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**INNOVATIVE AND COMMERCIALY SUSTAINABLE
APPROACHES TO POVERTY ALLEVIATION**
*OPPORTUNITIES AND CHALLENGES FACING MICROENTERPRISE DEVELOPMENT
IN CENTRAL AND EASTERN EUROPE*

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I. Introduction

Poverty is as old as humanity. One of the major stories in the 20th century, the rise and fall of communism, was portrayed mainly as a radical but failed solution to the problem of poverty and deprivation. The half-century after the end of World War II saw the collapse of this solution, paralleled by the rise of other responses.

In the second half of the 20th century, the fight against poverty became more systematic and institutionalized. This took place mainly through the emergence of the Bretton Woods institutions, the establishment of the Official Development Assistance (ODA) as an institutionalized foreign tool of Western and Northern governments, and the rapid rise of non-governmental organizations (NGOs) as an alternative to government responses to poverty. This paper explores the NGO response to poverty and focuses specifically on the microenterprise-development NGO.

Microenterprise-development (MED) NGOs have matured significantly over the last two decades. Although they are viewed as one of the period's great new innovations, some are critical of their role. The NGO industry faces increasing challenges, particularly in its poverty-alleviation strategies in the "North." Sustainability is the most serious obstacle. Put simply, the poverty problems faced by the world demand resources that far exceed those generated by either public funds or charity. Commercial models must be developed.

The enormous growth of microfinance institutions (MFIs) and the corresponding promise of a poverty-alleviation solution that "works in the marketplace" are attracting a great deal of attention. This is evidence from the fact that 2005 has been declared the "International Year of Microfinance" by the United Nations. However, this movement faces pressures as tension between the two competing goals of a poverty-alleviation vision and the need for financial sustainability continues to grow.

This paper examines the application of microenterprise development (MED) to Central and Eastern Europe and considers innovations that can help sustain both the poverty-alleviation mission of MED while potentially securing sustainable institutional capacity.

II. The "New Poor" of Central and Eastern Europe

Poverty in Central and Eastern Europe exhibits a range of features stemming primarily from the communist past and the democratic-transition experience. Though statistical data is admittedly weak, the number of people living below the absolute poverty line (\$2.15/day) in 1989 was 4%. By 1998, this number had grown to 20%, and in Russia, more than 60% of the citizens were living in poverty.

Post-socialist poverty in Central and Eastern Europe has proven persistent, largely due to the economic-transition pressures that resulted in whole populations being left behind. Those who previously had been financially secure found that their knowledge, skills and competency levels were suddenly irrelevant. Stubborn pockets of poverty emerged in

locations where economic life had been sustained artificially under a closed economic system. Typically, this poverty affected those who were least equipped to deal with it. The resulting growth of social ills, such as alcoholism, depression, suicide and domestic violence, has roots in the stubborn nature of the ensuing unemployment and poverty, and the hopelessness these conditions bring.

This “new poverty” has a deep emotional and social impact. Following are some quotes from the World Bank publication *Voices of the Poor: Can Anyone Hear Us?*

“Poverty is pain; it feels like a disease. It attacks a person not only materially but also morally. It eats away one’s dignity and drives one into total despair.” (Woman from Moldova)

“I feel very unpleasant when you ask me to describe my situation. I do not understand why, but I do understand that I am poor.” (Man from Macedonia)

“If an employed person still needs to worry about how to provide bread for her children...this is not normal.” (Woman from Latvia)

“If I were to admit to myself that I am poor, life would become emotionally much harder.” (Woman from Latvia)

“I went to bed a rich man and woke up a beggar.” (Ukrainian pensioner, referring to the collapse of communism)

“You gave birth to them; you feed them!” (Public official's response to appeals from Ukrainian women for food aid for their children)

The main risk factors contributing to this “new poverty” are: unemployment (long-term, more than 12 months unemployed); age (those who were 45 or older in 1989); location (rural and cities under 50,000 pop.); and ethnicity (minorities, particular Roma). Poor people in Central and Eastern Europe were not born poor — they “woke up” to the new political regime and its resulting reforms, and discovered to their surprise that they were poor.

One of the most stressful elements of this transition was the rise of inequality in an area of the world where people, though not rich, lived at the same level (which was low but not below the poverty line). Each of the countries in the region (with the exception of Croatia) saw a clear rise in the Gini coefficient (which measures inequality, rather than only poverty) during the 1990s. Armenia, the Kyrgyz Republic, Moldova and Russia are now among the most unequal countries in the world, with Gini coefficients nearly twice as high as their pre-transition levels.

Another phenomenon that perpetuates poverty in Central and Eastern Europe is the rapid rise of corruption, which was accelerated by a hasty, non-transparent and cronyistic privatization process. Much of the wealth of the region’s countries was siphoned off during the period in which privatization occurred. “State capture” — which occurs when private

interests use payments to public officials to influence the legal framework and policy-making process in an effort to secure rents and privileges — is a significant problem throughout the region. Research by the World Bank demonstrates a clear correlation between the level of state capture and the Gini coefficient in a country.

Poverty in the region can best be described as the poverty of opportunity. Those who do not suffer from one of the poverty-risk factors have experienced great opportunities during the transition period. But many who are unable to take advantage of those opportunities have been left behind. These are the “opportunity poor” of Central and Eastern Europe.

III. Microenterprise development: an uncertain future

Microenterprise development was introduced as a poverty-alleviation strategy in Central and Eastern Europe almost immediately after the collapse of communism in late 1989. NGOs that had been working with this strategy in other parts of the world saw a new opportunity and reacted quickly. In the early 1990s, some of the world’s largest MFIs developed strong programs, among them Opportunity International, Catholic Relief Services, FINCA, World Vision and Save the Children. At the same time, USAID established itself as the largest donor in the region, pouring millions of U.S. dollars into the establishment of MFIs.

These programs have gone a long way to reduce “opportunity poverty,” and the MED industry has achieved significant outreach in the region. The Microfinance Centre, an industry umbrella agency based in Warsaw, comprises 62 institutional members, with more than 245,000 clients and a combined portfolio of \$260 million. (See <http://www.mfc.org.pl/>)

At the same time, MFIs face serious challenges, particularly in the more advanced transition economies. The first challenge is the rise of consumer credit, which enables solvent and less risky clients to gain access to credit from the established financial sector more easily and at more favorable terms than the MFIs can afford to offer. Banks and other financial institutions continue to target increasingly poorer segments of society, offering credit to ever more risky clients.

Typically, the economic model for an MFI assumes that high-risk clients are balanced by those who are less risky. High-risk clients not only produce a higher PAR (portfolio-at-risk), but also demand greater resources in order to be served effectively. For example, often a range of business-related interventions, such as business-plan development, financial and marketing skills and production or merchandising, must be part of the credit package. While these elements increase the security of the loan and enhance the quality of support, they are costly for the MFI and negatively impact institutional financial sustainability. This reduces the luster of microfinance as a “silver bullet” that simultaneously offers a poverty-alleviation solution, provides commercial sustainability and even generates profits while creating no lasting drain on the public purse. This is

potentially good news for clients, who have a broader range of credit options, but bad news for the MFIs, which are unable to compete with the established financial sector.

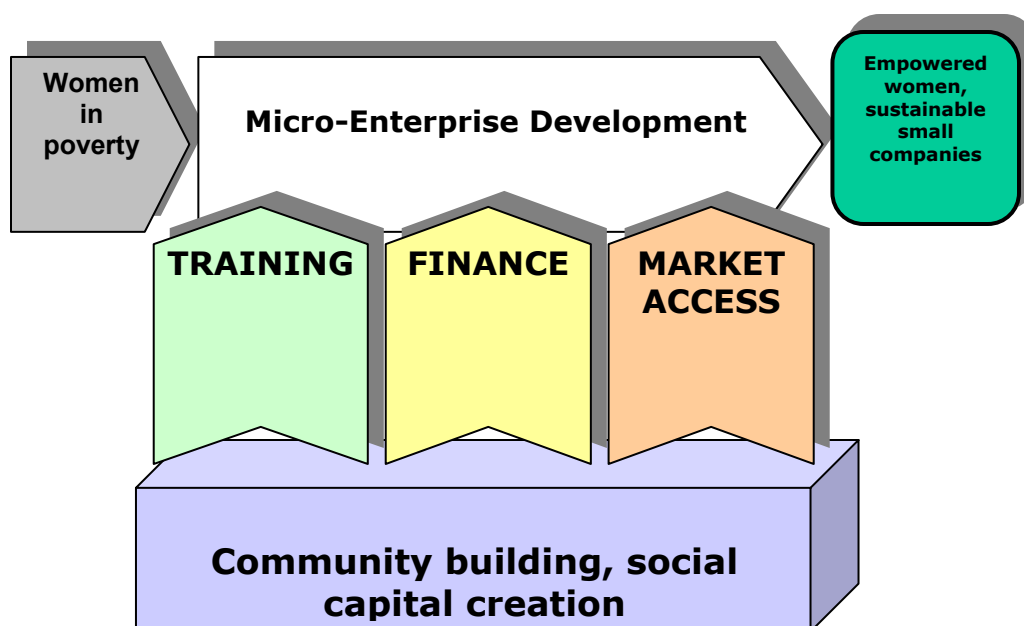
Another challenge to microfinance is the rapid transition of the marketplace, particularly the retail and wholesale-supply channels. With globalization and the fast emergence of modern retailing in this region, the typical microfinance client often is squeezed out of retail chains. There are three predominant categories of microenterprise clients in Central and Eastern Europe: market traders, small-scale producers and small agricultural producers. All face increased difficulty in gaining entry to modern retail-supply chains, which can procure goods easier and cheaper from global networks than small producers in the same city.

Both of these challenges pose a threat to MFIs by reducing the appeal of their product offerings and eliminating the viability of markets for their clients.

Innovations in the delivery of MED services in Central and Eastern Europe are needed to further the development of viable MED interventions that are both sustainable and have depth and breadth of outreach.

A creative combination of three interventions must be developed to assist the poor. These are: affordable access to financing, business-skills development to enhance competitiveness, and assistance in gaining access to markets. MED can only continue to be a significant poverty-alleviation strategy if it evolves from a simple finance-delivery mechanism to a more complex set of business-development interventions, thereby enabling those who are motivated but trapped in the “opportunity poverty” web.

One promising innovation that offers both opportunity and financial sustainability is market access. The interplay between the different interventions in MED is illustrated below:



IV. Market access: an emerging strategy

Retail-system changes and the implications for small businesses

Micro and small-business owners are directly affected by the nature of the retail system in their market area. The suppliers of the system are consumer-products manufacturers, handicraft-makers and agricultural-products growers. These suppliers provide bookkeeping, cleaning or other services to retail owners, or they themselves function as retailers, operating small open-market stalls or village convenience stores.

The environment in which small-business owners operate is constantly changing, bringing new challenges and threats, such as the globalization of the retail system and the rapid rise of supermarkets¹. According to Reardon², the Central and Eastern European region has followed this trend from the mid- or late-1990s to the present (depending on the country, as categorized by income level and stage of reform). For example, the market share of supermarkets was 40% to 50% of the total food-retail market in Czech Republic, Poland, Hungary and Slovakia in 2003, with southern and eastern areas catching up fast. The consequences of this change impact two groups of MED clients: producers/manufacturers and retailers.

Procurement changes

Profound changes in procurement systems have accompanied the shift from small national retailers to large multinational retail chains. During the transition period in the 1990s, private general-line wholesalers replaced state-managed, collective wholesale operations. Small private retailers purchased their supplies either from wholesalers or directly from producers, depending on the nature and size of the retail shop.

As new retail enterprises entered the regional markets, they sought efficient, low-cost procurement systems and established centralized (often cross-border) procurement offices and distribution centers. This enabled them to exploit economies of scale by buying in large volumes and to decrease transaction costs by dealing with fewer suppliers. Moreover, there was a shift from general-line wholesalers to specialized/dedicated wholesalers. These wholesalers, who specialize in certain product categories and are dedicated suppliers to supermarkets, are often held in the same holding company as the supermarkets. Supermarkets, together with wholesalers, have moved toward preferred-supplier systems, in which they select preferred suppliers who are capable of meeting quality and safety standards and then provide them with incentives to ensure the flow of goods in the desired volume and quality. Finally, leading supermarket chains are shifting toward safer, higher quality products by imposing private standards on their suppliers.

¹ We use the term “supermarkets” in this paper as a group name for all modern, large-format stores, such as supermarkets, hypermarkets, cash & carry, and discount stores.

² Dries, L. Reardon, T. Swinnen J.F.M. The Rapid Rise of Supermarkets in Central and Eastern Europe: Implications for the Agrifood Sector and Rural Development, Development Policy Review, 2004, 22 (5): 525-556

All these changes have dramatically reduced the market opportunities for small suppliers in recent years. With supermarkets increasing their market share, the number of alternative retail formats is decreasing, and small suppliers have to fight to get their products to the retail shelves. Many small suppliers have no chance to supply supermarkets, because they are unable to meet the quality and volume requirements. As supermarkets strive to keep their transaction costs at a minimum and to lower the risk of uncertainty and inconsistent supply, they prefer to deal with larger and/or multinational suppliers.

Yet, changes in the retail system also offer certain opportunities for small businesses. If they are able to improve the quality of their products and meet the requisite higher standards, they have the potential to grow and expand along with the supermarkets. Small suppliers could form cooperatives or other types of networks that would enable them to negotiate contracts with supermarkets. By their nature, small businesses are more flexible in their production processes than large corporations and can exploit this strength by adapting quickly to new requirements. Many small businesses are also innovative and able to offer unique products at lower prices. Lastly, small businesses have an opportunity to increase buyers' commitment to social responsibility by offering fair-trade products or products made by disadvantaged groups in local communities. Socially responsible niche marketing appeals to many customers and can be promoted as a special product line in supermarket chains or as an alternative retail format.

Changes in other retail formats

With the rise of supermarkets, many small retailers were forced to close their businesses. Those that survived must adjust to this new marketplace environment and find creative strategies that will enable them to succeed in the long-run. As large chains offer higher quality products for less, small retailers find they no longer price competitive. However, they can flourish in niche markets, filling gaps that are too small for supermarkets but still large enough to be profitable. Small retailers should offer value-added products and services with premium quality, and serve individual consumers with diverse demands. As the global environment changes more rapidly and competition tightens, successful companies need to be fast, innovative and able to respond to changes in consumer demand before the competition³.

The challenges facing small businesses require new assistance programs for MED clients. The successful efforts of small businesses, private corporations and NGOs to maintain the competitiveness of small businesses also furthers the economic development of Central and Eastern European countries. The focus should be on providing technical assistance in product-quality improvement, organizing networks of small business owners and advocating and promoting products and services provided by disadvantaged groups.

V. The Integra Market Access model: prospects for sustainability

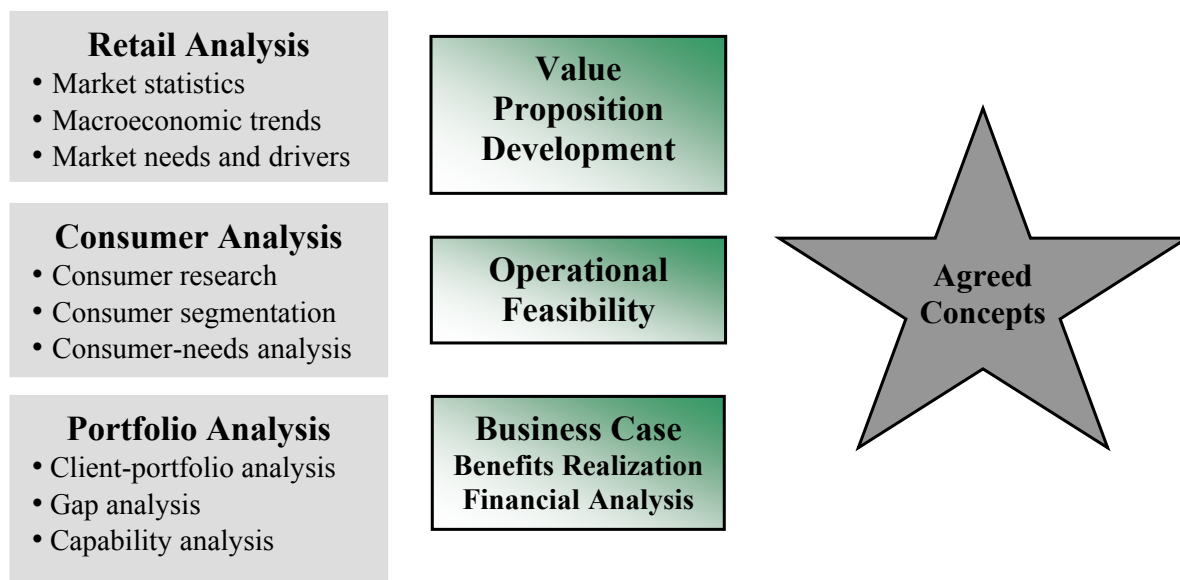
³ "Be fast or be gone," as Dr. Chris Peterson remarked in the unpublished presentation on The Future Food System, Michigan State University, 2004

With the advent of modern retailing, initially in Slovakia, it became clear that simply providing loans and business-skills training would not offer an adequate level of support to clients. In response, Integra, in partnership with the Shell Foundation and the Accenture Development Partnership, began in 2003 to develop a market-access strategy for Integra clients.

This strategy was targeted at the Integra MED program for women, which has grown since 1999 to serve more than 2,500 women clients in Slovakia, Romania, Bulgaria and Serbia. The program provides business start-up assistance for women at risk such as single mothers, divorcees with young children, refugee women, women who are victims of domestic violence, women with alcoholic or chronically unemployed partners, women who are unable to re-enter the work force after maternity leave, women with disabilities, and women from ethnic (mainly Roma) minorities. Other women can participate, but the program is designed to be accessible for this at-risk group.

The Integra Market Access program was developed to help women identify market channels for their products and to create end-to-end client services consisting of business-skills training, credit, follow-up support and market access. Integra had some previous experience, and limited success, with sales events involving the distribution of products to Shell retail shops as well as bazaars, occasional exports and seasonal sales.

The Integra Market Access strategy evolved from an initial three-month study conducted by the Accenture Development Partnership in Slovakia, which provided an analysis of Slovak market opportunities and demands. The research sought to match the clients' needs, products and capabilities with market demands. It also identified the most suitable market-access strategies for Integra to offer its clients. The process is illustrated as follows:



All stakeholders worked to develop the process and agreed on the market-access strategy, which includes:

- The development of an Integra Market Access brand that could add value to client product offerings
- An Integra-owned retail outlet in Bratislava for client product sales
- The enhancement of product-specific consulting capacity offered to clients
- An Integra-managed wholesale capacity that gives client product-and-services access to modern retail channels in Slovakia

A strategy was developed for each of the channels. It involved a detailed design of the operational requirements, the marketing mix, the business case and the financial sustainability. A similar process was later completed for the Integra programs in Romania and Bulgaria.

One of the key requirements for the entire program was to be financially self-sustainable by the fourth year. A four-year business plan was developed for the Market Access programs in Slovakia, Romania and Bulgaria. The investor (in this case, the Shell Foundation) made a commitment to fund the start-up costs during this period. Although the funding is not considered to be a true commercial investment due to the client-target group (the initial investment was given as a grant), the program aims to achieve social impact without the need for renewed subsidies. The investor demands that key performance targets be met as a condition for its continued participation over the three-year life of the start-up phase. Specifically, the retail and wholesale channels, which are to be run as a for-profit company called Ten Senses Ltd. will be held to strict performance targets.

The key performance indicators (KPIs) for the Market Access project are:

- KPI 1 Ten Senses Ltd. turnover growth – annual targets
- KPI 2 Ten Senses Ltd. profit growth (pre-tax) – annual targets
- KPI 3 Growth in number of clients that use Market Access client products with base – semi-annual targets
- KPI 4 Growth in Market Access client-business income – annual targets
- KPI 4a Clients with product consulting
- KPI 4b Clients without product consulting
- KPI 5 Growth in social capital of Market Access clients as tracked in CMS – end of project target
- KPI 6 % of Market Access clients from target group – end of project target
- KPI 7 Market Access jobs created – semi-annual targets
- KPI 8 Growth in number of clients receiving Market Access consulting/training – annual targets
- KPI 9 % of at-risk clients in Market Access – annual targets
- KPI 10 Growth in Market Access MFI consulting client numbers and final beneficiaries – end of project target
- KPI 11 Growth toward Market Access MFI consulting financial self-sustainability – end of project target

The Integra Market Access start-up phase will run until December 2007, during which time 4,800 clients in five countries will be offered Market Access services. Integra Market Access consulting capacity also will be offered to other MFIs, both in Central and Eastern Europe and the developing world. The first test outside Europe will be launched in Kenya during the first quarter of 2005.

A combined investment of \$650,000 is projected in Slovakia, Romania and Bulgaria for the launch of these Market Access channels, with break-even projections for the beginning of year four in each market.

In addition to providing market opportunities for Integra clients, these Market Access channels are designed to introduce fair trade to the Central and Eastern European market. Fair trade is almost completely unknown in this region, even in the new European Union member countries of Central Europe. The Integra Fair Trade “Ten Senses” brand has been launched. (Below)



Progress to date has been promising. Integrators have been signed with three major retailers in the Slovak market to provide access to client products from the Integra program. The number of women offering products of acceptable quality, volume and price has steadily increased. Initial response from clients, customers and retailers has been good. Although it is too early to declare the program a success, the early signs are hopeful.

VI. Which way forward?

The extent to which commercially sustainable approaches to alleviating poverty can be developed in Central and Eastern Europe remains to be seen. Microfinance offers an initial pathway, though this model faces limitations. Commercially viable Market Access interventions are promising in theory, but have yet to be proven. Some early lessons and recommendations can be noted:

- Charity models and government programs alone do not have the capacity to meet the level of poverty and deprivation that exists, so the market must be creatively engaged.
- The emerging corporate social responsibility (CSR) movement offers an opportunity to enlist corporations in the fight against poverty and social exclusion. This calls for new skills in developing private-public partnerships and multi-stakeholder approaches. Providing market access to clients from vulnerable groups can become a major arm of the CSR program of major retail chains.

- Even if achieving full financial sustainability is not possible, a wide range of promising strategies are available for reducing the cost of poverty alleviation. The best practices among these approaches need to be publicized and emulated.
- There is a growing demand by investors for investment opportunities that offer modest but real financial returns while delivering substantial social impact. It is conceivable that in the future, the money available will exceed the amount that can be effectively placed in such investments.⁴
- The poor have a wide range of assets that can be developed. They do not normally seek a handout, but the opportunity for a “hand up” has been denied or taken from them. Policy and practice must revolve around empowerment strategies, such as microenterprise development.

Though market-driven strategies cannot replace the need for purely social and charitable interventions in poverty alleviation, they can and should play an increasing role.

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⁴ Note the 2004 launch in the Netherlands of a series of “Green Funds” that provide investment for environmental and socially responsible projects. In the first year, there was a projected €40 mill from 15,000 depositors. The response was over 10 times as great as anticipated: € 4.5 billion from 170,000 depositors.

ABOUT THE AUTHORS

LEA UHRINOVA, a Slovak national, pioneered the country's first microenterprise-development program for women at risk. Working initially as a loan officer in the early stages of the program, she subsequently became a senior loan officer with supervisory responsibility for the management of the entire program's loan portfolio.

Uhrinova also helped to develop an innovative management-information system for Integra, which not only tracks financial performance, but also measures a range of impacts in social-capital growth among clients.

For the 2004-05 academic year, she is a Humphrey Scholar at Michigan State University, focusing on economic development and business management.

ALLAN BUSSARD, a native of Canada, has worked for the last 14 years in economic development in Central and Eastern Europe.

After founding the Integra Foundation in Slovakia, he pioneered the expansion of the Integra Venture into Russia, Romania, Serbia, Croatia and Bulgaria. More recently, he has been active in delivering technical-assistance programs in Africa.