

Reading Summary: Reluctant Entrepreneurs

The microfinance and 'social business' movement is based on the premise that the poor are natural born entrepreneurs and helping them succeed can help eradicate poverty. Muhammad Yunus of Grameen Bank in Bangladesh and many in the microfinance movement believe that everyone has a shot at being a successful entrepreneur since the market has ignored the bottom of the pyramid they are more likely to think of low hanging fruit and fresh solutions.

Many microfinance websites showcase success stories such as a basic trash collector using loans to eventually organize a large network of trash collectors. In addition, there are talented individuals who become very successful without microfinance in the right circumstances, such as Xu Aihua who turned a basic education into an huge clothing export endeavor with many employees.

Based on an average from an 18 country data set, 50% of the extremely poor in urban areas (make less than \$1 a day) operate a nonagricultural business, even between 7-50% of the rural extremely poor run a non agricultural business in addition to those who own a farm (variance due to what country you are looking at). Circumstance seems to be against the poor being successful entrepreneurs, yet a combination of high interest rates and small default rates leads one to believe the poor have very high rates of return.

Despite these positive facts, closer examination of the businesses of the poor illuminates more dismal realities. A majority of businesses run by the poor have no paid staff, very limited assets, and are on average not making very much money. The low profitability of businesses run by the poor explains why microcredit does not seem to radically transform client's lives. The high rates of return are actually high rates of marginal return. Marginal return differs from overall return because it is the extra return on each additional item sold and is relevant when asking whether growing a little would be worthwhile, but total revenue is what decides whether one should be in business in the first place. Marginal returns can be high even if overall returns are low, which is often the case of the poor's businesses.

Figure 1 in the paper represents the production technology and shows a relationship between investment and returns. The returns are diminishing. There are large returns in the earlier period, but they are small as investment reaches the highest levels. For example, if a shop owner invests in new shelves and a counter, she needs inventory to sell. Although she get a small loan to buy inventory and have a high marginal benefit, it does not cover the investment of the shelves and counter. If she receives a loan large enough to buy enough inventory to pay off the investment, the marginal return on this loan is small. This cycle discourages investment and leads to empty shelves at shops in developing countries.

Although the marginal returns with small investment is high enough in the first period, business owners do not spend their time effectively. There are many shops which sell the same products in close proximity. These shop's workers spend a lot of time waiting for customers. If

they worked together, only one person would have to sit in the shop and the others could spend their time on other activities. These businesses are usually too small to create high profits.

There are three reasons that poor entrepreneur cannot make enough profit with small business. One reason is that they cannot borrow big enough loans from financial institutions. Another is that some people do not even choose to borrow. Lastly, people do not always save or invest money, a study in the paper showed that those who received \$500 tended to invest equal amounts as those who received \$250 and spend the other half.

As mentioned above, small business usually cannot make large returns like the line OP in the Figure 2. Poor entrepreneurs stop to invest on their business once they notice that their investment is not enough to increase returns. If they have possibility to get the profit like the OZ line, they might continue to invest more on their business.

The Figure 3 illustrates a possible business model for small businesses. At first, poor entrepreneurs are in the line OP which showcases small investment and small returns. Once they get enough money to invest in order to create a larger scale business, they will shift to the line OR. However, in the most case of the poor entrepreneurs, they cannot create or get enough money to invest on the second large investment. They get stuck on point M in the Figure 3 and can never 'jump the hump' to increase returns and increase investment which would then further increase returns.

This paper argues that a possible reason poor entrepreneurs do not commit more to their business is they realize they do not have a chance to pass the hump. In addition, they do not save money since they know their savings will not grow enough to be enough large to invest. Because there is no change in profit, sales, or assets even after a training program for business owners, it assumed that the small returns in their business is also because of their lack of enthusiasm.

If the poor are not enthused about their businesses, why run a business in the first place? Several analysis and researches reveal that poor people do not build a business because they have entrepreneur skills or spirit, but because it is the only option when more conventional employment opportunities are not available. Many start a business when someone in the family has some time on hand, this it is common for women to run businesses in addition to their housework. This is the situation of the family of Pak Awan, who live in the Bandung slum in Indonesia. Both Pak Awan and his wife could not find a job and have no other choice other than to start a business to get income and raise their two children. They received a loan and opened a shop where they live that so that Pak Awan's wife could run the business while taking care of the children. Many women do not like to run this kind of business and dread the thought of expanding it, even if they have the opportunity to do so. This is why in Sri Lanka when women business owners were offered \$250 for the purpose of investing it in their business, many used the funds for something else, whereas the men invested the money and got high returns from it.

If many of the poor do not choose to be entrepreneurs, it is important to ask what their ambitions are for their children. The data collected in Udaipur (Rajasthan) shows that they hope for their child to find a government job because it brings a stable wage and secure employment, unlike the uncertainty of owning their own business.

Indeed, stability is one thing that distinguished the middle class from the poor. A study was made by Andrew Foster and Mark Rosenzweig which demonstrate that the role of factories

employment in Rajasthan villages promotes wage growth and enabling a virtuous circle of human capital investment. For example, in an Rajasthan village of Udaipur District, a zinc factory were built. A man from the village got a stable job on the factory and thanks to its steady income, he was enabled to send his kids to high school. Then his kids get a job too in this factory, and were enabled too to afford education for their own family. Thanks to the factory, and the availability of secure jobs, a feeling of prosperity appeared in this village.

David Atkin examined too the importance of the stable job in poor area with its study “working for the future”. He studied children’s height in Mexico’s poor areas with the assumption that there is a gap between height of poor and well-fed American child. He noticed that children whose mothers work in maquiladoras were much better than those whose mothers did not have this job opportunity. Even if maquiladoras have the reputation of being exploitative and paying low wages, they offer a stable job with an income coming every month. Good, stable jobs allow women the mental space to build their own careers and those of their children in order to build a future. However, if they do not have this stability, poor people are worried they be not able afford the entire education for their children, so investing is too risky and represents a waste of money.

Big cities give more opportunities to offer affordable education and well-paid job for poor people, yet very little move their families to big cities. The main reason is that the housing in city is too insalubrious. So, men move alone there to work for few weeks and save money by sleeping in the street. He can go back often in his village where houses are bigger and quieter. It is evident that not everybody can move in the city and the consistent solution is to create job in smaller cities, next to villages. But to reach that, poor countries must improve their industrial infrastructures and implement strong labor laws promoting job security.

Comments

Critical analysis of ideas meant to help the eradication of poverty is extremely necessary to evade the trap outlined in *Poverty Inc.* of turning possible solutions to poverty into a business. A critical analysis of microfinance in this case is necessary to understand why not all poor people jump at the opportunity to grow their businesses if they have a chance and illustrate that while microfinance has an important role in the lives of the poor it can not pave the way for a mass exit from poverty. The argument is convincing; however, psychological analysis could be useful in addition to the financial argument. The explanation of entrepreneurship as ‘too hard’ does not seem to encapsulate the more nuanced reasons that some people have a higher drive to succeed, poor or not, while others are more comfortable where they are.

While the discussion of ‘crossing the hump’ seemed to lack some human emotion, the discussion of stability seemed to encapsulate human desires better. It is often mentioned that it is an issue that the poor temporarily migrate for work but would be more successful if they did permanently, and this discussion of why seemed to include the best discussion of why that is.

Usually, it is suggested that starting business is a solution to overcome poverty. However, although microfinance can create small investment on the business, the profit cannot reach the entrepreneurs’ expectation. In addition, people who owns business in poor areas have no choice other than starting business. From this report, situation in developing areas is completely different from that of rich areas. Not only people’s skill and knowledge, their mindset

cause the less profits in their business. The real situation should be considered carefully to seek a solution for poverty.