
From Microenterprises to Small Businesses in Rural Mexico: The Next Step*

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Abstract

Microenterprises are invaluable at stabilizing family incomes. These microenterprises rely heavily on microfinances and microcredit. However, there is little evidence that these microenterprises grow into small and medium enterprises (SMEs) that lead to wealth creation and truly move families out of poverty. The same restrictions that are often the cause of poverty still work to inhibit the growth of microenterprises into SMEs. The primary inhibitors to this growth are the lack of education, specifically business education, and capital. The authors discovered that these factors are also true for the Afro-Mexican population in the Costa Chica (long coast, in Spanish). A concerted effort is needed to provide greater access to business education and capital so that the region might be able to catch up with the rest of Mexico in terms of economic growth.

* Funded in part by U.S. Department of Education Grant #21A040074 (LA). Morehouse in Oaxaca, Fulbright Hays Group Project Abroad; and a Summer Research Grant from the Deans Office, Division of Business and Economics, Morehouse College

Introduction

The creation of microenterprises, using microfinance and microcredit, to alleviate poverty, while relatively new in official public policy, is based on one of civilization's oldest ideals. An ancient Chinese proverb states "Give a man a fish and you feed him for today; teach him to fish and you feed him for a lifetime". By the same token, the emphasis on creating microenterprises allows people to use their own skills and resources to improve their household situations. As in the proverb, the programs emphasize the sustainability of such entrepreneurial efforts compared to direct donations of food and money.

In 2004, the senior author participated in a study of microenterprises in rural Mexico among the Afro-Mexican population as part of Morehouse in Oaxaca (MIO), a Fulbright-Hays Group Project Abroad. The author traveled as a member of this group with the intention of researching microenterprises and microfinance. The co-author joined him in July of 2005 to study the economic development of the community as a result of the microfinancing efforts.

Microenterprises are invaluable at stabilizing family incomes. However, there is little evidence that these microenterprises grow into small and medium enterprises (SMEs) that lead to wealth creation and truly move families out of poverty. The same restrictions that are often the cause of poverty still work to inhibit the growth of microenterprises into SMEs. The primary inhibitors to this growth are the lack of education, specifically business education, and capital. The authors discovered that these factors are also true for the Afro-Mexican population in the Costa Chica. A concerted effort is needed to provide greater access to business education and capital so that the region might be able to catch up with the rest of Mexico in terms of economic growth.

The structure of the paper is as follows. Section two is a literature review on the failure of microenterprises to grow into SMEs. Section three describes the Costa Chica region, the interview subjects, and the interviews the authors conducted during the two visits to the area. Section four analyzes how the experience in Mexico agrees with the literature. The final section addresses future work.

Literature Review on Microenterprises

In essence, microenterprises are the smallest of businesses, often created by the very poor, that generate income to help sustain the individual. Governments and NGOs encourage such microenterprises through various methods, including microfinance, training services, and regulations. "Microfinance refers to loans, savings, insurance, transfer services, and all financial products aimed at low income clients" (International Year of Microcredit 2006). Microcredit can be loosely defined as loaning small amounts of capital by banks and other institutions for the very poor to create these microenterprises (Fairley 1998). It helps those who desire

to be self-employed but who cannot obtain credit through traditional channels (Servon and Bates 1998).

Over the last 25 years, we have seen a huge explosion of microfinance institutions dedicated to this cause in the developing world (Joeques 1999). In 1997, a Microcredit Summit was held in Washington, D.C., to discuss ways to create more opportunities for such ventures. At that time, over 2500 varied institutions were present and the goal was created to reach 100 million of the world's poorest families by 2005. In fact, 2005 was named by the United Nations as the International Year of Microcredit.

Undoubtedly, this microenterprise revolution has had positive effects. Successes such as the Grameen Bank in India and BRAC in Bangladesh have contributed to millions of people, often women, moving out of the ranks of the extremely poor. Since they are entrepreneurial, the microenterprises help create self-esteem and independence (Fairley 1998). In countries like Bolivia, Brazil, and Indonesia millions of the previously unbanked now have access to basic banking services (UNDP 2005).

Still, the question remains: "Are microenterprises effective at eliminating poverty?" According to the literature, the answer to this question is not positive. Mosley and Hulme (1998) posit that microfinance institutions (MFIs) rarely help the poorest of the poor, but more often help those who already have financial stability. They demonstrated that for the very poor microfinance often has a negative impact, leading to more debt. Morduch (2000) agreed, finding that in Bolivia the MFIs most often reached not the very poorest but those just above or below the poverty line. Shaw (2004), in her study of Sri Lankans, discovered that the microenterprises of the "less poor" performed better on average than those of the poor. Servon and Bates (1998), in a study of microenterprises in the US, found that those who had the most success were already educated or possessed specific skills, possessed significant capitalization, and enjoyed strong support networks of family, friends, and mentors.

Even in cases where microenterprises (ME) have been successful in alleviating poverty, concern remains in the growth of microenterprises into small and medium enterprises (SMEs). Grosh and Somolekae (1996) quote a World Bank report on Sub-Saharan Africa, which laments the "missing middle" as the region is filled with countless microenterprises with a few "medium" to "large" firms but with little in between. One would assume that the microenterprises should be a seedbed of experienced entrepreneurs from which the missing middle could grow, but there has been little evidence of that over the years.

Rogerson (2005) found the majority of the entrepreneurial activities in South Africa to be microenterprises. In particular, he found in 2004 that these microenterprises, even if successful, do not grow or create employment. In general he found that the businesses most dynamic and growing in terms of the employment were the already existing medium enterprises.

Servon and Bates (1998) found that small business ownership is often considered working towards lowering poverty, but failed to lead to economic self-sufficiency. Often, poorer families use the microcredit to protect their subsistence incomes rather than using them to create a production income. Although microenterprise is still a very worthwhile goal, and it provides more food, health care, and education to the family, the question remains: "what prevents these microenterprises from growing into SMEs?"

Grosh and Somolekae (1996) detail many of the obstacles that might prevent an ME from expanding to an SME. One of these is access to capital. She comments in her paper that most entrepreneurs are forced to grow dependent only upon retained earnings. This is consistent with Eversole's contention that the difference between a subsistence producer and microentrepreneur is the scale of their retained earnings.

Eversole's (2003) evidence from research in Bolivia and other Latin American countries maintains that the only difference between subsistence producers and microenterprises is one of scale not style. She argues that the only reason some people become microentrepreneurs rather than subsistence producers is their access to greater resources, rather than a radically different approach to running the business. Often for the very poor, their small cushion to be used for reinvestment can be subsumed by the needs of the household, such as an illness or educational needs.

While the world has created many MFIs to give micro loans to help people start MEs, a gap still exists between the micro loans of the MFIs and the regular collateralized loans of mainstream institutions. The amount of capital necessary to expand from a microenterprise to a SME is often beyond the scope of a local microfinance institution with limits on what can be borrowed and not large enough to merit the attention of a mainstream institution. A portion of this lack of access is also self-inflicted. Often the poor are risk-averse as described in Mosley and Hulme (1998). They borrow only enough to protect their subsistence incomes. Only those who are financially stable are more likely to borrow money for promotional activities such as hiring more labor or purchasing more equipment.

Another obstacle to expansion is the increased knowledge and training necessary to run a larger business. Many microcredit institutions are now mandating business training as part of the process of receiving a loan. It is becoming more and more apparent that capital alone is inadequate to create a successful enterprise. Pretes (2002) writes of the Village Enterprise Fund, insisting on training while giving out microequity grants. This vital training includes general management skills, bookkeeping, and ways to grow a business. Rogerson (2004) discusses the successes and failures of the Local Business Service Centers (LBSCs) in South Africa, created as part of the country's push to expand the amount of entrepreneurial activity. Though the LBSC's have had mixed results, more consistent results have been found in the Manufacturing Advice Center (MAC) programs. The MAC programs not

only provided financing, but also delivered business services to SMEs, similar to a business incubator, and created a Business Referral and Information Network which disseminated strategic business advice at all stages of a business life cycle.

Other obstacles to expansion include access to land and the increase in technology. In many countries, little land is needed to run a microenterprise. They are often created on the sidewalk with no official permits needed. However, to have an SME, one often needs a permanent place of business. De Soto (2000) speaks of how it takes seven years in Peru to purchase land and get an official title. He has similar horror stories from other developing nations (De Soto 1989). In countries, such as Mexico until the advent of NAFTA, all land was community owned, known as *ejido* land. It may take years to actually have the land necessary to create a business.

So, we see in reviewing the literature that microenterprises have been successful, but often in the context of helping the moderately poor maintain a subsistence lifestyle. There is less evidence to support that it helps the very poor or that it helps microentrepreneurs grow their businesses into small businesses. The main obstacles are (1) capital, often needed in higher amounts than is offered by MFIs; (2) education — general education increasing the literacy of the population and business education to help build the knowledge of creating a small business; and (3) a strong network of support from family, friends, associates as well as governmental assistance for becoming a part of a more formal trade sector.

Experience in Mexico

The Afro-Mexicans are descendants of the slaves who were brought to Mexico during the colonial period. Though very little has been written about the Mexican slave trade, slaves outnumbered the Spanish by three to one in the sixteenth century and two and one-half times to one in the seventeenth (Vaughn 1995). Over the years, the slaves integrated into the population the same way the Spanish and indigenous people coalesced. However, in two remote areas of the country, near Veracruz and the Costa Chica, much evidence of the African heritage remains.

Unfortunately, racial prejudice still exists in Mexico, even though the government claims to be race neutral due to the mixed heritage of the vast majority of the country (Montiel 1994). Recently, starting with the work of Aguirre Beltran (1908–1996), the late University of Veracruz professor of anthropology and forerunner in studying the history of Blacks in Mexico, recognition of Mexico's African heritage began to grow. It is undoubtedly true, whether due to racial causes or not, that the Costa Chica is among the poorest areas of Mexico. On almost any measure, the state of Oaxaca ranks among the poorest in Mexico, and the Costa Chica is one of the poorer areas of Oaxaca. The coast has a higher illiteracy rate and a smaller percentage attending high school than the state as a whole and than the country (INEGI 2001). In social terms, the area also has a smaller percentage with running water, plumbing and electricity.

The senior author arrived in the Costa Chica region in late December 2004 and conducted interviews over the next two weeks into January 2005. The interviews were arranged by the nonprofit organization Mexico Negro. The emphasis of the interviews was to meet people who had an interest in or had already created small microenterprises and people who were involved in microfinancial institutions. In addition, a second trip was made during July 2005 along with the co-author to follow up on initial observations and to explore other possibilities that might lead to economic development of this community.

Mexico Negro, over the years, had created several community-based microfinance institutions (*cajas populares*) in response to what was perceived to be a lack of capital sources in the area. Three of the interviews conducted in the winter were with individuals directly involved in these ventures. Two more interviews were conducted in the summer with other local institutions dedicated to microfinance. Initials have been used to protect the anonymity of the interviewees.

January 2005

1. DA – This individual is the president of the small savings & loan (*caja popular*) in Corralero. Members join this *caja* by paying a fee of 30 pesos. They, with two witnesses who stand in for them, are allowed to borrow up to four times their deposits. The interest rate is 60 percent per annum with most loans for only three months. At the end of the year, profits are divided among the members; so the interest on deposits is a respectable 20 percent per annum. The *caja* has 220 members at the present time with an average of 7,000 pesos on deposit. However, this *caja* only has approximately 300,000 pesos in assets, so most of the money is out for loans. The default rate is extremely low.

The majority of the borrowers are women, although there are no gender limitations. Women borrow the money to provide extra income to the family. Some buy fish at the docks and sell them in town for a higher profit. Others borrow the money to open small *tiendas* or little snack stores. Much of the women's money is used for health care and food. It was stated that the men's money was used for education. The community only has a primary school and a televised secondary school. Any student wanting to attend preparatory school (essentially grades 9-12) must leave the community. The vast majority of the money is for productive purposes, not consumer goods.

2. R & S – These two individuals run the small *caja popular* in Lagunillas. R is the Treasurer and S is the President. It is very similar to the one in Corralero having also been started by Mexico Negro. Again, the members generate the deposits. They currently have 95 members with approximately \$300,000 under deposit. The interest rates are again 60 percent per annum and the dividends on deposits are slightly higher at 38 percent. They consider the institutions to be a benefit to the com-

munity. Women are the main borrowers, but this may be because men do not want to be seen asking for money. Thus, they often ask their wives to borrow the money for them. The community has a primary school and a secondary school but no preparatory school. Any student desiring to reach that level must travel to Pinotepa Nacional or Cuaji, both of which are approximately 1 hour away.

3. **DE** was the former President of the *caja popular* in Santiago Tapextla, also created by Mexico Negro. It is currently no longer in operation as a man from Pinotepa came in and created a rival. The new *caja* only required 10 pesos to join as opposed to the normal 30 pesos. Gradually, the people in the community shifted over. Unfortunately, this new operation takes the profits back to Pinotepa Nacional rather than having them stay in the community as the first did.

July 2005

4. **Cooperativa Sinvacrem.** This is a small savings and loan institution operating in the town of Pinotepa Nacional. The members of this *caja* can secure a loan for a maximum of five years and the interest rate is 3.5 percent per month. The bank manager shared with the authors the details of the loan structure where most borrowers have to produce their income statement, a valid ID and a credit report. The average loan period was two years and the average loan amount was 500 pesos. However, this bank was experiencing a rising default rate, as most borrowers did not have collateral.
5. **Savings Bank #2.** Another small savings bank operating in the same area was offering loans at the rate of 3 percent a month but had no maximum limits to the amount that can be borrowed. It did not have any stringent conditions attached either but required a cosigner if the borrower could not provide sufficient proof of property holdings. The average loan period in this bank was one year.
6. **HSBC** is the only commercial bank operating in Pinotepa area. The bank manager informed them that they were not in favor of making start up loans to small enterprises. They only catered to individual business loans starting from 5,000 pesos charging 5 percent per month. To qualify for the loan, the business has to be in existence for at least two years.

In addition to interviewing those involved in the local *cajas populares*, the authors interviewed five individuals or groups of currently involved in or planning microenterprises. These groups were interviewed first in January 2005 and again in July 2005.

1. **DE** initiated a farming cooperative, but with little success thus far. He feels the community needs to be taught to work together as opposed to in-

dividual efforts. His current dream is to recreate the farming cooperative with multiple families working small plots of land to grow vegetables that could be consumed by the families with excess going to the markets nearby. Even though this part of Mexico is semi-tropical, most vegetables are imported. He has the technical expertise necessary, having taken a farming course in Oaxaca, but he lacks capital. In his estimation, he only needs \$120 (US) to start his own farming plot; but, for the moment, that is completely out of reach. He is not exactly sure where or how he would sell the excess vegetables, but he is convinced it can be done. In July, the authors met him and his group again as a follow up on their entrepreneurial efforts. They now seem to be more organized in a cooperative spirit. The authors spent an entire afternoon with this group teaching them how to develop a business plan and budget, starting from land preparation to harvesting and selling the vegetables in the market.

2. **A, C, and E.** These three men are involved in a fishing cooperative in the coastal town of Corralero, adjacent to the Corralero Lagoon. The cooperatives were started a few years back by the government as a way to crack down on illegal fishing. The men considered the cooperatives a blessing, but they do not work in the traditional sense of cooperatives, since the profits and expenses are not shared equally among the members. They are concerned by the over fishing being performed illegally too near to the coast, but their complaints to authorities have had no effect. According to E, if the over fishing is not curtailed; the local industry will be gone in ten years.

Their dream is to create shrimp farms within the lagoon as a way to have a more steady income. They are currently halted by the lack of capital and the lack of technical expertise. The men estimate they would need 300,000 pesos to start the shrimp farm. However, every bank to which they have applied has turned them down. They already owe money for the boats they use to do their current fishing in the lagoon.

E also owns a small open-air restaurant on the strip of land between the lagoon and the Pacific Ocean. Most of the customers are local Mexicans coming to the beach on holiday. There are no hotels in the area, and the tourists sleep in their cars if they are staying overnight. The men remarked that they would love to see a hotel in the area but they were also afraid that if it had a restaurant, it might run the smaller operations out of business.

3. **J & H.** These two young men were part of a group organized by Mexico Negro for the authors to interview. The group lives in the town of Minitan on the Corralero Lagoon. The young men, ranging in age from 16 to 24, are interested in creating a small business so they are not forced to migrate to America. The young men are part of a current inoperable fishing cooperative. They were lax in maintaining the reg-
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istration and now must pay large fees to get the official license back. Meanwhile, they are fishing illegally and that hinders their operation. Their desire was to create a shrimp farm in a nearby lake with access to the lagoon. When farming fish rather than shrimp was suggested, their response was that shrimp sold much better in the local markets although they have yet to survey the markets. They had no sense of the money necessary to create this farm, nor technical expertise regarding shrimp farms.

In July, these men were interviewed again with more wide-ranging options for them to pursue. The options included collecting mussels, gathering salt, and tourism. For each topic, the young men were asked about the market size for that endeavor as well as the cost of setting up and maintaining such a business. The group had very general ideas on the market size but had obviously thought little about the requirements necessary to start.

4. **F.** With three other men in the town of Callejon de Romulo, F had already tried to create two businesses with the support and advice of Mexico Negro. Their first attempt was a tree nursery. Even though this part of Mexico is very rural, a market for trees still exists, as the government wants people to create "living fences" around their fields, where every other post is a small tree. The men made it clear, however, that they were only trying to beautify the community and were not seeking profit so the project only lasted one year.

Their second attempt was to create a fish farm, raising tilapia. They got a loan from the NGO, Mexico Negro, found a suitable location, and dug a well to provide fresh water for the tanks. However, a split in the group stopped the work, and before peace could be attained, the capital ran out. In July, when we visited this group again, the men indicated that they were still interested in working together on the fish farm if more money could be obtained. They also expressed the need for formal training in how to set up the farming strategy. When asked how they wished to make revenue by selling fish raised in the farm, these men once again had a general idea that the nearby markets would serve as a good outlet, but they have not explored the markets.

5. **The Bakery Women.** At the time of F's interview, the senior author was also able to interview a group of women, including F's wife, who run a bakery cooperative. F built an adobe oven for his wife several years ago. She and the several other women bake bread in the oven each day. Each one makes the same type of bread, but each has a different town for her market so they do not compete with each other. The women were asked if they kept track of their expenses and knew their profit from the venture. They replied that they had a general idea in their heads but had never written it down. They have borrowed money from the government to build a new bakery building and they have already pur-

chased a new gas oven. In July, the authors visited the bakery once again. The building was incomplete due to lack of available labor. The women also complained that they do not have the working capital to keep the bakery running.

6. Men of San Jose Estancia Grande. In July, the authors also met a group of men in the town of San Jose Estancia Grande. These men own lands ranging from eight to 76 hectares. But most of the land is used as pasture lands for their cattle and only two or three hectares are used for growing corn. All of these men have only middle school education and a history of early marriage. At the interview, these men expressed eagerness to start fish farming for commercial purpose. When asked what they would like to do with the money earned, most of them wanted to build a house or spend on children's marriage, but none had the concept of investing further in businesses.

Towards the end of their trip in July, the authors also met with Dr. LS of Universidad Del Mar at Puerto Angel, to learn more about fish farms that his institution is helping the "Zapotalito" communities establish near the "Chacahua" town close to Pinotepa Nacional. These farms have started operating two years ago building five earthen ponds. Each pond is 10 meters in diameter and can be harvested three times a year. The authors obtained rich ideas from the professor about creating circular tanks for tilapia farming in these small village communities.

Interpretation and Results

As mentioned above, two main reasons often cited for the failure of microenterprises to grow into SMEs are (1) lack of capital and (2) lack of education, particularly business education. The interviews indicate that both of those resources are in short supply in the Costa Chica region.

The *cajas populares* do a good job of giving the members of the community access to cash for small expenditures. Each of the interviews conducted revealed that a large proportion of the community is involved in the endeavors. The depositors were taking advantage of the access since the large majority (90 percent in the Corralero *caja*) were active borrowers from the organization. The *cajas* appear to be financially sound as they were paying interest on deposits. However, they are not suited to the needs of helping members grow into larger businesses.

One reason is the amount of capital available. For example, the Corralero *caja* had approximately 300,000 pesos on deposit available for loans. However, A, C. & E, the fishermen in Corralero, estimated that it would take \$300,000 pesos for them to start the fish farm. It is not feasible to expect the local *caja* to loan all of their money to one group of borrowers. Since their entire source of new members is the village, they would not be expected to grow large enough over the short term,

or to be capable of handling this request for money. The other *cajas* were of a similar size according to Mexico Negro.

When the Bakery Women in Callejon Romulo needed money to build a bakery building and increase the size of their operations, it was necessary to borrow money from the government, but even this amount was insufficient. The government program they accessed only allowed money to be used for infrastructure development. They were forced to acquire volunteer labor to build and still had no money left for operating expenses.

Besides the local *caja* and the government, the other lending institutions that exist might work to generate operating capital, but the amount and the timing would not be sufficient to acquire infrastructure such as a shrimp farm or a building for the bakery. As mentioned earlier, the local commercial bank in Pinotepa did not make small business loans. Consequently, the options for acquiring the large infusions of capital needed to grow a business are few. It is also true that the cost of capital is quite high. The local *cajas populares*, created by Mexico Negro, had interest rates of 60 percent per annum. The Pinotepa Nacional *cajas* had interest rates of 36 percent and 42 percent per annum. While this is not too burdensome when one is borrowing a smaller amount for a three-month limit, it becomes prohibitive when borrowing a large amount for a longer period of time.

Most of the people interviewed are not fully aware of their options, which recalls the second cause: the lack of business education. A majority had not progressed beyond primary school. Although sufficient for normal tasks, more education and a more specialized education are often necessary to properly manage a business larger than a microenterprise. The lack of this kind of business knowledge was seen in every interview.

None of the interviewees had conducted a preliminary market survey in any of the interviews. None was familiar with the idea of a business plan. As mentioned earlier, the Bakery Women did not keep written records of expenses and sales so they could verify their income, a practice that could be a great benefit to them when seeking outside capital. The young men located in Minitan were not familiar with the procedures involved in calculating the expenses that would be required to operate the small businesses mentioned in our interviews.

While most spoke of the technical knowledge needed to start the various ventures, this did not extend to the technical knowledge needed to run a business. The interviewees assumed that special skills and training were not needed to run a business. In essence, they expected those aspects to take care of themselves. If fish or baked goods were produced, one simply took them to the local market to sell. That process does work in microenterprises, it is insufficient to grow a business to the point where wealth can be created and it can be self-sustaining beyond the life of the owner.

Implications and Future Work

In order to help ease the poverty of the Afro-Mexican population located in the Costa Chica region, more needs to be done to help them become self-sustaining. We must, in essence, "teach them how to fish." It is apparent from the interviews conducted in the region that more education is needed for the population, specifically in the area of operating and growing a business. While it is true that more and larger capital sources are necessary in order for businesses to grow, evidence abounds that money by itself is insufficient without the knowledge of how to properly utilize it.

It is also true that better business education would help the entrepreneurs to gain access to more capital. Being able to create a business plan showing the market available for any goods or services produced, along with discipline to record and verify expenses and revenues, would allow them to access larger sources of capital. Even with a proper business plan that demonstrates excellent market and revenue potential, the local *cajas*, both in the villages and in Pinotepa Nacional, would be unable to inject a large sum of capital to jump-start a small business. The local commercial banks are not even interested in this type of small business. Consequently, more research is necessary to discover additional sources of capital.

More research is also necessary to understand the type of training that would be most effective in transmitting business knowledge. Given that the majority of the people have only completed an elementary, or possibly secondary, education, a textbook and lecture-based classroom setting would probably not be the most effective. Other options include a business simulation, small group interactions, and apprenticeship training. The type of training to be used is still under discussion, although Morehouse College is currently planning to create a small business workshop to be conducted in the area in the near future.

The most comforting aspect of this study is the realization that the entrepreneurial spirit is very strong in the area. Despite years of marginalization and poverty, the people interviewed are quite optimistic about the potential for economic growth. Little economic development has been taken place in this area and many entrepreneurial opportunities abound. Much of the land is still undeveloped agriculturally. Tourism is practically nonexistent. With greater sources of capital and more business education, the economic possibilities in the area have great potential.

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