al (2017) Fiala (2018), Klapper (2011), Hardy & Kagy (2018)

Many women borrow to fund men's enterprises and assets or their household expenditures

- Money borrowed by women is often not invested in their own enterprise, but in the enterprises of the men in their household, whether by choice or not.
- While there may be rational economic reasons for why this is the case, it poses several social and agential risks for women in the household.

Sources: Friedson-Ridenour and Pierotti (2019), Jakiela and Ozier (2016), Fafchamps et.al. (2014), de Mel et.al. (2009) and Bernhardt et al. (2017)

The Impacts of microcredit are also mediated by loan characteristics

- Larger sized loans with individual liability have been shown to have greater impact on enterprise profits compared to smaller, group liability loans.
- But despite comparable repayment rates and cost effectiveness, loan officers are reluctant to offer individual liability loans.
- Providing a **repayment holiday option encourages risk averse borrowers to start enterprises**, increasing their profits, but in some cases, it also increases default rates.
- Loan contracts with the **option of flexible repayments at a higher interest rates attract high quality borrowers** (strivers), whose enterprise revenues, profits and asset values improve from access to finance.

Sources: Alibhai et al (2018), Giné & Karlan (2014), Field et al (2013), Barboni and Agarwal (2018) and Gulesci & Madestam (2018)

For women borrowers, channel of delivery may be an important driver of impact

Women borrowers who received their microfinance loans on their mobile money accounts had greater privacy and decreased pressure to share money with their spouse or family members, leading to higher business profits and capital, compared to women who received it in cash.



Photo Credit: Tony Karumba for Communication for Development, 2020

Source: Emma Riley (2019)

SECTION IV

Knowledge Gaps

The Need for an
Updated Narrative

Photo Credit: Tuna Akcay, CGAP Photo Contest, 2014



Available evidence offers a narrow view of impact **through the lens of microcredit**. There are significant knowledge gaps that prevent us from fully understanding how access to finance impacts micro and small enterprises.



Photo Credit: Eakarín Ekartchariyawong, CGAP Photo Contest 2016

MSE finance is not just microcredit

- Much of the existing impact evidence comes from evaluations of the group lending model of microcredit, with the individual microentrepreneur as the unit of analysis
- Evaluations of individual liability microcredit, other traditional sources of finance like working capital loans, trade credit, invoice discounting, factoring, and recent, DFS enabled sources like merchant cash advances and digital credit are notably absent.
- Research on firm level impacts (beyond one-person microenterprise) is scant

Sources: Ayyagari et al (2016) and Giang et al 2019)

RCTs are not the only way to demonstrate evidence of impact, there is need for other kinds of evidence

- Existing evidence largely rests on the results of randomized control trials (RCT), which are only one of the many methods of estimating impact. Non-RCT based quantitative methods and qualitative methods like ethnography, case studies or social performance reports by funders are rare.
- Small sample sizes, high drop out rates, unique country contexts and lack of a standardized research design make it hard to meaningfully interpret or compare findings and synthesize a global view of impact.

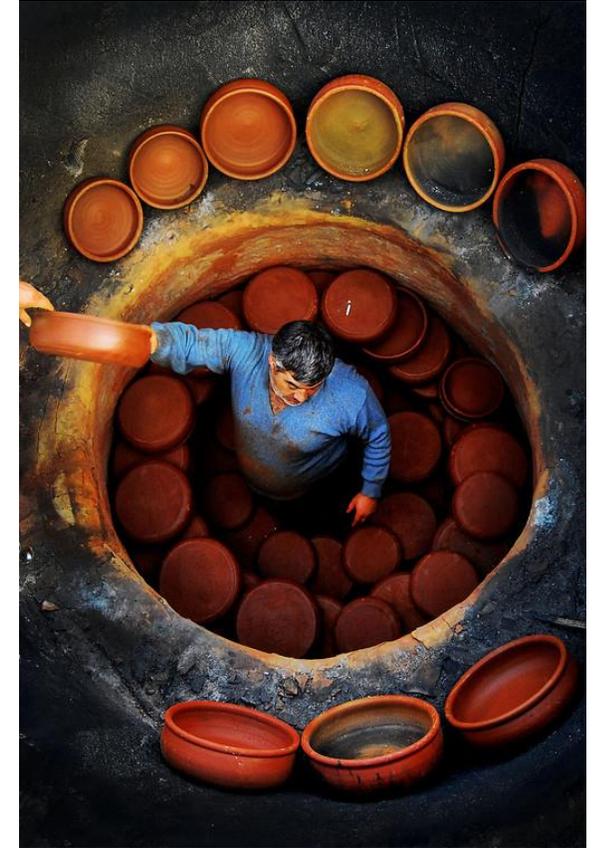
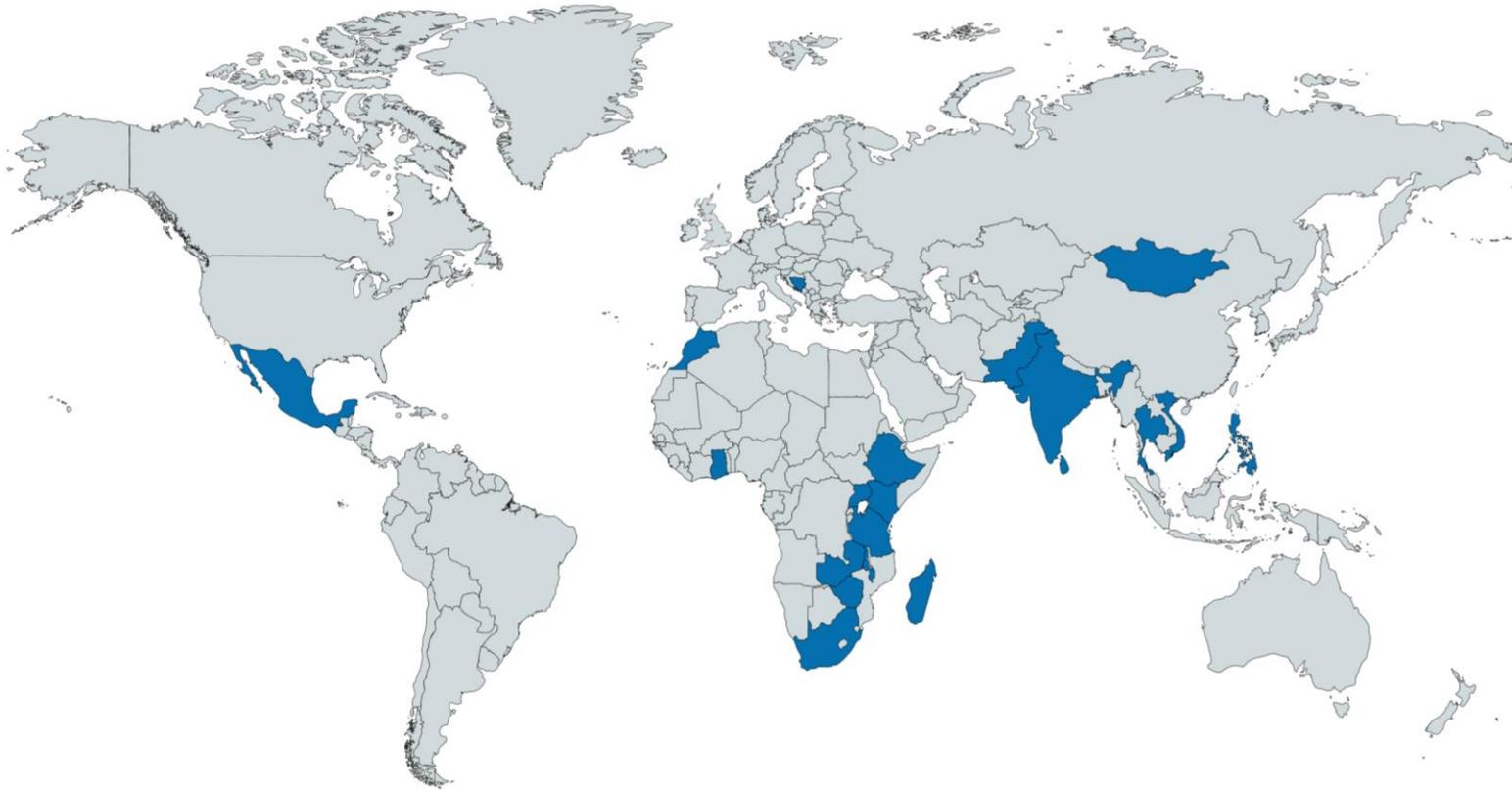


Photo Credit: Tuna Akcay, CGAP Photo Contest, 2014

The geographic footprint of impact evidence covers only about 20 countries, missing important geographies, notably Latin America and the Caribbean

- Bosnia & Herzegovina
- Ethiopia
- Ghana
- India
- Kenya
- Madagascar
- Malawi
- Mexico
- Mongolia
- Morocco



- Pakistan
- Philippines
- South Africa
- Sri Lanka
- Tanzania
- Thailand
- Uganda
- Vietnam
- Zambia
- Zimbabwe

Looking beyond enterprise growth and an escape from poverty

Existing evidence base focuses on a narrow set of objectives centered around enterprise outcomes – growth in size, scale, revenue, profits, increased household income and consumption, and an escape from poverty, while demonstrating the impact of access to finance for MSEs.



Photo Credit: Abhijit Banerjee, CGAP Photo Contest 2016

But such a research approach misses the broader ways in which financing MSEs can impact the livelihoods of the poor by helping them seize opportunities and become resilient, including providing income stability and diversity, enabling them to manage household expenses, enabling access to markets, ability to manage risks and respond to economic shocks, and through their enterprise, creating a sense of enhanced self-worth and purpose towards society, and creating employment opportunities for other low-income people.

There is need for an improved and more comprehensive impact narrative, and further evidence of how access to finance can benefit MSEs.

SECTION V

The Role of Researchers and Funders

Where Do We Go From Here?

Photo Credit: Vikash Kumar, CGAP Photo Contest, 2014



From MSEs to SDGs

Better understanding the impacts of access to finance **will help donors and investors** make informed decisions to support potentially scalable approaches to MSE finance that can advance several SDGs.

SUSTAINABLE DEVELOPMENT GOALS



Now what? The role of researchers and donors

Researchers & Practitioners

Address knowledge gaps identified through an updated theory of change and undertake further research to gather evidence of impact

Donors

Fund and support further research on impact of MSE Finance

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