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ABSTRACT

DETERMINANTS OF MICROENTERPRISE INCOME: FOCUS ON A LOW INCOME COMMUNITY IN A HIGH INCOME COUNTRY

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Income to microenterprises operated in low income communities can be important to households which struggle to provide for basic needs. The frequency and type of firms which exist must be identified to examine the income earned through microenterprises. The competitive environment of local markets, proprietors' background, and firm operation play important roles in profit levels. These three types of income determinants form a complex environment which creates possibilities for a diversity of microenterprises.

A household survey in Detroit reveals preliminary information about microenterprises in a low income urban community. Microenterprises vary in terms of sectors and income levels, however almost all firms involve specialized skills of the proprietor.

Debate surrounds appropriate assistance to the poor. Research on the importance of microenterprise income and the determinants of income will guide investment in initiatives which address structural barriers of markets, constraints of social institutions and the capabilities of individuals.

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INTRODUCTION

In the United States approximately 67% of employment is found in firms with 100 or more workers (Small Business Administration 1994). Those who choose, or are compelled, to earn income apart from a large-scale employer attract special attention because they marshal resources in an alternative manner. Independent earners in low income households who start businesses with highly limited resources are even more interesting. Microenterprises[1] in economically distressed areas generate income to individuals and important economic activity in poor communities of contemporary United States cities. The combination of household economic decision-making and the complexities of modern business environments creates an intricate web within which individuals may choose to operate a microenterprise.

An individual's decision to create a microenterprise must be considered in contrast to other income earning options. Job options are compared based on wages paid and on the ability of an individual to secure employment. Educational background, and work and life experiences influence a person's ability to secure employment, earn high wages or identify a business opportunity.

Skills are necessary to earn income through enterprise operation or through wage and salary work. Individuals with low levels of education or work experience will have more difficulty in earning income than others. The character of real economic opportunities which are open to individuals with less formal education or work

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[1]The definition of microenterprises is this paper will be a *firm with five employees or fewer*. This will be discussed further in a subsequent section.

experience is questionable. Many low wage jobs do not provide health insurance and minimum wage full-time jobs often do not pay enough to sustain a family. Microenterprise is an alternative earning option, however the potential returns of this method of income generation have many different facets.

The popular press in the United States increasingly mentions microenterprise assistance programs in either a positive or negative light. Debate about the benefit of microenterprise development is political because it involves funding to programs which assist the poor. There has been, however, little investigation of the role of microenterprises in the lives of people living on low incomes in the United States.

Section I of this paper provides background information to the study of microenterprises in low income communities of the United States and Section II is a review of the current literature. Section III discusses a conceptual model of income determinants to microenterprises. Section IV presents selected points of comparison of microenterprises in countries with different levels of income. Section V presents the results of a survey of households in a low income community to identify microenterprises and Section VI proposes next steps in research on this topic, including suggestions for improved methodology. Section VII presents some concluding remarks.

I. Microenterprise in the United States

A. Objectives of the research

This paper explores key factors which affect the ability of microenterprises to earn income in a poor community. Three components are addressed. A primary focus is the

conceptualization of determinants of income received by microenterprises across sectors which are operated by households in low income communities. Clarity about the factors that determine microenterprise income will help identify forces, both internal and external to the firm, which influence microenterprise profitability. Three types of determinants are distinguished here: market structure, firm characteristics, and personal characteristics. The interaction of these three types of determinants is also important to firm operation.

Secondly, a small sample of microenterpries in Detroit, Michigan provides empirical information about the sectors, income levels received, and characteristics of these firms. This research is one step in determination of appropriate assistance measures to microenterprises in low income communities. It can be difficult to identify and collect information from very small firms. The methodology remains to be refined for further research in this field and recommendations for improved methodology are suggested.

Thirdly, comparisons are made to microenterprise activities in developing countries. The high percentage of employment in microenterprises in developing countries is compared to the relatively low level of involvement in these activities in the United States. Conceptual explanations of these differences, based on national levels of development, are proposed. Similarities between the experience of very small enterprise owners in nations of various levels of development are explored as well. These comparisons are important because microenterprise research in developing countries has a longer history and some of its lessons may be relevant for microenterprise development in the United States.

B. Background

Data from the United States Small Business Administration reports that firms with one to four employees comprised 50% of the total number of establishments in 1991 and are the most numerous in almost every sector. However, firms with 1-4 employees provide only 5% of total employment and income earned is often low. Tax returns reveal that two-thirds of nonfarm sole proprietorships received less than $25,000 in 1992 (Small Business Administration 1994). Many people operate small firms but they often generate low returns and provide employment for themselves and one or two others.

As mentioned above, a minority of the population operates or is employed by small businesses. The percentage of the population with nonagricultural self-employment[2] income declined nationally for approximately 100 years, and then began to rise after 1970. The number of nonagricultural self-employed workers decreased from 6.1 million in 1948 to 5.2 million in 1970 and rose to 7.6 million by 1983. This represented 6.9% of total workers in 1970 and 7.8% of total workers in 1983 (Becker 1984).

Although the percentage of the population has risen, operation of one's own enterprise is still an uncommon earnings option. This is further illustrated by the fact that nonfarm self-employment income is only 4% of wage and salary income, which totals $194 million, within the zip code area in which the research for this paper was focused. However, the aggregate income from nonfarm self-employment in 1989 represented a substantial amount, $8 million dollars within the zip code (Michigan Census of Population

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[2]The comparability of the terms microenterprise and self-employment is discussed in the section on definition of microenterprise.

and Housing 1990).

Estimates of the informal economy vary but it is reasonable to surmise that the size of the microenterprise, or self-employment and very small business economy, would be larger if data on unreported firms were available. All microenterprises do not belong to the informal economy (Those firms not reported to the government), however many may operate informally. This points to the potentially difficult nature of data collection on microenterprises. In addition, when enterprises are a part of the formal economy, they are small and not readily visible. Firms first must be identified, and secondly the proprietor must be willing to provide information about the firm. Microenterprises are found in both the formal and informal sectors.

C. Income generation of microenterprises

A combination of economic, psychological and sociological concepts arise in evaluation of self-employment in low-income populations (Balkin 1989). Decisions regarding employment options are based on individual perception of earnings opportunities, the effects of social institutions, and the workings of one's psyche. Income earned is determined by a combination of all of these factors. Each of these aspects affects proprietors' decisions about how to operate a microenterprise within existing markets.

Firm operators must identify a market opportunity and meet the demand over time to earn profits. Real market opportunities faced by very small firms can be difficult to identify. Serious questions concern the ability of individuals to create competitive advantage, and consequently earn income through microenterprises in a complex market

environment.

Determinants of microenterprise income generation operate on individual, firm and market structure levels. Microenterprises which exist in a low income community also provide clues about the role of this method of income generation to households.

D. Definition of microenterprise

The concept of *microenterprise* does not have a standard definition in the United States. The term has assumed a concrete definition in international development work through formal use of the term over time by large agencies[3]. Funders and researchers working with U.S. microenterprise development have adopted a revised definition from the international term to adjust for the larger scale of the industrialized market economy. A microenterprise is considered to be a firm with five workers or less for the purposes of this study[4].

Very small firms in the United States are often sophisticated and make high profits which could justify the downward adjustment of the international definition of microenterprise. There may be greater opportunities to earn profits with fewer workers through increased access to technology, education and capital in a developed economy.

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[3]The USAID definition of a *microenterprise* is a firm with "no more than approximately 10 employees....An attempt to define or limit the size of a microenterprise too severely would exclude from the program some enterprises that Congress desired to receive the benefit of this program, i.e., made up of poor people" (USAID 1988).

[4]This is the definition used by two major participants in microenterprise assistance programming in the United States, Shorebank Advisory Services and the Mott Foundation.

Access to these resources makes labor more productive and increases the returns to a small scale firm.

Although the definition can be stated simply, controversy exists over optimal breakdown in the classification of very small firms[5]. The distinction between microenterprises and other methods of categorizing small businesses is not strict.

Microenterprises can be viewed as small businesses or self-employment. Previous research has found many microenterprises to be one person firms (Liedholm and Mead 1992; Clark et al. 1994; Raheim et al. 1995). This includes self-employment and businesses with five workers or less. The terms are not completely comparable, however data on both types of firm populations are used here to discuss microenterprises. This reflects two different sides of the discussion about microenterprises, small business operation and household income sources.

Data which describe microenterprises are collected by the federal government in the general categories of both small business and self-employment. Self-employment firms qualify as microenterprises as long as there are five workers or less[6]. The smallest category of firms in Small Business Administration data is those firms with one to four employees. The average size of nonfarm sole proprietorships in this category in 1991 was 1.7 employees (Small Business Administration 1994).

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[5]For a review of several classifications based on growth prospects of very small firms in a developing country context see Davies, Mead and Seale, 1992.

[6]In the Current Population Survey of the Bureau of Labor Statistics, if the firm is a corporation, the owner is considered to be an employee of the corporation and is not considered to be self-employed (Bregger 1996).

Another term often used to describe businesses which could be termed microenterprises is *home-based business*. Microenterprises can be self-employment and/or home based businesses but they are not necessarily either one. These two terms describe potential characteristics of a firm of any size. Confusion arises in the collection of data concerning different types of firms and the complementarity of data sets because firms may belong to one group and not the other.

The major distinguishing characteristic of microenterprises in the United States may be that they intentionally refer to entrepreneurial efforts of persons with few assets and little economic security. This characteristic is a main motivating factor for the current interest in microenterprises in contributing to poverty alleviation.

"...Microenterprise development targets women, low-income individuals, displaced wage earners, and the under- or unemployed. This approach focuses on creating local entrepreneurial capacity that will catalyze indigenous economic growth within communities" (Shorebank Advisory Services 1992).

This concentration on economically disadvantaged populations is a distinguishing characteristic from the broad focus on self-employed workers and is a compelling reason for study of microenterprise activities.

II. Literature Review

Research on microenterprises in the United States has grown out of efforts to evaluate newly established microenterprise assistance programs. The research has drawn samples from assistance program client lists, including individuals receiving federal income assistance. Two major efforts have collected primary data on microenterprise activities of low income individuals who have received agency assistance.

A three-year study (1992-95), referred to as the Self-Employment Learning Project (SELP), uses a sample consisting of 302 randomly drawn microenterprises from five different program client lists. Interim reports present profiles of microentrepreneurs and their businesses, discussions of their levels of profitability, and methodology of assistance agencies (Clark et al. 1994).

The first focus of this study is to describe general characteristics of this target population. Microentrepreneurs having received assistance are predominantly female[7] and have graduated from high school. Ethnic composition was reported to reflect the demographics of the low-income communities in which the programs are located and which they were designed to serve. Almost half of microentreprenuers in this study have two or more sources of income, including their business and most respondents reported the business to be their primary source of income. Almost two-thirds of the businesses are based in the home. Firms are typically less than five years old[8] and two-thirds provide

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[7]Some assistance programs were originally established to serve only women (ISED). Many have recently begun serving men and male clients have increased.

[8]Some assistance programs offer assistance in starting businesses so there may be more very young firms.

employment for only one paid worker, the owner. Microenterprises were involved in the following three industries most frequently(N=302): apparel and textile businesses (n=81), varied wholesale and retail products businesses (n=78), and professional services (n=66) (Clark et al. 1994).

Due to the method of drawing the sample from program client lists, the study includes only microenterprises which sought and received assistance. This is useful for the second focus of the study which is to evaluate effectiveness of assistance programs, however some bias exists in the sample because all firms or proprietors had some characteristics which resulted in seeking assistance for the firm. Firm owners who had not reached the point at which they were motivated to seek assistance are not represented in this research.

A second research effort was designed to be a "test of the feasibility of self-employment as a route to economic self-sufficiency for families dependent on AFDC" (Raheim et al. 1995). The Self-Employment Investment Demonstration (SEID) offered business training, loan assistance and asset accumulation waivers to AFDC recipients as a pilot project in eight locations across the United States from 1988-1992. A random sample of those who elected to participate in the program was analyzed two years after it began. Results of this study include a profile of the typical AFDC recipients who chose self-employment and several lessons about the potential of microenterprise development to contribute to poverty alleviation (Raheim et al. 1995)

There are some parallels and some distinctions among microentrepreneurs in this sample compared to the one above. All participants are women due to the focus on

AFDC recipients. More than half have some vocational training or some college education, more than two-thirds are single heads of households, and 14% have more than three children. The ethnic composition reflects the larger AFDC recipient population. A majority of enterprises assisted by this program are in the service sector (73%), followed far behind in frequency by the retail sector (20%). Two years after the program began, 79% of the businesses were still in operation and the median income provided was $8,000. The businesses had created .53 jobs for every one business excluding the owners and seasonal labor.

A large deterrent to foregoing federal income assistance was found to be the loss of medical benefits. In addition, a significant barrier to self-employment by welfare recipients was found to be federal regulation which disallows receipt of AFDC benefits in the presence of minimum levels of income and asset accumulation (Raheim et al. 1994). These levels are quite low. A person could reach these limits and still face a great deal of economic insecurity.

Both studies found benefits from microenterprise operation other than monetary income. Many reported increased confidence levels of proprietors in their personal and professional lives, better relationships with children and other family members, and increased self-esteem.

Another study, based on the SELP sample and on Census Bureau Survey of Income and Program Participation (SIPP) data, compares business and personal characteristics of different types of female microentrepreneurs to evaluate the "success" of microenterprises in raising incomes and helping women work their way off welfare. The

authors find that microenterprise income is a small part of family income and clearly point out that the population of potentially self-employed "successes" among AFDC recipients exists, but is small. Several concluding suggestions include support for increased education, health insurance, microlending institutions, income supports to packagers, asset accumulation levels for AFDC recipients and recruitment of women of color (Spalter-Roth et al. 1994). The discussion of suggested policies does not specify methods by which candidates could be targeted although they point out that this method of income generation is not suitable for all.

Some authors have discussed the potential for microenterprise development to contribute to poverty alleviation and local economic development by examining international models. This is appropriate because the history of researching and providing assistance to microenterprises is longer in developing countries than in the United States. Obstacles to the suitability of microenterprise assistance initiatives in the United States are raised.

Several barriers to transferring "minimalist"[9] microenterprise assistance programs to the United States are mentioned: 1) The informal sector is not as concentrated or as large as that of developing countries; 2) It is not clear that a lack of access to credit is the main constraint in the United States, implying that there are other important obstacles to microenterprises (This is also a point of debate in international microenterprise development and research); 3) Welfare options inhibit self-employment; 4) Doubts exist

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[9]This is a common term for microenterprise assistance models in that they limit the range of assistance offered in order to address issues of efficiency and scale in program delivery. Minimalist models typically involve credit.

about the profitability of firms in the long run (Novogratz 1992; Solomon 1992).

There is a great deal of literature on various aspects of self-employment. Two studies viewed the reversal of a hundred year declining trend of self-employment to be worthy of examination. One found potential earnings to be the main determinant of the choice to be self-employed for a sample of Canadian, white men. Another found changing technology and industrial structure to be the major determinants in the increase in self-employment in the general population (Blau 1897; Bernhardt 1994). Neither of these studies focused primarily on low income populations.

One body of literature on self-employment focuses on entrepreneurism in immigrant communities in the United States. Case study examination of microenterprise activity in ethnic enclave communities shows evidence of varying levels of microenterprise success in different types of communities (Novogratz 1992). Ethnicity and culture are distinguishing characteristics and play a role in the level of entrepreneurship or self employment in a community. Microenterprise assistance can have various affects across communities with populations of different cultures.

Various researchers have produced contradictory results regarding the relative returns to labor of self-employment versus wage and salaried work in first and second generation immigrant communities. They determine that the form of the equation used to estimate earnings influences which type of earnings is greater. Their sample is composed of men and uses nationality or cultural backgrounds as the distinction between groups (Portes and Zhou 1996). Writings on immigration and self-employment provide a basis for consideration of culture and ethnicity as a significant variable in research on self-

employment. Although immigrants often have little financial wealth, the focus is not limited to low income populations.

A central reason for developing country interest in microenterprises is the high percentage of the labor force which is employed in this part of the economy. Several frameworks have been used to evaluate constraints to the ability of microenterprises to contribute to poverty alleviation and economic growth on a national scale.

One research project on microenterprises, the GEMINI project, conducted several country-wide cross-industry studies in south and east Africa which have been able to paint a rich picture of the scope and breadth of microenterprise activities. The research has described the role microenterprises play in creating income and employment and factors which may affect enterprises operating on this scale.

Some key findings come out of the GEMINI research:

1) Microenterprises are dynamic and diverse. Data from several country-wide studies has shown the world of micro-firms to be extremely varied by both activity and income earned.

2) There are high rates of birth and death of firms. Births have been found to be higher during macroeconomic downturns, whereas growth of existing firms was found to be higher during times of national economic prosperity.

3) Most firm deaths occur within the first three years of the start of the enterprise and this is often for other than financial reasons.

4) Most firms (two-thirds) employ one person, the owner, and do not grow.

As the first key finding reveals, the world of microenterprises is dynamic and diverse. Categories within this diversity have been identified in which each group of firms has different growth rates, proprietor characteristics and potential assistance demands (Liedholm and Mead 1995). Each group appears to have a different set of assistance needs. The four categories are described as: 1) new firms, 2) established firms that do not grow, 3) firms that are growing slowly, 4)firms that have grown larger but are still small. An implication of the GEMINI research project is that "different types of micro and small enterprises have very different contributions to make to the dual objectives of poverty alleviation and growth" (Leidholm and Mead 1995).

III. Conceptual Determinants of Microenterprise Income

Income to firms is determined by their ability to produce and sell goods and services at low cost and earn a profit as well as or better than others. Firms use available resources to enter into exchanges in the existing business, social and political climate. The idea that a firm must produce a good or service that is demanded to make profits may be the most elemental concept in capitalist economics or business school courses. To identify income determinants of microenterprises, this principle must be applied to small firms operated by poor people. This discussion will focus on the forces, internal and external to the firm, which are of particular relevance to microenterprises in low income communities.

The model in this discussion attempts to identify the factors which affect income received by microenterprises. Three proposed categories of income determinants are market structure, firm characteristics and personal characteristics of the proprietor. These categories can interact with one another and they all are influenced by the political and social institutions under which all firms operate.

The discussion of factors of microenterprise income generation focuses on local markets. It assumes that very small firms run by households in low income communities have more experience with, and are more centered, around local markets. An international exporter of high quality china, for example, could be a microenterprise based in a low income community, but research has not revealed such sophisticated firms. This assumed focus on the local economy makes sense in that poverty in the United States is in specific

localities which are not distant from wealthy communities[10]. Economic distress is a localized phenomenon and thus attention is focussed on these geographic communities for the purposes of this discussion.

Each category of income determinants has several components. This discussion will highlight critical aspects within each category of determinants. Markets consist of the levels of supply and demand within a particular geographic area and are external to individual microenterprise firms. Market structure includes transaction costs of an industry, particularly information costs, which can usually be considered a component of supply costs.

A second category of income determinants are firm characteristics. Characteristics of the firm determine the price, quality and availability of the good or service. These characteristics will depend on the technical and managment skill levels of the firm's owner. Price, quality and availability of substitutes will also influence the firm's product offerings. Methods of reaching customers, ie. advertising, also play a role in the income received by microenterprises.

The third category of income determinants is characteristics of the proprietor. Personal characteristics of the owner play a large role in determination of firm characteristics, as well as in the direct operation and income earned by the firm. Gender, education, ethnicity and experience are discussed in this paper. Experience is defined to

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[10]The presence of large amounts of spending power is benficial to microenterprises if they are sophisticated enough to operate in those markets. This is an advantage for these firms in developed countries as opposed to developing countries where the proportion of the population with high disposable income is much lower than the United States.

be both work and life experiences. Various types of experience influence the expertise used in firm operation, an individual's outlook and attitude towards income generation, and the ability to access resources and solve problems. Additional personal characteristics of proprietors which are not discussed in detail here can include family stability and level of economic security.

The three types of income determinants are deeply related. They are all formed by the political and social insitutions within which they operate. Aspects of a person inevitably affect the operation and characteristics of a one or two person business. The neighborhood in which a child is raised and the school attended by that child have a deep affect on the grown person's problem-solving abilities and perceived opportunities later in life. In the aggregate, these social and political experiences form the context within which all businesses and jobseekers operate. These are the markets for goods and services within which microenterprises compete.

A. Market structure

Structural aspects of markets affect decisions made in operation of microenterprises. In the same manner that individuals use Simon's procedural rationality to select among various income earning options, microenterprise proprietors use this bounded rationality (Simon 1986) to select methods of operating their firms within a complex environment.

The following concepts are part of the context within which proprietors make decisions about how to operate firms. The methods by which microenterprises enter

output markets to sell their products are influenced by effective levels of demand and supply in local markets and transaction costs. These structural aspects of the local economy surround individual decisions about what to sell and to whom.

1. Effective demand in a low income community

If firms are to earn income, they must supply products which meet a demand. If firms most often supply local markets, the level of effective demand (demand backed by purchasing power) for particular goods and services in low-income communities is important. The dearth of large low cost firms may be understood as an indicator of low effective demand and little potential profits in a low income community. Demand may exist, but if there are not enough paying customers to cover a firm's costs, there is not sufficient effective demand for the firm to survive.

Alternatively, larger firms with profitable operations elsewhere may not enter a specific community if the projected profits do not reach a designated profit level. The minimum acceptable profit level for a multimillion dollar firm could be higher than the minimally acceptable profit level for a firm run by individuals with more limited earning and investment options. The larger firm may choose not to enter a market if effective demand is perceived to be too low to meet target profit levels. Although firms make careful decisions about where to operate, imperfect information about the effective purchasing power of a community can be hypothesized.

2. Supply in a low income community

Two basic sources of competitive advantage for firms are to be a *low cost provider* or to provide *differentiated* products. Strategic management literature suggests that if a firm can not achieve a competitive cost structure, the firm should pursue an alternate strategy which often involves differentiation of its goods or services in some way to gain customers (Thompson and Strickland 1995).

Large scale national firms are often low cost providers, due in part to their gigantic scale of operations. If one of these firms chooses to supply an area, it is difficult for smaller firms to compete on price in the same product markets. If a low cost provider firm does not enter a specific geographic market, there may be room for smaller firms. Customers would be willing to pay a slightly higher price to smaller local firms due to savings in transportation costs and convenience. The geographic niche could exist as long as products are competitive in terms of price and quality.

An example of this in Southwest Detroit is a butcher shop which was reported to be a favorite shopping location by a large number of respondents to a recent household survey[11]. Many people reported shopping at this butcher even though most food shopping is done in neighboring communities at hypermarkets such as Meijer's or Farmer Jack's. This butcher shop competes with low cost providers by differentiating its meat products. Although there are greater opportunities to attract customers through product differentiation, challenges to microenterprises still exist 1) in the identification of the

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[11]The survey which included questions about "self-employment business activities" to provide data on microenterprises in the 48209 zip code of Southwest Detroit asked about income and expenditures of households.

demand for specialized products, and 2) in reaching consumers with purchasing power.

Production of some goods and services are potential markets for microenterprises and some are not. One case within this sample is a mechanic (automotive repair) with a low net income. Some respondents reported car repair as a type of businesses they would like to see in the area. There is a mechanic making low profits in the sample of microenterprises and there are consumers who demand the services of this firm. Local supply and demand for car repair do not meet.

Improbable industries for microenterprises include the most frequently demanded shopping option for a large scale low cost retailer, such as Target. It is difficult to imagine how a microenterprise could match the prices and quality of Target, albeit on a much smaller scale. Demand for different types of goods or services provides varying levels of opportunity for microenterprises.

3. Transactions costs

Transactions costs are associated with governance and information used by the firm. These costs arise due to bounded rationality and the "hazards of opportunism" both within and without the firm (Williamson 1985).

Political, economic and social institutions are a source of transactions costs (You, 1996). An example in the case of social institutions is ethnic or class differences which could raise costs of serving a particular geographic market due to uncertainty or information costs. Higher costs require higher demand levels or prices to make profits.

If ethnicity influences preferences, people from Chaldean, Latino and African-American cultures might have demands different from the majority. If minority demand is not great enough to cover costs, it may not be supplied by large scale producers. The preferences of consumers are interdependent because producers will supply those goods and services for which they can realize profitable economies of scale (Schmid 1987). Southwest Detroit has a heterogenous population which decreased overall by 4% between 1990-1994. This could suggest a decreasing supply of specialized goods or services in this community.

Lack of specialized knowledge of preferences could increase information costs to a firm which is unfamiliar with this market. Access to this knowledge could be one source of comparative advantage to small local firms. This can be termed a cultural barrier and ethnic foods or products provide an example.

Two tortilla factories exist in Southwest Detroit. A retailer who wants to sell tortillas in another part of Michigan could use contracts to arrange a steady supply from one of the two firms which specialize in tortillas. These tortillas are sold in supermarkets in Lansing, Michigan. The supermarkets have bakery departments and could produce tortillas themselves. Southwest Detroit's Mexican-American culture supports a comparative advantage in Mexican food products.

A cultural institution (Mexican-American culture) has supported the development of a network of Mexican restaurants in this area, which may some of the customers of the tortilla factories. The area has come to be known as Mexicantown and has developed as a location node for Mexican foods and products. The fact that people think of going to

Mexicantown for Mexican-American goods or services is an advantage to a Mexican restaurant which is located there, as opposed to a Mexican restaurant or a tortilla seller on the North side of Detroit.

Another source of advantage for small local firms, besides a knowledge of specialized preferences, may lie in the method in which large firms make location decisions. Rules of thumb used by large firms about location based on mean household income level in the community or proximity to other shopping and highways could provide opportunities for small firms to earn income. Effective demand may exist in a community, but the knowledge of whether it is enough to earn target profit levels is imperfect. Transactions costs of determining the actual level of demand may be prohibitive, so location decisions are based on the information which is available.

Transactions costs of operating in an unfamiliar setting may also be a deterrent to low cost producers. Costs of operating in a high crime area or a community with high levels of environmental contamination may pose high costs. Asset specificity of buildings and land may prevent a firm from making location decisions which seem more risky due to uncertainty. There is a question of whether someone from the community would be better able to handle costs of this type. In the case of crime, a local person may have lower costs by securing the help of neighbors in patroling and keeping watch over property. In the second scenario, a large firm is probably better able to bear environmental cleanup costs than a microenteprise although these costs can be prohibitive to large firms as well.

Information costs to large firms may raise the costs of supply and create greater opportunities for microenterprises, which generally face higher average cost structures.

Large firms could reduce this type of transactions costs by avoiding particular locations where costs are higher or by working with local or specialized firms. There may be advantages to both small and large firms to minimize costs by jointly supplying markets through the use of contracts. Contracting involves the coordination of activities through markets as opposed to within the firm and allows greater specialization of individual firms.

Contracts have been identified as mechanisms for microenterprises to become integrated in vertical production systems through interaction with more established firms (Mead 1984). Contracts can be utilized among small and large firms in the United States to mitigate information costs. Large firms with scale economies and low overall cost structures may want to serve a specific market niche which could be more cost effectively addressed by subcontracting. Subcontracting could be attractive if microenterprises can offer lower prices for competitive products based on knowledge or access to underutilized resources in low income communities (labor or land). Local knowledge may reduce operating costs due to uncertainty for microenterprises in local markets. This would apply if the large firm did not have the same type of access to the resources

Contracting with small firms could provide specialized knowledge of local preferences or product niches. Sharing of capital costs could benefit the microenterprise and specific knowledge of local markets could benefit the large firm. Contracts could provide a more secure source of output markets for microenterprises. This would reduce the activities required of the microenterprise, such as large scale advertising, in which the smaller firm does not have comparative advantage.

Costs of negotiation and enforcement increase the transactions costs of subcontracting as the number of firms rises due to problems of large groups (Olson 1965). This will limit the number of firms which can participate in particular contracting arrangements. The distribution of the negotiation and enforcement costs of contracts is important to microenterprises which are not able to bear the costs. Large firms may be unwilling to bear costs over a certain amount and microenterprises may not be willing or able to bear much of these costs at all.

Transactions costs, often due to costs of information, affect the supply of firms to particular markets. Sources of competitive advantage which have been identified in low income central city communities (Porter 1995) have transactions costs due to imperfect information. Market opportunities for microenterprises in a low-income community could be increased or decreased as a result of transaction costs. Contracts among large and small firms could be useful to reduce these transaction costs and increase opportunities for firms of various sizes.

B. Firm characteristics

The interaction of competitive environment, the firm and the individual create the microenterprise capacity for income generation. The ability of a firm proprietor to assess demand and to successfully enter into that market is influenced by personal and firm characteristics. Personal and firms characteristics are deeply interwoven. Their separation within this paper signifies different stages of economic decision making and different points of influence of external factors on the individual involved in enterprise activities.

As addressed previously, the level of effective demand for goods or services is a critical determinant of income earned by the firm. Within the firm, the choice of what to produce plays a large part in the potential profits earned by the firm. Decisions about what and how to produce, the quality of the product and the prices charged rely on qualities of the person making those decisions. The experience, knowledge and decisions of the individual determine the subsector in which the firm is involved and the level of sophistication at which the firm operates.

Methods of entry into markets are related to the types of markets a firm owner chooses to enter. An income tax preparer who is competing with H&R Block must be able to convey reliability and accuracy to people who have the disposable income to pay someone for this service. In one specialized case, a horse show judge may not have to advertise at all if there is little competition.

Access to output markets are important to reach customers. Economies of scale in advertising and brand name recognition can be identified as a source of advantage to large firms in reaching customers (Scherer 1986). A microenterprise may be able to charge a lower price than a more established, larger firm due to low overhead or avoidance of some government regulations. If the microenterprise can not or does not advertise this lower price effectively, a more visible larger firm will probably have more customers.

Related to the method of advertising goods and services and their prices are methods of conveying product quality. If a market is identified and product designed to fit that market, customers must be informed that the good or service will meet their needs. Microenterprises do not have the benefits of franchises which can rely on national quality

standards and recognition of their products.

Small, independent proprietors rely more heavily on the revealed quality of their products through past customers than franchises or larger firms. In face of a multitude of choices, consumers and other firms must have some basis for making decisions. Heiner's standard operating procedures (SOP's) provide a rationale for selections based on familiarity which advantage large firms over smaller firms (Heiner 1983). Alternatively, large firms may actually provide higher quality products with better service due to lower cost structures and economies of scale throughout the production chain. Whether large or small firms have better quality or prices, customers often face a multitude of choices and need a clear and readily available basis for making decisions.

Methods by which microenterprises reach customers through advertising of price and quality is important to their ability to generate income. Anecdotal evidence suggests that word-of-mouth is utilized often in reaching customers. This suggests the importance of social networks to the profitability of microenterprises.

Reich's breakdown of skills necessary for success in the modern economy has one category at the top of the earnings pyramid, problem identifiers and solvers (Reich 1991). If microenterprise owners were highly skilled problem solvers, this would be reflected in higher incomes as the return (or marginal value product) to their labor. However, the ability to identify and solve problems is essential to successfully discover a market demand and sell the good or service on a scale large enough to cover costs. Some level of expertise is required to earn income from a microenterprise. Consideration of the problem solving ability of microenterprise proprietors leads to a discussion of characteristics of firm

owners as they affect one's ability to operate the firm profitably.

C. Personal characteristics

Many personal characteristics such as education, family life, and experiences with social, economic and political institutions affect an individual's cognitive outlook on life and the ability to successfully earn income. The dependence of the future on one's ability to imagine and create suggests the role of hope and vision in improving one's economic situation (Littlechild 1989).

Experiences of the individual in labor markets will influence the psychology of the person and the ability to earn income. Periods of unemployment cause depression which can reduce a worker's future productivity and earning potential (Goldsmith and Darity 1996). Concepts of behavioral reinforcement and path dependency may also be important in consideration of earning abilities of the very poor, such as the chronically unemployed.

A central question is whether individuals face limited opportunities to access resources for economic success based on who they are. The variables here include gender, age, ethnicity/culture and geographic community (side of the tracks). Exceptional individuals will succeed regardless of where they are from. Do people from poor communities have to be more exceptional than people from wealthy communities to get a loan from a bank? The role of social contacts or the ability to relate socially to those in control of resources is important.

The ability of an individual to successfully earn income depends upon the person's interaction with social, economic and political institutions. Political institutions

theoretically treat all legal residents as equal. The concept of an inextricably wound political and economic system has been described as the *legal-economic nexus* (Samuels 1989). Social institutions have variable affects on individuals depending on personal characteristics. The environment in which an individual makes economic decisions about his or her life could be termed the *social-economic nexus*. Society and all of its institutions influence people from early childhood. Educational and work experiences are sought out and absorbed within this *social-economic nexus*.

Workers with greater skill levels command higher incomes due to their increased productivity. Less skilled workers face difficulty to earn sufficient income to meet basic needs. Job opportunities have changed through the decline of production and nonsupervisory jobs in manufacturing and the increase of jobs in the retail and service industries which offer below average weekly pay[12].

An increase in low wage jobs to low income households has been hypothesized to contribute to increased income inequality among households over the past 16 years (Ryscavage 1995). In addition, low earnings have been found to be an important contributing factor to poverty in the presence of other labor market problems (BLS 1989). These labor market trends suggest that marketable skills and experience are important to an individual's ability to earn income. Expertise is important whether one works for oneself or for someone else.

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[12]Average weekly pay for all production and nonsupervisory jobs was $254 in March 1996. Average weekly pay in manufacturing, retail and services industries was $327, $143, and $240 respectively (Bureau of Labor Statistics 1996).

Determination of the importance of some firm and personal characteristics is produced for Kenyan microenterprises in a subsequent section. This is an example of techniques that might be used to determine the importance of personal characteristics on determinants of microenterprise earnings in low income communities in the United States.

IV. Selected Aspects of Comparison with Microenterprises in Low Income Countries

A. Comparison of the number of firms between countries of different income levels

The history of microenterprise research is short in the United States compared to the amount of attention which has been focused on this topic in developing countries over the past several decades. African nations are mentioned as examples of low income countries in a discussion of microenterprises because a substantial amount of research has focused on this topic in several African countries. The interest in microenterprises in south and east Africa is motivated by the large numbers of people working in these types of firms. A critique of microenterprise development efforts in the United States is that this avenue of assistance to the poor or to support economic development is not significant because number of people involved is much smaller. There are several reasons why there might be many more microenterprises in African countries than in the United States. The implications of current economic and political trends are also important to consider in the following discussion of suggested reasons for the existence of fewer microenterprises in the United States.

First, the larger size of the developed economy in the United States offers greater numbers of job opportunities to nonfarm workers besides microenterprise activities. However, the quality of these jobs as measured by the wages paid is questionable as trends show that greater numbers of households need two wage earners to maintain the quality of life which was supported by one wage earner several decades ago (Thurow 1996).

Secondly, as has been pointed out in the literature, federal income assistance programs create disincentives to operate microenterprises (Novogratz 1992). Welfare programs are a safety net in which those without a source of earnings receive an income if they qualify. Political action in the United States is creating great changes in the safety net system as General Assistance programs (an income assistance program for single adults) have been eliminated in some states and major changes such as time limits and work requirements to AFDC[13] are currently being considered in the United States Congress.

Welfare programs have also been portrayed as a disincentive to microenterprise operation due to their asset accumulation limits (Sherraden 1989; Friedman et al. 1994). The hypothesis is that rules against benefits receipt and the accumulation of minimum savings or asset levels[14] decreases the likelihood that this segment of the low income population will attempt to generate income through microenterprise activities. Research on the ability of welfare recipients to relinquish benefits in favor of self-employment found the option was suitable for a small portion of this population provided that asset accumulation waivers were procured.

A third explanation of the lower level of microenterprise activity in the United States is the enforcement power of government. As compared to the periodic clearing of

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[13]Aid to Families with Dependent Children, a federal income assistance program for single women with children.

[14]Restrictions on asset levels include: one motor vehicle with equity value of $1,500 and real and personal property with equity value of $1,000 (Taken from Overview of the Findings from the Self Employment Investment Demonstration (SEID).

the informal market vendors in Lima, Peru[15], street vending is more strictly monitored in the United States with fines charged for noncompliance with licensing requirements. Although the government may have more power to enforce regulations and tax laws in the United States, the level of formality can be hypothesized as a continuum with most microenterprises somewhere in the middle in both developing and developed countries.

A fourth, and perhaps most critical, deterrent to microenterprise activity in the United States is the multitude of sources of low cost goods and services. Low cost producers make or import all products demanded by consumers or intermediate product firms. This points to a central topic of this paper, real opportunities to make profits and the ability of microenterprises to supply quality goods or services which meet a demand.

If large firms with economies of scale profitably supply all markets, there may not be many opportunities for microenterprises to supply existing markets (although opportunity for innovation always exists). This condition applies to developing and developed countries, however capital restrictions could prevent developing nations from producing or importing the profusion of products offered in a high income country. Even in a high income county, there may be some products which are not optimally mass produced. This may provide microenterprise opportunities in the face of high degrees of competition from low cost producers.

There may a difference in the nature of goods and services consumed in low income countries versus those consumed most frequently in higher income countries. In economic development theory, demand for more differentiated products grows as national

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[15]As described by Hernando de Soto in The Other Path.

income increases. Markets which are dominated by more sophisticated products, and firms which supply those products, may pose different types of opportunities for microenterprises than a national economy which mainly produces and consumes commodity products.

Different types of barriers to entry could exist in terms of the sophistication and information needed to operate profitably in markets or the technologies used to learn about specialized demands and produce highly differentiated products. Higher consumer income levels in a more industrialized country support profit making opportunities for many different firms. However, consumption patterns in lower income countries might support greater opportunities for microenterprises, although their profits are often very low.

Proposed explanations for larger numbers of microenterprises in African nations as opposed to the United States are based on differences in market structures and political institutions. The framework within which microenterprises operate appears to be important to internal development of micro-firms, even at the level of firm start-up which is indicated by the differences in the number of microenterprises found in low and high income countries.

B. Determinants of income to microenterprises in a low income country

Recent inquiries of microenterprises in Nairobi, Kenya have produced a data set on income levels in these firms (Daniels, Mead and Musinga 1995). Regression analysis using this data has provided a quantitative picture of the determinants of income to

microenterprises. Interestingly, the national average of returns per worker per month were higher than the Kenyan minimum wage. However, the variance of these returns is very high.

Gender, age of the firm, utilization of paid employees, and higher levels of education were found to be significant determinants of income to microenterprises. Business sector, macro-location (rural versus urban), micro-location (home, marketplace, roadside etc.) and capital asset investment were found to be insignificant variables for profit levels. (Daniels and Mead 1996).

These results present an interesting indication of what matters in terms of income generation to microenterprises. It seems that variables which can be chosen, such as location and product, were not significant. Variables which are more difficult or impossible to choose, such as one's gender or the age of the firm, are important. Education levels and decisions to invest in equipment or hire employees are choices which are made in operation of the firm. This knowledge can be helpful to identify clearly the varying assistance needs of different types of microenterprises.

This framework provides a basis for identification of key determinants of income levels based on characteristics of firms and proprietors. These factors are significant aspects of firms which suggest higher income generation levels. Based on commonalities of some microenterprise characteristics in developing and developed countries, this framework can suggest aspects of domestic microenterprises to test for significance in the determination of income levels.

V. Empirical Research on Microenterprises in Southwest Detroit, Michigan

Investigation into the contribution of microenterprises to income and employment to low-income households begins with questions about the types of enterprises which exist. A description of microenterprises in a low-income community answers preliminary questions about the number and activities of these firms and provides a base for future inquiries into the potential of microenterprises.

A. Methods

A survey of households from the 48209 zip code in Southwest Detroit was conducted in June, 1996 to determine general income and expenditures of residents[16]. Questions concerning self-employment were included in the survey instrument to provide data describing the incidence and nature of microenterprises in a low income community. The questionnaire was self-administered and mailed to 575 randomly selected households.

Sixty blocks, weighted for population, were selected randomly from Census tract block maps. Due to the absence of a complete address list for households in the zip code area, block level street maps were used to construct a list of all buildings on the block. Ten houses from each block were selected randomly and questionnaires sent to each house. Apartment buildings with more than five units were visited to ensure that they are inhabited.

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[16]This project was conducted in conjunction with an applied research project of the Michigan State University, Center for Urban Affairs, Community and Economic Development Program.

Pre-survey letters were mailed to the selected addresses. Due to vandalism and abandonment, many addresses listed on 1992 block level maps were no longer valid. Undeliverable pre-survey letters were returned to MSU and a decision rule guided the selection of replacement houses. For invalid addresses, the decision rule was to select the next house in the block. This process was repeated so that three attempts were made to identify a valid address before the case number was eliminated from the sample. Unreturned pre-survey letters were followed by a survey one week later. A reminder postcard was sent one week after the questionnaires were mailed and a second mailing took place one week after the postcard. Primary data collection from households was completed at the end of June, 1996. The final response rate for the survey was 24%. One hundred forty out of 575 questionnaires were completed and returned. Ten of these questionnaires provided information on "self-employed business activities" in the household.

A second distribution method of the survey was conducted at the request of the community sponsor of this project, the Southwest Detroit Business Association (SDBA). An employee of the SDBA, a local nonprofit, took questionnaires to other local nonprofit and community organizations. Members or employees of the organizations were asked to complete the survey. This distribution method yielded 89 nonrandom, completed questionnaires. Nine of these questionnaires provided information on "self-employed business activities" in the household.

B. Results of the survey

The survey of households identified microenterprises in the 48209 zip code area of Southwest Detroit. Low returns resulted in a small sample of firms, however the results illuminate some empirical aspects of microenterprises in a low income urban area of the United States.

1. Incidence

Within the random sample of households in the 48209 zip code of Southwest Detroit, microenterprise firms were reported to exist in 10 out of 140 respondents to a self-administered mailed questionnaire. This suggests a 7% incidence rate of microenterprises in the larger population. Non-response bias and the inability to statistically compare characteristics of households with microenterprises to households without microenterprises reduce the power of the data. However, this initial step in identifying and characterizing microenterprises provides a starting point for future investigation and a suggestion of how many households are involved in these activities. Microenterprises are a source of income for some small percentage of households in a low-income community.

There are measurement problems in this research because source of income is a sensitive subject and individuals may not wish to disclose information. One attempt to measure hidden labor in the economy cites previous estimates of 10-33% of official GNP and presents several different aspects of activities which can be considered a part of the underground economy (Koopmans, 1994). Economic activities could be under-reported

for several different reasons according to Koopmans: 1) economic activities not included in official statistics, 2) economic activities on which no taxes are paid, 3) illegal activities. Under-reporting of microenterprises can be expected if the individual does not consider the firm to be a business, or due to fear of any consequences as a result of belonging to the second two categories listed above. Measurement problems can arise because: 1) Individuals may not reveal the existence of the firm, or 2) Individuals may not feel comfortable revealing the amount of income generated by the firm. The sample design can also be expected to affect the willingness of individuals to disclose sensitive information.

Several respondents to the questionnaire did not provide information on a firm in the self-employed business activities section, but did report self-employment income in their list of income sources (7 cases). Some of these may be due to respondent confusion and others due to unwillingness to provide firm level data as indicated in the discussion of underground economy. Combination of these households with those who did report on their enterprises results in a 13% incidence rate of self-employment income among households in zip code 48209. This is higher than average national rates of self-employment and much higher than official statistics on self-employment income within the zip code[17]. Households in this low-income community are involved in microenterprise activities more often than is reflected by national statistics.

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[17]The national incidence rate of self-employment in the general population is 7.5% as measured in the Burearu of Labor Statistics' Current Population Survey (Bregger 1996). The rate of nonfarm self-employment in this zip code of Detroit is 4% (Michigan Census of Population and Housing 1990).

This incidence rate of microenterprises in a low income urban community of the United States can be compared to the rate of microenterprises found in urban areas of a low income country, Kenya. In Kenya, microenterprises were identified in 35% of households interviewed. However, the rate in low income urban areas of Kenya is reported to be relatively lower than the incidence rate in rural areas of Kenya and in other African nations. Hostile government attitude to informal sector activities, easy access to wage employment and access to products made outside the immediate area are offered as explanations for the lower incidence rates in this urban area (Liedholm and Mead, 1993). Similar hypotheses are offered earlier in this paper to explain the lower number of microenterprises found in the United States compared to less industrialized countries.

1.1 Random Sample Bias

Respondents to this questionnaire encountered the following introductory paragraph on which they were asked to determine if their household operates a microenterprise:

> *SECTION V. SELF-EMPLOYMENT. We are interested in encouraging small business in our community. Please complete this section if you or anyone in your household owns or operates a business, or earns income from independently contracted work, even if you do not consider it an official business. Examples include hair styling, car repair, lawn care, or child care in your home.*

This paragraph was designed to be inclusive of all types of firms, no matter how well established. It was specifically aimed at the least established firms to encourage owners to report their firms. Longer standing firm owners were hypothesized to have more

confidence and be more accustomed and willing to report their firms. Very few firms of the types which were proposed as examples were reported. These examples were chosen based on observation and conversation. Explanation for this may be that the examples were inaccurate propositions, or perhaps operators of these types of firms were less likely to report them. This is the problem of non-response bias.

The response rate to this mailed survey was 24% (140 out of 575). There are many households which were randomly selected to complete the questionnaire which did not respond. Households with certain types of firms may have been more likely to report microenterprises than others. Certain types of people may have been more likely to report their microenterprises than others.

The characteristics of households and firms which did not respond to the survey is unknown and it is impossible to know if those who did not respond are similar to those who did respond. It can be hypothesized that those least likely to complete the survey and report microenterprise activities are the less educated and more disenfranchised portions of the population, such as a homeless person who collects cans for recycling. It is possible that a greater portion of people who did not respond to the survey operate microenterprises. It is also possible that fewer of those who did not respond to the survey operate microenterprises.

Identification of microenterprises which did not respond to the survey is important to understand well the income contribution of microenterprises to households in low income communities. Methods used to identify firms are important because they influence which individuals are contacted and the willingness of people to disclose information

about income earning activities. Methods used in this survey need refinement to better document microenterprise activity in a low income community. Suggestions for improved methodology are offered in a subsequent section.

2. Firm characteristics

2.1 Sample

The following discussion presents the characteristics of microenterprises and their owners which were discovered through this questionnaire. Two distinct methods of survey distribution contributed to this sample. The first method was a random mail survey on which the above incidence rates were based (number of firms identified=10).

The second method was a community-based method in which surveys were distributed through local nonprofit organizations (number of firms identified=9). Microenterprises identified from both of these distribution efforts compose the sample (N=19) used to analyze firm and proprietor characteristics in the following sections. Characteristics of firms such as their activities, location, customers, reported net incomes, problems and personal characteristics of owners are reported below.

2.2 Sector

The activities in which firms are engaged are presented in Table 1. They are a diverse group with the predominance of firms in service sectors. As hypothesized above in the reasons for fewer microenterprises in a highly industrialized economy, access to imported (meant here in the sense of brought into the community, not the country)

manufactured products may leave more opportunities for microenterprises in services which are more difficult to ship long distances.

Within the services category, there are many different types of firms. The most numerous two-digit SIC code category is "Business services" (SIC=73, n=5), and within the "Business services" category, activities and characteristics are varied.

Table 1: Sectors of microenterprises in 48209 with SIC codes

Activity	SIC	Frequency
Building contractor	15	1
Manufacturing (apparel)[2]	23	1
Woodcraft, Cabinet production	24	2
Transportation services (Detroit Free Press delivery)	47	1
Retail trade- apparel, books	56	2
Business services (communications, fundraising, income tax preparation, miscellaneous)	73	5
Automotive repair (mechanic)	75	1
Miscellaneous repair (general labors)[1]	76	1
Amusement services (mime)	79	1
Health services (care giver)	80	1
Educational services (art programs, lectures/teaching)	82	2
Social services[2] (shelter for distressed families)	83	1
Art services, production	84	1
Miscellaneous services (horse show judge)	89	1
Activity not reported	99	1
Total		22

Total in sample = 19

1. Closed enterprise due to medical problems, was in operation 1989-94 **not included in sample.**
2. Both of these business were reported in the same household. The respondent reported thirty employees but no income, due to "building closed for repair", **not included in sample.**

2.3 Income

Microenterprises in this sample typically generated low net incomes in 1995 (median=$5,000 mean=$16,511 SD=6,061). Households with microenterprises had total household income with a median of $15,000 in 1995. This can be compared to the median income of households without microenterprises in the random sample of $6,250 in 1995. These measures of central tendency can be compared to the annual minimum wage in this country of $8,840 before taxes for full-time work[18]. Median per capita income in the subsample of households with microenterprises was $12,500 in 1995.

The following breakdown of microenterprise income levels provides a rough picture of the importance of microenterprise income to individual households in a low income community. Presentation of a breakdown of firms based on contribution to household income illustrates that firms can play large, intermediate and small roles in generation of household income. Firms in all three categories seem to require some skills and there are similar levels of total household income across groups. The types of firms which generate different levels of returns to households are varied. There is no clear money making or losing sector based on this data. The breakdown shown in Table 2 illustrates three different levels of importance of the microenterprise contribution to total household income. The sample is small, but it is fairly evenly divided among these three categories.

In some cases firms contributed a large portion of total household income to

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[18]This is calculated at the present minimum wage of $4.25/hour. The Congress voted this Spring to raise the minimum wage by $.90 which brings the hourly wage to $5.15/hour and the annual full-time wage to $10,712 before taxes.

relatively high income households. Household incomes for which microenterprises generated more than half of total household income ranges from approximately $25,000 to greater than $50,000. Microenterprises can be considered a valuable source of income to these households.

In a second category, microenterprises **contribute an intermediate amount to total household incomes**. Net income levels for these microenterprises may be low, but total household incomes are also low in some cases which makes the marginal income contribution of the activity a more important source of income than it would be in a higher income household. The lower the level of total household income, the more important is the intermediate contribution of the microenterprise to the households. At lower levels of income, money is more critical to fill basic needs.

The third category of microenterprise income levels which can be distinguished are those which **contribute a small amount to total household income**. This may represent a more sideline type of firm. The reasons that the firm has not become a more important source of income to the household are not known.

Income earned by firms provides information about the importance of firms to total household income. High levels of income suggest that microenterprises generate significant income to households in low income communities. Low income levels can also be important sources of income if they provide a significant portion of total household income. Different income levels could reflect different levels of demand for various goods and services or different levels of ability or motivation of the firm owner.

Average income levels across categories are similar, regardless of the difference in the microenterprise contribution to total household income. Enterprises which generate low levels of income do not generally occur in households with low total income. Households with greater income resources do not necessarily generate higher income levels than microenterprises in households with lower total incomes.

Profits earned by microenterprises illustrate the returns to resources (labor and capital) of these activities. Net income of these firms can be compared to the amount of income earned by an individual with the same skill level through working for someone else. This is the opportunity cost of labor involved in microenterprise activities. In this sample, for example, there is a building contractor who earns most of total household income through a one-person microenterprise which he has operated for 10 years. Comparison of this firm's net income to the salary of a contractor with similar experience would illustrate the marginal benefit of income generation through microenterprises compared to income earned through working for someone else.

Income levels earned from microenterprises can be compared to that earned from employment for others to determine the attractiveness of self-employment compared to wage and salary work. It is important to note that there may be benefits to self-employment aside from monetary income such as the ability to care for children or older family members. In addition, there is no guarantee of employment which requires the skills possessed by an individual. A person may be a skilled mechanic, but there may not be many employment opportunities for mechanics, which could reflect low effective demand for automotive repair services. Alternatively, there could be several job openings

for mechanics, but an employer may be reluctant to hire a person if the applicant checks "yes" on the application question which reveals that he or she was a convicted felon. It is critical to remember that employment opportunities may be scarce or other barriers may prevent gainful employment, such as imperfect information or discrimination on behalf of both job seekers and employers.

Microenterprises contribute varying amounts to total household income. The choice of this method of income generation could be motivated by many different forces or circumstances. The benefit of microenterprises must be analyzed in comparison with available income generation possibilities. Firms with various levels of sophistication will have different types of assistance needs. Income levels earned by firms and the importance to household income are important pieces of information in the consideration of assistance initiatives to microenterprises in low income communities.

Table 2: Microenterprise contribution to household income

Microenterprise Net Income, 1995 (% of household income)	Approximate Total Household Income, 1995	Business Activity as reported by respondent with SIC
Firm contributes large portion of total household income (n=5)		
100%	$35,000	Ladies apparel store (56)
78	$45,000	Building products, independent contracting (15)
70	$50,000 or higher	Art production (84)
60	$25,000	Adjudicate equine events (89) *(Horse show judge)* Cabinet production (24)
Firm contributes an intermediate amount of household income (n=5)		
33%	$15,000	Income tax preparation (73)
33	$45,000	Consultant to individuals (73) [legal secretary]
30	$50,000 or higher	Art services to schools (82)
25	$10,000	Detroit Free Press delivery (47)
14	$35,000	Mechanic (75)
Firm contributes a small portion of total household income (n=7)		
10%	$25,000	Communications, fund-raising, organizing (73) Writer (73) Woodcraft (24) Mime (79)
7	$35,000	Sell books (59)
6	$45,000	Care giver (80)
5	$50,000 or higher	Consultant to community organizations (73)

This table includes 17 firms because one firm did not report an activity and another did not report income level of firm.

2.4 Growth, age and employment of firms

Analysis of the demand for goods and services of microenterprises involves a broad view of consumer demand and the competitive structure within specific sectors. It is difficult to analyze the competitive opportunities for microenterprises based on this sample due to the small sample size. One hint concerning the market opportunity for these firms is that although the growth rate in this data set is effectively zero[19] (.4) in terms of the growth of workers per firm over time, the average age of firms is 9 years (SD=7 years). Most firms begin and remain one-person firms. At the time of this survey, the number of jobs provided by microenterprises reported here was 1.4, including proprietors.

High failure rates for small businesses in the United States are infamous. Additionally, the first three years are critical to microenterprise survival, as has been identified by previous research (Liedholm and Mead, 1993). The higher average age of firms in this sample may reflect some ability to meet a market demand, based on the assumption that households in a low-income community could not afford income losses over a sustained period of time. The high average age could also reflect a sideline nature to the firms which enables individuals to engage in the microenterprise activities while earning most income elsewhere.

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[19]This growth rate is calculated based on questions about the year the firm began, the number of workers in the firm at that time and the number of workers in the firm at the time of the survey.

2.5 Personal characteristics of firm proprietors

Microenterprises are often one person firms (11 out of 16 cases) which implies that personal characteristics of the owner have substantial influence on the nature of the firm. Personal characteristics of microentrepreneurs contribute to the perceived options (bounded rationality) encountered in both labor and goods markets and will influence the manner in which the individual does business. The education, gender, ethnicity and experience of the owners provides a profile of microenterprise owners compared to other respondents to this survey and to U.S. Census data.

The average education level of survey respondents from households with microenterprise income is higher than survey respondents from households without microenterprises. The median levels of education for households with microenterprises, households without microenterprises and Census data for the entire zip code are some college or technical school, high school graduate and between ninth and twelfth grade without a diploma, respectively. This comparison indicates that the survey reached a more educated segment of the population. Those households with microenterprises seem to be somewhat more educated than survey respondents from households without microenterprises.

Approximately 50% of firm owners are female (9 out of 19 cases). This rate is higher than rates of self-employed women revealed in the Bureau of Labor Statistics Current Population Survey in 1983 (29%) and the percentage of women-owned nonfarm sole proprietorships in 1991 (33%). This could be due to a less official nature of women owned firms and a lower tendency to report these firms in government counts. The

relatively higher rate of female participation in microenterprise activities discovered here can be compared to high rates of female microenterprise ownership in developing countries. Among urban firms in Kenya, 43% are women-owned and a 7 country average of women-owned microenterprises from South and East Africa[20] is 64%. Higher rates of female participation in microenterprises points to the significance of this method of income generation to women on an international scale which includes highly industrialized nations. The varying statistics may also reflect different methods of data collection and the effectiveness of reaching particular populations with different methods.

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[20]This is based on country-wide surveys conducted in Botswana, Kenya, Lesotho, Malawi, South Africa, Swaziland and Zimbabwe.

Table 3: Female ownership comparison across data sources

Source of Data, Activity Surveyed and Date of Collection		Rate of Female Ownership %
Southwest Detroit household survey *Self employed business activities* 1996		47
Current Population Survey *Self employment* 1983		29
Small Business Administration *Nonfarm sole proprietorships* 1991		33
Country-wide Micro & Small Enterprise surveys *Firms with 50 workers or less* 1990-1993		
	Kenya	43
	7 Country average*	64

*Includes Botswana, Kenya, Lesotho, Malawi, Swaziland, South Africa, and Zimbabwe.

The ethnic composition of the household sample matches Census data for peoples of European and Latino descent, but not for those of African descent. Census data show that 10% of the population of the zip code is of African descent but only 6% of survey respondents are African Americans. Perhaps as a result of this under-representation, there are no African American proprietors of microenterprises included in the sample of households with microenterprises. There were two firms reported by African American respondents, however one was a closed microenterprise and the other reported 30

employees (but no income)[21].

Ethnic representation and education level may be indications that the survey did not reach a representative sample of the population. Higher numbers of women-owned firms than are reflected in official counts may signify that this survey reached some segments of the population which are not typically well counted, however it did not successfully reach some segments of the population such as African Americans and those with less than a high school education. The small number of cases with firms prevented statistical testing for differences between respondents with and without microenterprises.

Skill level of proprietors was not directly addressed in this survey, but some level of skill can be inferred from the activity of the microenterprise. Most firms, regardless of the level of income contribution to the household, seemed to require technical expertise. There is only one firm which involves less specialized skills, Detroit Free Press delivery. This is also the household with the lowest level of total household income ($10,000 in 1995) out of 19 households with microenterprises.

2.6 Summary of microenterprise evidence from Southwest Detroit

The firms discussed above reveal specific enterprises undertaken by residents of a low-income community in Southwest Detroit, Michigan. Their general characteristics of income level, location, credit and major customers reflect trends which have been

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[21]These two firms were excluded from the sample because they did not meet the definition of a firm with 5 workers or less.

identified in previous work on microenterprises in developing countries. They reveal a one-person firm based in the home using personal savings and selling to individuals. Two-thirds of firms often have one of these four common characteristics, however, the other third often reflect "something different" from this scenario. Some firms earn substantial income from their efforts which reflects a market value in that "something different".

Some microenterprises demonstrate ability to meet a customer demand by earning income levels high enough to contribute significantly to household income. Others earn very little which could reflect a large range of factors. The option to engage in microenterprise activities is available, but not successful, for all individuals.

The extensive list of factors which contributes to the level of income generated by microenterprises was not thoroughly addressed by this survey. The initial step to identify the activities, income levels and basic characteristics of firms and their owners provides a jumping off point for more extensive identification and analysis of supply factors and the target population for future investigation.

VI. Next Steps

A. Future research

The discussion suggests several avenues for future research to more clearly delineate the benefits and key determinants of income to microenterprises. Further knowledge about the returns to different types of firms and the determinants of these income levels will provide a solid basis for design of policies and programs to assist low income populations involved in microenterprises.

Two pieces of information which will facilitate evaluation of microenterprise income are methods used to enter markets and the returns to resources in the firm. The method in which microenterprises enter markets can be examined in two ways. One approach involves the owners' motivations for operating a microenterprise. This could also provide clues about why owners' choose to go into business for themselves, and to provide particular goods or services. This would lend insight into whether proprietors identify a demand and then proceed to take advantage of that opportunity. It would also reveal the extent to which firm owners are meeting their goals in microenterprise operation and whether there are other benefits to firm creation besides monetary income, as suggested in previous research.

Secondly, methods used to reach customers illustrate the degree of sophistication used by firm operators to sell their goods and services. The correlation between method used and income level could reveal an opportunity for intervention through education on reaching consumers or institutional initiatives to increase output markets for very small

firms like small firm yellow pages or local marketplaces.

Another avenue which must be explored further are the returns to resources within the firm. Investment levels in terms of both time and money will reveal the return to resources used in operation of the firm. Returns to labor can be compared to wages in alternative job opportunities or the minimum wage to determine the relative value of microenterprises in generating income to low income households. A series of questions could be asked of the universe of microenterprises, such as the following: What are alternatives to earn income?; What are the returns from each alternative?; and What is the potential for the more lucrative alternatives?

The following hypotheses are proposed for future research on the determinants of income earned by microenterprises in low income communities. These hypotheses can be tested if a larger data set is successfully collected.

Ho: Microenterprises generate returns to labor higher than the minimum wage

Ho: Microenterprises sell in local markets more often than outside the community

Ho: Microenterprises reach customers through word-of-mouth (social capital) more often than through formal advertising channels

Ho: Microenterprises sell differentiated products more often than standardized goods or services

Ho: Microenterprises that sell differentiated products make higher returns than microenterprises selling standardized goods or services

Additional hypotheses can also be drawn based on the Kenyan research on the determinants of income to microenterprises. Variables for ethnicity might be added to this equation given the diversity of ethnic backgrounds in United States cities. A variable for family structure could also be added in light of the high levels of mobility and the recognized rise of poverty in female, single-headed households.

Another important step will be to focus on a sector in which microenterprises operate to determine modes of interaction within vertical chains of production. A sector which was reported in this research can be selected as a basis for further inquiry, such as "Business services" which was the largest group of firms. Rapid appraisal techniques can be used to confirm the importance of these sectors and to investigate local markets.

B. Methodological improvements

Empirical research in this study was the result of an effort to apply methods which have been utilized successfully in developing countries. Similarities to a developing country context were found in the absence of a sample frame for both microenterprises and for households in the zip code area.

Refinement of the methodology can produce a larger pool of microenterprise firms. A larger sample could provide greater diversity of activities and a basis on which to make statements about the connections between types of activities and firm characteristics which this sample was too small to provide. A larger sample would also allow comparison of personal characteristics of microenterprise proprietors with the general population.

Many factors may have contributed to the small sample size in this survey which provides opportunity for improvement. Questions about self-employment were included in a longer survey instrument which limited space for questions in this section and required respondents to complete several sections before identifying a microenterprise in the household.

A simpler method to identify a microenterprise within a household, preferably through in-person questioning, could successfully discover more firms as a first stage in a refined methodology. It is important to collect information on whether a firm is present from a group of households which is representative of the community in terms of education, ethnicity and work experience. A second stage would involve the administration of follow-up questionnaires to all sites which reported the presence of a microenterprise in the household.

As an outsider entering a community there may be little response at all if there is no introduction and explanation of the reasons for such inquiries. Questions about firm formality or compliance with government rules and regulations were not asked for these reasons. An opportunity to work with a local organization and ask a simple identification question to households may be an optimal method of locating larger numbers of microenterprises.

Household visits to a targeted area would avoid the need for a household address list which was difficult to compile for this community. The clustered sampling technique used in Microenterprise Baseline Surveys of the GEMINI project was specifically developed to collect data from microenterprises in south and east Africa (McPherson and

Parker 1992). This method of on-site interviews at every establishment within a designated cluster could be applied in an inner city community in the United States. A follow-up interview with identified firms could ask more in-depth questions about start-up and operation of firms and additional income generation in the households.

In addition to households, interviews could also be conducted with establishments on commercial strips by asking an initial identifier question about the number of employees. Combination of the two methods would be an interesting community development approach in that it integrates the residents and the local business community. It would be necessary to ask the specific location of firms identified in households to ensure against double counting.

Valuable insight into the supply and demand possibilities for micro-firms in a low-income community can be gained through: 1) a more comprehensive view of existing microenterprises through a larger sample; 2) several targeted questions about microenterprise resource use and firm operation; 3) a focused look at the demand for microenterprise goods or services within a specific sector.

VII. Conclusion

Knowledge of microenterprises within low income communities is useful to those interested in issues of poverty, employment, and local economic development. The choice to open a microenterprise is made through comparison with other possibilities to earn money to buy necessities. The decision to operate a firm may be either proactive in view of a market opportunity or reactive in face of limited perceived options.

Determinants of income to microenterprises in low income communities which fall into the following three categories have been proposed: local market structures, firm characteristics and personal characteristics of the proprietor. These three types of determinants of firm income form a complex environment. This environment creates a wide range of possibilities which results in a diversity of microenterprises.

Research on microenterprises reveals a foundation of self-employed business activities in a low income community of Southwest Detroit, Michigan. Microenterprises are found to vary in terms of sectors and net income levels, however almost all firms involve specialized technical experience or skills on behalf of the proprietor. There are probably more different types of firms in the community than were successfully identified in this survey. Notably under represented are firms which require lower amounts of expertise than those typically found in this sample. The diversity of firms creates a variegated picture of the potential of microenterprises and their assistance needs.

Much debate surrounds appropriate levels and types of assistance to the poor. A focus on microenterprises is one type of assistance to households and communities in

economic distress. Public policy which affects microenterprises could be a valuable tool in poverty alleviation or local economic development to economically distressed communities. Measures which assist very small firms could encourage local growth and economic diversity. Support to microenterprises could take many different forms, including institutional measures or direct assistance to firms. Different types of assistance to microenterprises help very small firms to cut costs, find new markets or improve management skills. More precise estimates of the significance of microenterprises to total household income and the determinants of firm income levels could provide valuable insight into potential poverty alleviation measures and the target populations for such measures.

If firms are important sources of earnings to low income households, as some cases in this sample have demonstrated, there may be support for consideration of specialized institutions or policies which encourage these activities. Support of these firms could increase household income and assist firm growth which would create jobs and increase local economic activity. There may also be other positive benefits in the community such as the provision of positive role models for children in a volatile social climate.

Firms which generate lower returns are more complicated. There could be many explanations for these low returns. Firms which generate low returns to poor households can be considered particularly critical in terms of poverty alleviation. Benefits of assisting profitable firms mentioned above also applies to these firms. It is more difficult to determine the levels and timing of assistance to be given to less profitable or unprofitable

firms. The best type of assistance to these firms in the long term may be to change product markets or discontinue operation and work elsewhere, if possible. Microenterprise operation is not a good income earning option for everyone. In many cases the earnings can be very low.

Discussion of the determinants of income to microenterprises presents various levels of opportunity to earn profits through very small businesses in low income communities. The competitive environment of local markets, the background of individual proprietors, and specific decisions about firm operation play important roles in the profit level of microenterprises. Further research on the importance of microenterprise income and the significance of individual factors in determining income levels will guide investment in assistance initiatives and policy measures which address structural barriers of markets, constraints of social institutions and the capabilities of individuals.

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