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A Microenterprise-Centered Economic Development Strategy for the Rural South: Sustaining Growth with Economic Opportunity

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Microenterprise programs (MEPs) have become an important research concern and rural development strategy in international development circles. The basic premise of this approach is that microenterprises[1], that is firms with fewer than 10 employees, can be provided with a series of small loans that allow them to start or expand productive activities and thereby increase incomes and escape poverty. Governments and donor agencies have expanded funding for microfinance programs in low-income countries and more articles appear in the Western media about the success of this new approach in assisting the poor. This strategy is recognized widely because some of the programs have had a positive impact on clients' income levels, employment generation, and social empowerment. Moreover, they have the potential to be financially self-sustaining in a relatively short period of time.[2] Though the evidence on impacts is not conclusive, governments, policymakers, and concerned community activists in industrialized countries are nonetheless interested in transplanting MEPs and their innovative service delivery technologies from the southern hemisphere to poor regions of the northern hemisphere. Interestingly, this transformation of an economic development paradigm is perhaps the first major model of economic development to date to have migrated from south to north.

This paper discusses the suitability of this transplant strategy, specifically in regards to the rural South of the United States. Whether the attempt to transplant the microenterprise programs of the developing world succeeds depends in part on how the context of the U.S. differs from the context overseas. First, we attempt to define the concept and then develop a conceptual framework that helps explain the role of microenterprises in economic development. Second, we identify the principal contextual characteristics of successful overseas

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[1] "While the term *microenterprise* was in common use internationally by the late 1970s, it came into domestic use about a decade later. Traditionally, the business sector has been divided into three groups: large, medium, and small. The U.S. Small Business Administration (SBA) defines small businesses as those with up to 500 employees, and the smallest firms are those with fewer than 20 employees. Microenterprises generally have fewer than five employees and were not recognized by the SBA as a separate category until 1991, when the SBA established the Microloan Demonstration Project," *Building a Model: Accion's Approach to Microenterprise in the United States*, by William Burrus and Katherine Stearns, The U.S. ISSUES SERIES No. 1.

[2] A well-managed program can typically attain financial self-sufficiency (financial income covers all operating costs adjusted for inflation and subsidies) within 5–7 years.

microfinance programs. (What is the common social, policy, and institutional setting? What are the common characteristics of microfinance clients? Do the poorest of the poor participate and benefit from microfinance programs?) Third, we seek to determine the degree to which these conditions and characteristics hold in the rural South of the U.S. (What are the socio-economic and demographic characteristics of small- and micro-business operators in the rural South? Can an entrepreneurial-centered economic development strategy be fashioned that relies heavily on the proven principles of overseas microfinance in the Southern U.S context?) Fourth, we discuss the implications of the micro and macro context to give guidance to a microenterprise-centered strategy and public policy for economic development of the rural South.

Micro Enterprise Development from Concept to Conceptual Understanding

The Beginning

In the 1970s a few pioneering individuals and organizations did the absurd. They made unsecured small loans to poor people and expected repayment. In Bangladesh, Muhammed Yunus, a university economics professor, used his own salary as loan capital to make loans of $25–50. In Recife, Brazil, Accion International, a U.S. non-governmental organization, used private donations raised in the United States to make small-group loans to bicycle makers and seamstresses. From this modest start on two continents, the delivery technologies used have evolved, and the number of microfinance providers has mushroomed.

In February 1997, close to 3000 persons gathered in Washington, D.C. for the Summit on Microcredit and pledged to disburse $21 billion to 100 million poor households in developing countries by 2005 (RESULTS). The Summit was attended by heads of states, the First Lady of the United States, distinguished pioneers in the field of development finance, the staff of international donor organizations, and hundreds of microenterprise technical service providers, practitioners, and clients. This event represented a coming of age for a movement that started modestly 30 years ago.

Today, the developing world boasts thousands of microfinance institutions, but only 40 or so are known to be profitable, financially self-sufficient microfinance intermediaries, but they serve millions of moderate- and low-income individuals (MicroBanking Bulletin).[3] The largest, Bank Rayat Indonesia, despite a massive financial crisis in 1997–98, still posts profits, maintains high asset quality, and serves two million borrowers and 17 million savers. In Latin America, 12 to 15 credit-granting non-governmental institutions have either transformed or are in the process of transforming into regulated financial intermediaries. BancoSol in Bolivia, serves 76,000 borrowers, which represents 25 percent of the active clients in the whole financial system.[4] This bank has a loan portfolio of US$66 million and consistently generates returns on assets in the 4–5 percent range.[5] In Kenya, Uganda, Mali, Ghana, and South Africa other success stories exist albeit on a smaller scale. In Eastern and Central Europe, microenterprise programs have just started and while financial self-sufficiency has not been attained, promising programs have been initiated even in post-conflict countries such as Bosnia.

In terms of economic and social impact, the microfinance programs seem to have generally improved credit access rates, contributed to poverty alleviation and employment generation, and increased feelings of empowerment. Hulme and Mosley (1996) report that access to microcredit tends to result in a greater income increase for those above the poverty line than those below the poverty line. Thus, ac-

[3] Systematic data gathering efforts are under the way to report financial performance on a regular basis for the largest possible number. Currently, an initiative led by Calmeadow Foundation of Canada and supported financially by the Consultative Group to Assist the Poor has been publishing information on 81 of the leading microfinance organizations.

[4] Source: Asociación de Entidades Financieras Especializadas en Microfinanazas (ASOFIN), Junio 1999 and Boletin Informativo de la Superintendencia de Bancos y Entidades Financieras, Julio 1999.

[5] Source: The Microbanking Bulletin, Issue No.3, July 1999.

cess is not a guaranteed cure for poverty. Some of the poor may become better off and others worse off. Access to credit for those below the poverty line seems to help reduce vulnerability. However, evaluation data are incomplete and methodological issues abound. Many researchers state that the claims of the microenterprise/microfinance movement have yet to be backed by careful evidence (Morduch, 1999; Sanders; Ssewamala and Britt; and Bates, 1997).

Incontrovertibly, microfinance products have been well received by low-income clients, and the demand for microcredit and other financial services such as savings, insurance, leasing, and credit cards continue to grow.

The Concept: What Exactly is Microfinance?

Before discussing the suitability of transplanting overseas microfinance programs to the rural South of the U.S., a description of the product, its typical terms, the principal suppliers, and explanations of main approaches to microfinance are in order. Microfinance is the provision of financial services to moderate- and low-income individuals, primarily credit but in some cases savings deposits as well. In the case of the credit product, the principal characteristics are small loan size ($US50–1,000), short term (3 to 18 months), high interest rates (2–5 percent per month), use of repayment incentives such as the promise of a larger loan (graduated or step lending), and little reliance on physical collateral. Loan evaluations are based on total household cash flow analysis and less on the proposed investment project cashflow. The typical forms of collateral used are social and reputational, not assets. Often joint and several liability contracts are used wherein a group is responsible for repayment, even if one or two members of the group fail to earn sufficient return on their individual investments. Thus, the group engages in peer monitoring to ensure full and timely repayment. Other times, village elders and respected third parties are used to identify "creditworthy" clients solely based on character and managerial ability. Other typical forms of collateral are co-signers and liens on moveable assets.

Another key feature of microfinance is relatively rapid loan processing compared to traditional commercial and state-owned banks. The documentation used tends to be simple and the average turnaround time is short, ranging from a matter of hours to a few days, depending on whether the client is a repeat customer and the physical distances between the client and the central office of the microcredit provider. In short, transactions costs for both the lender and the borrower are minimized.

The range of institutions that provide the services are quite varied: (1) non-profit, non-governmental organizations (NGOs), (2) village banks or self-help groups (SHGs), (3) credit unions, (4) cooperatives, (5) state-owned development banks, (6) private commercial banks, and (7) finance companies. No particular institutional form has proven to be dominant in performance. Each organizational type, however, has particular strengths and weaknesses. Non-governmental and mutualist organizations (credit unions, self-help groups, cooperatives) tend to have strong commitments to assisting the low-income, target population and hold superior, virtually costless information on prospective clients, but are sometimes plagued by poor governance incentives, limited capital, and lack of a business-like approach. State-owned banks are subject to political interference, inadequate operating rules, and a tolerance for high delinquency. Commercial banks have larger capital bases, are profit-driven, but are disadvantaged in terms of information gathering, service delivery technology, and may not share a degree of commitment to the sector. NGOs, SHGs, credit unions, and cooperatives are the most commonplace providers of microfinance in developing countries.

In the field of microfinance two philosophical camps have emerged. One camp espouses the "financial systems approach," and the other camp espouses the "poverty lending approach." The former believes that the overall goal of microfinance is to provide sustainable financial services to low-income people, but not necessarily to the poorest of the poor.

Credit is seen as a means of facilitating risk and liquidity management and not as a cure for poverty. Therefore, the emphasis should be on building strong and permanent financial intermediaries that can provide a sustained flow of financial services to a working poor clientele. For the intermediary to become sustainable, it must charge interest rates that cover operating expenses and a risk premium. These high interest rates may exclude a segment of the poor. Whereas operational subsidies may be needed at the start of the program, no subsidies are foreseen or deemed warranted after a short time. The fear is that subsidies distort institutions, foster dependence, and undermine financial discipline.

The second school, the "poverty lending approach," believes that the principal goal of microfinance should be poverty reduction and social empowerment. Therefore, microfinance intermediaries should target the poor, including the poorest of the poor, and conduct impact assessments to "prove" the poverty-reducing effect of the financial service provided. Furthermore, ancillary business development services may be needed to contribute to poverty reduction. Due to the implied social welfare benefits, the microfinance programs may require and may be justified in receiving subsidies for an extended period.

In short, microfinance is a new field in development and financial sector economics that has grown rapidly in the last 10–15 years and now faces growing pains. Some proponents want to "commercialize" and fully integrate microfinance into the formal financial sector by stressing operational and institutional sustainability over poverty alleviation. If poverty alleviation occurs, it is an incidental by-product. Others seek to maintain the original anti-poverty focus and are willing to use subsidies to this end. Practically, microfinance thrives in certain conditions and can contribute to poverty reduction to some degree. It is not a "silver bullet," but nonetheless an important anti-poverty instrument. The policy challenge is how to best promote efficient and sustainable microfinance given limited public resources, in other words how to best use this limited instrument to help not all the poor but as many of the poor as possible.

Building a Conceptual Understanding of a Micro-Enterprise-Centered Economic Development Strategy

Despite efforts of multilateral, national, and local policy programs to induce economic prosperity, most nations have economically depressed regions. A dualistic economy is a product of discrimination, resource degradation, government and market failure (Lewis). This paper suggests a way to develop economically depressed regions based on a micro-enterprise-centered economic development strategy.

Development theories of economic growth have largely ignored the existence of something called *micro-enterprise* (entrepreneurial). Where they do exist, theories are somewhat fragmented. Most theories on entrepreneurship center on three main categories: 1) individual-specific factors, where the characteristics of the business owner are emphasized; 2) environmental factors, where the importance of access to markets, financing, labor force characteristics, and institutions (government, civic, legal and economic) are stressed; and 3) group factors, where the ability to mobilize the population to facilitate institutional and attitudinal change is central to enterprise development. Examples of such changes include the Civil Rights Movement, affirmative action and equal opportunity employment (Ahiara).

Drawing from a broad overview of growth and development theories, we provide a framework for understanding of entrepreneurship and community economic development. Traditional development theory begins the development process by identifying the deficits (capital, human capital, infrastructure, etc.) in low-income areas. Alternatively, a micro-enterprise-centered paradigm starts by asking what assets there are (in many cases, social capital is an important asset) and how to further invest in them to initiate the development process. This paradigm serves as a guide to current determinants underlying the complex relationships of the economic development process.

Kraybill and Weber acknowledge the initial ascendancy of political institutions over market and civic institutions. Beginning with the New Deal in the 1930s, "the federal government [became] the moving force in creating institutions and organizations that raised living standards of low income rural residents" (Kraybill & Weber). New Deal policy, however, "created large, bureaucratic organizations that were slow to adapt to a rural economy in which employment and income were no longer based primarily on natural resources" (Kraybill & Weber). Much later in the 1980s, conventional wisdom held that:

> the institution of the market was strengthened by legislative and judicial action in response to perceived deficiencies of governments, shifting the focus from market failure as a rationale for government interventions to a focus on 'government failure' as a reason for avoiding intervention. Agricultural commodity programs, as well as area and rural development programs, were widely criticized as unnecessary and ineffective (Kraybill & Weber, pg. 1265).

Kraybill and Weber contend that civic organizations possess the potential for providing rural revitalization opportunities that market and political institutions are unable to offer in the 1990s. Social scientists are now realizing that these organizations, embedded in local culture, are important sources to build upon for economic and political advancement. Thus, civic organizations can play a major supporting role along with government in development efforts of rural communities. Sustainable economic growth strategies in rural communities can no longer exclusively consider enterprise innovation separate from necessary innovations in government and civic institutions. Innovative combinations supporting both institution and business efforts are imperative.

While knowledge about the economic development process has accumulated gradually over the past fifty years, the question of how to generate entrepreneurship and sustainable economic growth remains unanswered (Vosloo). What is needed is a conceptual understanding of entrepreneurship and its role in the process of economic development. Vosloo contends that evidence from developing and developed countries supports the position that government should not manage development in detail. He states that:

> Many forms of intervention have proved counterproductive and the importance of openness and competition has been acknowledged. Theory and practical experience indicate that interventions are more likely to hinder than help development unless they are market friendly (Vosloo, pg. 2).

This view supports the argument that interventions are most successful at facilitating growth if they provide an "enabling environment" for business. Michael Porter asserts that this favorable climate can be accomplished if government uses public funds in ways that do not distort business incentives, but rather focus on providing infrastructure to support "genuinely profitable businesses."

Porter's model of Inner City Economic Development provides fundamental principles that inform the conceptual framework of this paper. His model is based not on redistributing wealth but on creating wealth within disadvantaged communities. The goal is "to identify and exploit the competitive advantages of inner cities that will translate into truly profitable business" (Porter). Thus, the focus of such a model is the private sector, as opposed to government and social service organizations. Another important factor in his model is engaging skilled and experienced minorities in building business versus engaging them solely in the social service sector. What is essential to the proper functioning of such a model is that:

> Government assume[s] a more effective role by supporting the private sector in new economic initiatives. It must shift its focus from direct involvement and intervention to creating a favorable environment for business. This is not to say that public funds will not

be necessary. But subsidies must be spent in ways that do not distort business incentives, focusing instead on providing the infrastructure to support genuinely profitable business (Porter, pg. 67).

Drawing from Porter, fundamental principles underlying a micro-enterprise-centered strategy are:

- An economic versus a social focus, emphasizing the creation rather than the redistribution of wealth within economically disadvantaged rural communities.
- An emphasis on the private sector as opposed to the government and social service sector, but highlights the supportive role of government and social services.
- An emphasis on having skilled and experienced individuals engaged in entrepreneurial activities.

Our conceptualization of the micro-enterprise movement has several key components that concern relationships entailing reciprocity. Those components are both economic and non-economic (the entrepreneur, inputs and outputs, economic base, etc.). The outputs are what comprise the sustainable economic base that is linked to sustainable economic development by positive economic growth. Four macro components of this system that constrain or enable development are the amount and/or quality of human resources, technology, institutions, and the environment.[6] Within the micro-environment of this conceptualization is the **entrepreneur**, who fuels this economic system and sets the development process in motion through creation of businesses or improvement of existing businesses.

Charactistics of Successful Microfinance/ Enterprise Programs in Developing Countries

Successful microfinance programs are the result of the confluence of auspicious internal and external factors. Abstracting from the obvious internal factors, such as the presence of committed and competent leadership, well-trained and motivated staff, proper governance incentives, well-designed and appropriately priced products, adequate management information systems, this section focuses more on the external conditions that may contribute to program success. Common external conditions that help explain successful MEPs in developing country context are the following.

Scarcity of Financial Alternatives

In developing countries, formal, regulated financial institutions are largely absent from rural areas. The predominant sources of finance are family, friends, traders/suppliers, and moneylenders. This scarcity of supply creates a noncompetitive environment for a microfinance institutions entering the rural marketplace. The institution can charge rates of interest slightly below the informal rates and be assured a clientele. Moreover, the client will have incentives to repay promptly to maintain access to a future stream of financial services provided the microfinance institution provides good service. This situation allows the microfinance institution ample margin to cover operational expenses and attain financial sustainability in a relative short space. In some cases, state-owned development banks may be present and offer loan products with the lowest interest rates. Unfortunately, state-owned banks also tend to impose high transaction costs on clients (i.e., excessive loan processing times and inopportune disbursements). In terms of quality of service, a microfinance institution can compete effectively against a state-owned bank.

Low Levels of Mobility and High Degrees of Social Cohesion

With the exception of countries that have experienced civil conflicts or ones that have many rural communities with multi-ethnic pluralities, the rural areas of most developing countries are marked by low levels of mobility and high degress of social cohesion. The rates

[6] The environment as a driving force is significant because it is the ecological support system for development.

of out-migration tend to be highest in the young adult population, a population in and of itself not prone to be highly creditworthy due to lack of enterpreneurial experience. Although the middle-aged population may migrate, the pattern may be seasonal. Typically, the male head of household may spend part of the year working on the harvest of cash crops on distant plantations or in cities in casual employment during the agricultural off-season. Thus, microfinance institutions can employ service delivery technologies that rely heavily on reputation and long-term residence in a particular community, that is group credit and unsecured step lending. In such a setting, microfinance institutions can easily locate delinquent clients, invoke social sanctions (i.e, inform neighbors, relatives, and village elders about the delinquency), and develop a long-term relationship with clients based largely on trust and less on physical collateral.

Limited Availability of Formal Rural Wage Employment

In many developing countries, the opportunities for rural wage employment are quite limited. Few industries have located in rural areas and thus a high percentage of the economically active rural population is either self-employed or employed in informal family-run enterprises, where renumeration may be in-kind or at or below official minimum-wage standards. This situation creates many entrepreneurs and potential clients for microfinance institutions. The lack of formal employment opportunities means that persons with higher levels of education and managerial talent are more likely to be entrepreneurs and not paid employees.

Absence of Social Safety Nets

Rural areas in developing countries tend to have higher rates of poverty than urban areas. However, unlike residents of urban areas, rural residents have little recourse to welfare assistance or income maintenance programs. Poor rural residents have to depend more on extended family networks, friends, and community organizations for insurance and assistance in times of crisis. The lack of social safety nets results in a high level of averseness to assume debt obligations, but once the obligation has been assumed, a greater willingness to repay financial obligations to avoid losing what few assets they hold.

Structure of the Microenterprise Market

In many rural areas of developing countries the commerce and agricultural sectors are dominated by small and micro entrepreneurs. In the commerce sector high rates of capital turnover are possible. This high turnover rate makes acceptance of high-interest, short-term loan obligations feasible. In other sectors, such as agriculture and manufacturing, the production cycles are longer, reducing the ability to assume high-interest, short-term obligations. Nonetheless, certain activities such as poultry and swine raising and some annual grain and vegetable crops can be still be financed. These sectors face high and widespread demand for their outputs. Moreover, small firms are competitive. Thus, microfinance institutions can focus on a profitable niche in the market.

Legal, Regulatory, and Economic Policy Framework

The legal, regulatory, and economic policies of many developing countries have not been favorable in general to rural economic development, the growth of prosperous microenterprises, and to the development of viable and strong financial intermediaries. Though this situation has improved in the last decade—in the wake of pricing, trade, and financial sector liberalizations—obstacles still remain. In the presence of weak state institutions and weak regulatory frameworks, however, community-based organizations and internationally supported microfinance intermediaries have been able to experiment with new technologies largely due to the absence of regulation. For example, the use of forced savings in village banking schemes as a screening device and collateral substitute may not have been allowed in settings where strict rules on the collection of deposits from the public exist. The principal challenge now is to formalize these financial innovations, improve the profitability of a number of rural activities so as to increase incomes, and scale-up microfinance institutions.

Context for Micro Enterprise Programs in the U.S.

The number of microenterprise/microfinance programs in the U.S. has grown from fewer than 20 in the 1980s to more than 300 in the mid 1990s (Severens and Kays). Most of the MEPs in the U.S. target the working poor, the unemployed, and welfare recipients. The factors that influence the success of MEPs in the U.S. are detailed below.

Availability of Financial Alternatives

In the U.S. the employed and the prospective entrepreneur have greater access to credit cards, pawnshops, and check-advance services. Thus more small and micro businesses can be self-financed. The effective interest rate ceiling for microfinance programs will be the going interest on credit cards (19–21 percent pa). Thus microfinance institutions operating in the U.S. will have to be able to cover all operating costs with this amount as a ceiling.

Greater Mobility and Less Social Cohesion

The typical American moves at least three times in his or her lifetime and the culture is highly individualistic. In the rural Southern U.S., the levels of out-migration have been consistently high from around WWII to the 1980s, first to northern and western cities and more recently to larger cities within the South. The high degree of mobility undermines cohesion and a sense of place. Moreover, the South has been marked by a legacy of racial discrimination and racial economic inequality that undermines collective action across racial lines. The reduced cohesiveness limits the potential effectiveness of group loan technologies that rely heavily on social capital—the embodiment of trust, willingness to cooperate, to share resources and information, and to engage in mutual insurance.

When the social capital of a community or even a particular homogeneous subgroup within a community has not been developed, the cost to the microfinance institution of trying to create this capital can be high. In the U.S., where market and household transactions tend to be impersonal and often one-time, building social capital is inherently more costly than building it in developing countries where economic-social relationships are multi-stranded and repeated. For example, in a U.S. community with low social capital, the microfinance institution may have to invest heavily in group training sessions and screening activities before lending. These educational activities increase operational costs and in an environment with *de facto* interest rate ceilings set by credit card companies, the attainment of institutional financial self-sufficiency becomes more difficult. If the microfinance institution does not invest in building social capital, it may be faced with high delinquency rates and high collection costs, again delaying the attainment of self-sufficiency.

Greater Availability of Wage Employment

In the U.S. in general, and even in the rural South, there exists a greater density of firms that offer wage employment compared to most developing countries. Thus, those with relatively higher levels of human capital can more easily find wage employment. This reduces the pool of highly prepared and motivated entrepreneurs.

The chief constraints to self-employment in the U.S. are lack of personal savings (wealth) and lack of human skills. Due to higher costs of starting a business in the U.S. (e.g., a higher government regulatory and tax burden, and the more capital-intensive nature of production or service delivery) many potential entrepreneurs have to save more to start businesses than their counterparts in developing countries. Also, because the economy is more complete, better integrated, and more complex, more technical skills and more education are needed to survive.

Even those with wage employment and some savings who seek to become entrepreneurs may find the cost in time too high to participate in imported microfinance group credit schemes marked by frequent mandatory meetings. These individuals may prefer to access individual loans. If they possess sufficient collateral, then no obstacle exists. However, if these prospective clients lack collateral and do not want to bear the costs associated with group lending, an innovation designed to mitigate the lack of physical collateral, there is a dilemma for lenders.

Presence of Social Safety Net

Unlike the governments in most developing countries, the U.S. government provides an extensive social safety net. Numerous public assistance programs exist (Aid to Families with Dependent Children; Supplemental Social Security; Unemployment Compensation; Women, Infant, Child Nutrition Programs (WIC); Food Stamps; etc.) and subsidized educational and job-training programs designed to reduce the social and economic burden of disability, unemployment, and poverty. The existence of those programs, while contributing to income maintenance and poverty alleviation, also contributes to an entitlement mentality. Unlike prospective microfinance clients abroad who fear failure because of the threat of starvation and thus work hard to succeed, the pressure to succeed is considerably less in the U.S. and other industrialized countries because the consequences of failure are less harsh. Thus the presence of an extensive social safety net constitutes a moral problem for microfinance lenders.

Structure of the U.S. Microenterprise Market

Whereas small and microentrepreneurs constitute 60–80 percent of all business firms in developing countries and are active in all sectors of the economy, U.S. microentrepreneurs constitute less than 8 percent of all business firms and are almost exclusively concentrated in services. Small farmers in the U.S. can not easily compete with corporate farms, and small retailers can not easily compete with nationally based discount chains. Income from microenterprises in the U.S. tend to be low since most microenterprises start with low levels of investment and exist in sectors with low barriers to entry (Bates, 1995 and 1996). Thus, these microenterprises have low productivity and face high competition. Microenterprises in depressed areas also face low demand since they often sell services that their customers could do for themselves. The end result is high effort, high risk, and low profits.

Legal, Regulatory, and Economic Policy Environment in the U.S.

Whereas the typical legal, regulatory, and policy framework of many developing countries can be inadequate or missing with respect to signals and conditions needed to promote microenterprise development, the framework in the U.S. is developed and complicated. The legal framework, for example, provides many safeguards and opportunities for recourse to contract enforcement remedies that do not exist for the typical microenterpreneur in a developing country. In addition, the favorable macroeconomic and sectoral conditions—low interest rates, low inflation, a steadily growing economy, and access to a number of small business assistance programs—bring enormous benefits. On the other hand, the regulatory apparatus ranging from business registration, to health and safety standards, labelling requirements, and compliance with labor, environmental, and tax requirements can be extensive and confusing. Unlike developing countries, the U.S. government has greater enforcement capacity therefore the rules are effective. The net result may be not to deter small and micro business formation or to make them uncompetitive but to require a higher level of initial investment of both financial and human capital.

Determinants of Micro-Enterprise Development in the Rural South: Creating the Enabling Micro-Environment

This section describes the relationship between the micro variables (derived from the conceptual overview of entrepreneurship and economic growth and development theories) expected to have a significant role in determining the rate of business ownership and their subsequent impact on community development. Hypotheses are also set forth regarding how these variables directly or indirectly influence the rate of business ownership in a community. These determinants of entrepreneurship fall into three main categories: human capital, economic well-being, and locational attributes. They are discussed to facilitate an understanding of the positive impacts of enterprise development. The aim is to give policy-makers insight into the factors that can enhance business development initiatives.

The substantial number of studies on business ownership and development strategies has focused primarily on urban areas in the U.S., providing little information on rural-owned business. The rural perspective must be included to fully analyze enterprise development in the South, the most rural region of the nation. The literature clearly indicates significant differences between socio-economic characteristic in rural and urban areas, demographics and other factors that affect business and community development.

Human Capital Determinants

The connection between education and economic growth is exceedingly complex. It is difficult to identify those attributes of education that are useful in economic endeavors. It takes years to develop entrepreneurial capabilities and for those capabilities to prove their worth.

One explanation of the persistent poverty in rural areas is the continued departure of persons with high levels of human capital, i.e. the education, training and experience needed to fuel development efforts. African-American entrepreneurship relies on individuals with such human capital. Considering the direct relationship between education and income, increases in education should have positive impact on the African-American business ownership rate. However, empirical studies report the different impacts of education on business development in low-income areas. Within rural areas, high school education is positively linked to business development whereas college and professional training show a weaker association. This weak relationship between higher education and business development in rural areas underscores the fact that investments in education increase the mobility of the work force.

Economic-Well Being Determinants

Existing businesses must have capital to expand and new ones must have capital to form. "Throughout the literature, access to capital has been recognized as a factor restricting black business ownership and limiting the size of black owned businesses." (O'Hare). A major source of capital for many business owners is personal wealth, as opposed to loans. As with most of the socio-economic characteristics of the African-American population, African Americans lag far behind their white counterparts in the accumulation of wealth. O'Hare asserts that:

> The major source of wealth for most U.S. families is equity in a home. Consequently, groups that have higher rates of home ownership are likely to have more wealth and more financial resources available . . . for business purposes (O'Hare, pg. 101).

Thus, the rate of African-American home ownership is commonly used as a proxy for capital. The median household income of a community, a proxy for the economic well-being of the entire community, is also expected to be directly related to the rate of African-American business development.

Traditionally, black-owned businesses operated in a "protected" market. The fact that segregation and racial discrimination restricted the clientele of African-American-owned businesses initially served as a protective trade barrier. However, with de-segregation came not only increased competition, but a decrease in demand for the products and services of African-American-owned businesses. Baer and Jones state that ". . . integration diminished the capacity and strength of the incidental collective actions of African Americans toward economic development." As these "barriers to trade" fell, black business owners did not explore many market expansion activities. As such, African-American businesses continued, and many continue, to serve a diminished clientele (O'Hare).

In its report on the characteristics of business owners, the *Economic Census* contains statistics that demonstrate the limits of the market for most African-American entrepreneurs. Minorities comprised 75 to 100 percent of the customers of over 40 percent of all African-American-owned firms in the U.S. This restriction in clientele has serious implications for the rate of African-American business ownership. The percentage of the population that is African American is not only a measure of the supply of African-American entrepreneurship, but is also a measure of demand (market) for products of black-owned firms. The African-American business owners' potential for success will be inhibited by the socio-economic characteristics of the rural southern African-American population (high levels of poverty and subsequent low incomes). "To the extent that black-owned businesses serve solely or largely black customers, demand is simply the product of the number of blacks and their incomes."(O'Hare).

The size of the African-American population in a county and the average income of African-Americans in the county are thus proxies for business demand. Results indicate that as the average income of the African-American population increases, so does the rate of black business ownership. This relationship does not always hold true as African-Americans with higher incomes may patronize other businesses that are not African-American owned.

Locational Attributes of a Community as Determinants

In his theoretical appraisal of entrepreneurship, Leibenstein recognizes that the incidence and nature of entrepreneurial activities depends on the nature and variety of markets necessary to sustain a firm. Thus, attention should be given to the environment in which a firm operates. Along with a measure of rurality (distance from urban area) other locational attributes include available financial services, transportation services, access to information and technology, and links with government and civic institutions.

Is there something in the micro-environment that either retards or accelerates business development? At the core of the answers to this question are the following observations:

- Several socio-economic and demographic characteristics of a county prove to be influential factors in determining business development.
- The characteristics that are important determinants of business ownership rates in the rural counties are the rate of African-American home ownership, the rate of African-American high school completion, and the concentration of the African-American population.
- The incidence of black business ownership between rural and urban areas differs and significant variations exist within rural areas in terms of socio-economic and demographic characteristics of the black population and the economic condition of the county.

Creating an Enabling Macro-Environment: Policy Implications

The southern rural economy has lagged behind in economic development due to its isolation from centers of economic activity, the difficulties in structural adjustment that stem from inadequate rural institutions and the characteristics of the labor population (Rural Revitalization Task Force). Rural residents who have the ability to migrate to areas where economic prosperity seems to be more of a reality do so to escape poor economic conditions. So human capital development has the effect of increasing not only individual incomes; in a rapidly changing economy it also increases mobility.

Rural communities are poorly equipped to provide job opportunities for individuals with college degrees. The flight of these educated individuals from rural communities erodes the property tax base that serves as the major source of income for schools and other public services.

These stagnant economic conditions, inability to sustain incomes, insufficient tax bases, and limited opportunities for highly skilled or highly educated individuals all stem from, among other factors, the inability to adapt to structural changes in the national economy. It is abundantly clear that the agricultural sector is becoming a less important economic entity in many rural communities. Transformations of the agricultural sector of the rural economy have created major human-resource problems. The lack of public response is due partly to the lack of well-organized rural community institutions stretching from local communities to the state, region and nation to provide a voice for rural society. This major transformation of rural areas is not well understood, and as a result no strategy for resolving critical problems exists.

Many local communities are turning to indigenous development strategies, such as microenterprise-centered economic development. With such strategies, public policy makers must become occupied with creating an "enabling environment" for business. In this sense, the market becomes an important institution for rural development problems of our time.

Handy and Swinton note that the ". . . general reliance on market forces will not bring about parity in the rates of business ownership" and that interventionist strategies are also required (Handy and Swinton). Thus, what we need is a clear understanding of rural development policy goals and objectives. Economic development requires an agreement on economic goals, the strategies to accomplish those goals, and the design and implementation of institutions that will establish both public and private policies.

From the empirical findings of several studies, it is clear that the *general* policy objectives for these rural areas would be to:

- Retain financial capital
- Encourage in-migration or stem out-migration by providing incentives to individuals with high levels of human capital
- Stimulate business development and economic growth.

The types of instruments or policy levers available would be:

- Capital subsidies
- Improvement of infrastructure
- Tax breaks and relaxed regulations
- Human capital development and management training

These policies should be directed toward entrepreneurs or existing private sector employees (Brown). This is a *general* picture of policy goals, levers and targets.[7]

To foster the economic growth and development of rural communities in economically depressed areas it is important to develop public policy that supports micro-enterprises and entrepreneurial growth. Programs should be developed that help to retain financial capital, encourage business development, and provide incentives to stem out-migration of skilled individuals and attract such people. Examples of such "policy levers" are capital subsidies, improvement of infrastructure, tax breaks, and relaxed regulations for businesses. But beyond those traditional policies, enlighted public policy must build upon the existing "social capital" within economically depressed rural regions. Faith-based institutions can play an important role as they have served historically as political, social, and economic institutions for the improvement of the lives of disadvantaged people.

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[7] The term *target* refers to the group, region, etc. that a policy is directed toward.

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