MICROCREDIT AND SELF-EMPLOYMENT:

COMPARING HIGH-INCOME AND DEVELOPING COUNTRY PROGRAMMES

by

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B.A., McGill University, 2005

PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF PUBLIC POLICY

In the
Faculty
of
Arts and Social Sciences

SIMON FRASER UNIVERSITY

Fall 2009

APPROVAL

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Degree: **M.P.P.**

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Date Defended/Approved: November 7, 2008

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Abstract

Micro-enterprises in developing countries that receive a microcredit loan from a microcredit institution are not receiving additional non-financial services that maximize the potential for micro-enterprise sustainability and growth. Too many micro-enterprises that receive credit fail to generate significant additional employment. Microcredit institutions need policy changes to correct this problem. The uptake of growth-oriented policies needs to be widespread among microcredit institutions to ensure that clients sustain and grow their micro-enterprises. Micro-enterprises that flourish create jobs, which contribute to economic growth. To identify good practices for micro-enterprise sustainability and growth, I examine the literature and review case studies of microcredit programmes in both high-income and developing countries. These case studies are analyzed for their strengths and weaknesses. As to the latter, recommendations for improvement include offering three different training options, each bundled with a loan product: introductory training for micro-enterprise starters; comprehensive assistance for micro-enterprise expansion; and a strategic mentoring programme.

Executive Summary

Micro-enterprises in developing countries are not reaching their maximum growth potential. Upon receiving a microcredit loan, most micro-enterprises experience minimal growth and then even out. Often, three constraints act as the major barriers to sustainability and growth: weak providers of business development services, weak operating environments, and weak human capacity and skills. These inhibiting factors make sustainability and growth potential difficult to realize for micro-entrepreneurs.

Policy Problem

The policy problem central to this study is that microcredit institutions offer too few well-designed non-financial services that aim to assist clients to achieve micro-enterprise sustainability and growth. At present, most microcredit institutions focus non-financial services on teaching proper credit management or basic vocational training. For the purposes of this work, the aim is to determine a range of alternative services, in addition to a loan, that can be offered that focus on sustaining micro-enterprises, and that are likely to increase their growth potential.

Methodology and Results

The identification of a gap in services between what the literature dictates as good practice and what is presently offered by microcredit institutions shape the central hypothesis of this study: If micro-entrepreneurs receive well-designed services focused on sustaining and growing their micro-enterprise, they will be better positioned to realize this potential. This study examines four case studies of non-profit self-employment programmes in high-income countries to establish benchmark areas of action that are proven to facilitate sustainability and growth potential. The four case studies include a non-profit self-employment programme in the United States, ACCION USA; two in England, The Prince's Trust and Bristol Enterprise Development Fund; and one in Ireland, Fist Step. One chosen benchmark area of action, namely the delivery of non-financial services, is then further developed through a literature review exclusively focused on developing countries. Combining this information in different practical forms, an analysis of four case studies of non-profit microcredit programmes in developing countries is used to

highlight gaps in programme content and service delivery. The four non-profit microcredit programmes in developing countries include one in Egypt, The Alexandria Business Association; two in Morocco, Al-Amana Association and Zakoura Foundation; and one in Bangladesh, The Bangladesh Rural Advancement Committee.

An examination of the non-profit self-employment programmes in high-income countries shows that effective non-financial services for facilitating micro-enterprise sustainability and growth include three broad areas: training, mentoring, and referral services, strategic partnerships and networking activities. On average, when clients receive such services, they are in business for three years and beyond, additional employment created matches or exceeds the results of a comprehensive study done by the International Labour Organization, and income increases. Developing and narrowing these broad areas to not only address the constraints revealed through the literature review and the case studies of non-profit microcredit programmes in developing countries, but to also be in line with recognized good practices, leads systematically to strategies for micro-enterprise sustainability and growth. As such, interventions need to be focused and administered by specialized managers, trainers and mentors; they need to incorporate skills upgrading in product quality/design/development and business management; and they need to assist clients in accessing markets for inputs and outputs. In addition, the literature reveals that interventions should aim to be demand led, relevant, cost-recoverable, and participatory.

Policy Alternatives

The four non-exclusive policy alternatives developed from the research are introductory training for micro-enterprise starters, comprehensive assistance for micro-enterprise expansion and strategic mentoring. The objective of each policy alternative is to increase the chance that micro-enterprises are sustainable, eventually grow, and generate additional employment. The goal of the first policy alternative is to strengthen clients business skills; for the second, it is to assist clients to expand by teaching expertise through specialized courses; and in the third case, it is to expand client micro-enterprises through partnerships with larger enterprises. Evaluation and comparison of the three alternatives against the status quo – basic training in credit management – is based on a set of objective criteria and measures for these criteria.

Policy Implications

The overall evaluation of the policy alternatives reveals a set of policy implications for non-profit microcredit institutions in developing countries.

- Appropriate and adequate market research should be conducted prior to the implementation of any policy alternative.
- A mechanism should be designed to revise policy alternatives based on client feedback. Strategies should also be devised for carrying out monitoring and evaluation practices, using both qualitative and quantitative indicators.
- Capacities of existing microcredit institutions should be carefully considered before moving forward with any of the policy alternatives.

Dedication

This work salutes the millions of micro-entrepreneurs in developing countries who slug it out every day in jobs and conditions that are unimaginable to businesspersons in Western societies.

Acknowledgements

To Dominique M. Gross, my capstone supervisor in MPP, thank you for your patience. To my family, thank you for your endless support.

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1 Introduction

"Money, says the proverb, makes money. When you have got a little it is often easy to get more. The great difficulty is to get that little."

Adam Smith, Wealth of Nations, p. 109

Poor people possess enormous potential to contribute to economic development while simultaneously improving the quality of their life. One way to give these people the chance to better themselves is by enabling them to start, maintain and grow a small business. However, this is often easier said than done, because poor people often lack the necessary tools to become economically independent; they do not have access to resources that would help them attain the goal of self-employment. For example, poor people are often under-educated and inexperienced in business (ILO, 2002a).[1] In addition, it is difficult for them to obtain credit from banks or other formal financial institutions (Buss, 1999).

But there is a solution. Microcredit, defined as a small loan or a micro-loan, can help poor people gain access to credit. Microcredit is an innovative and effective tool in international development because it facilitates self-employment for the poor and leads to micro-enterprise creation.[2] Advocates argue that the microfinance sector has helped to reduce poverty, improved educational opportunities, and generated or expanded millions of small businesses (Khandker, 1998). As of 2006, worldwide, 3,133 microcredit institutions provided loans to 113.3 million clients, finds the *State of the Microcredit Summit Campaign Report 2006 (*Daley-Harris, 2006).

Over the past three decades, the microfinance movement has become an intriguing way to reach some of the world's most impoverished people. In fact, the microfinance sector received its

[1] The ILO is the International Labour Organization.

[2] Industry Canada defines micro-enterprises as small businesses with 0-4 employees (Industry Canada, 2006).

highest endorsement in 2006, when the Nobel Peace Prize was awarded to the Grameen Bank of Bangladesh and its founder Muhammad Yunus.

Microfinance institutions operate in developing areas in Africa, Latin America, Asia, and Eastern Europe, as well as in high-income countries like Norway, the U.S. and the UK. Yet, despite over 3,000 microfinance institutions (MFI) worldwide, each serving on average over 25,000 low-income customers, very little research has been collected on the impact of these organizations (Armendáriz and Morduch, 2005). Balkenhol (2006, p. 21) remarks "(…) the fact remains that practically few MFIs know what goes on within the household-enterprise that its clients run, whether that relates to financial management, commercialization and labour use."

This capstone focuses on the employment effect of microcredit. Regression analyses have pointed to a diverse set of factors that contribute to the survival and growth of the micro-enterprises run by the self-employed. Variables found to be significant regarding the move into self-employment and its success include unconditional access to capital, relatively large amounts of start-up capital, and the influence of a "small business family" (Gross, 2001a). Obviously, a microfinance institution is unable to provide unconditional access to capital or influence, whether or not a borrower is from a small business family. Therefore, microfinance institutions need to determine how microcredit services can be best delivered to the poor entrepreneur in a way that maximizes the potential for micro-enterprise sustainability and growth.

I use case studies to examine "self-employment programmes for the poor in high-income countries" and "microcredit programmes for the poor in developing countries."[3] This is possible, since both kinds of programmes use microcredit to achieve a similar end goal, which is the creation of micro-enterprises. My methodology begins by briefly describing and analyzing self-employment programmes to highlight the best practices regarding micro-enterprise sustainability and growth. This is followed by a literature review that examines more closely one of the findings, but in the context of developing countries. Next, microcredit programmes are briefly analyzed to determine problematic strategies. Based on the successful tools of the self-employment programmes, and the gaps within the microcredit programmes, I propose policies that will most likely facilitate the sustainability and growth of micro-enterprises. Those core

[3] Henceforth, for the sake of brevity, 'self-employment programmes' refer to non-profit institutions in high-income countries that promote self-employment for the poor by offering micro-loans and non-financial services, and 'microcredit programmes' refer to non-profit institutions in developing countries that promote self-employment for the poor by offering micro-loans and non-financial services.

issues will be extremely important to future research in the area of microcredit and self-employment.

2 Policy Problem

The policy problem addressed in this essay relates to the impact that microcredit programmes have on micro-enterprise sustainability and growth. At present, too many micro-enterprises in developing countries that receive a loan from a microcredit programme fail or remain stagnant. Karnani (2007, p. 37) frankly concludes that:

> "Although some microcredit clients have created visionary businesses, the vast majority are caught in subsistence activities. They usually have no specialized skills, and so must compete with all the other self-employed poor people in entry-level trades. Most have no paid staff, own few assets, and operate at too small a scale to achieve efficiencies, and so make very meager earnings. In other words, most micro-enterprises are small and many fail – contrary to the United Nations' hype that microentrepreneurs will grow thriving businesses that lead to flourishing economies."

The objective, therefore, is to determine the best possible actions that microcredit programmes can take to ensure that self-employment activities by the poor are sustainable and reach their maximum growth potential.[4] However, removing even some of the barriers to business success for producers in the informal sector is a complex process. For this group, enterprise sustainability and expansion is held back by several factors, including lack of education, limited understanding of trade, low tolerance for risk, passive attitudes toward markets and customers, and growing competition for limited markets (Nelson, 1997). The goal is to find the most effective ways to achieve business sustainability and growth among microcredit clients who operate as informal sector producers.

However, donors – aid agencies and other organizations that fund microcredit programmes – heavily emphasize the need for microcredit programmes to operate on a financially sustainable basis (CGAP, 2006). This fact almost certainly affects how microcredit programmes

[4] For this work, a "sustainable micro-enterprise" is defined as a business that survives at least three years. Similarly, a "micro-enterprise with growth potential" is defined as a business that creates at least one additional job.

can improve client outcomes, since policy changes in this direction can have an impact on the financial sustainability of the programme.

Hence, this capstone addresses the following question: Can policies be implemented to improve microcredit programmes' ability to enhance the sustainability and growth potential of its clients? The question is studied by identifying the features of self-employment programmes that have been successful in facilitating micro-enterprise sustainability and growth. Thus, high-income countries' cases are used to establish benchmark areas of action; and in conjunction with the findings of a literature review focused on the developing country context, are used to identify policy gaps in some selected developing countries' microcredit programmes, which are in turn used to design policy recommendations.

The question is also interesting for at least two reasons: First, it presents an opportunity to assess microcredit programmes in developing countries in light of self-employment programmes in high-income countries; second, it discovers good practices related to an area of microfinance research that, at this time, is not well developed.[5] It is useful to study the sustainability and growth potential of micro-enterprises, since programmes can learn and implement tools that are most conducive to these features, and sustainable and growing micro-enterprises yield benefits for the individual and the economy, in terms of poverty reduction (ILO, 2002a).

Unfortunately, insufficient data on developing country micro-enterprises make the direct evaluation of microcredit programmes very difficult; therefore, an evaluation of self-employment programmes can be useful, since there is a high volume of applied and theoretical literature on the subject. Specifically, statistics have been recorded on micro-enterprise survival and employment creation (a proxy for micro-enterprise growth) for clients of self-employment programmes. This information thus reveals what programme practices are linked to sustainable and growing micro-enterprises. Although the proportion of clients who do create additional jobs is, on average, low for microcredit programmes, the sheer size of the market for microcredit services is likely to lead to significant overall job creation.[6]

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[5] Regarding the second reason, I refer principally to research on micro-enterprise growth in developing countries.

[6] "An impact assessment of microcredit schemes in Peru, for example, finds a positive effect of microcredit on employment, which is on average nine days of extra employment per month. Nine days of extra employment per month (…) may not seem large. However, if this estimate is extrapolated to the approximately 40,000 clients that ACP/Mibanco had at the end of 1999, the magnitude of the impact is striking: over 4.3 million workdays per year, or the equivalent of 17,414 full-time jobs, of which 6,259 are paid positions for non-household members. This translates into one full-time job for every 2.3 loans outstanding at the time" (AIMS Peru case study, 2001, p. xiv., as cited by ILO, 2002c, p. 5).

Relevant stakeholders that may be interested in these issues include microcredit programmes and their managers; donors to microcredit programmes (aid agencies, such as the World Bank and CGAP, non-profit institutions, charities and non-governmental organizations); international organizations (the ILO and other United Nations bodies, and the microfinance programmes of the European Union and the African Union); and various private sector firms (banks, socially oriented venture capital funds, and relevant associations, such as the Microfinance Gateway or the Microfinance Information Exchange).[7] Although the goals of each group of institutions certainly differ, improved client outcomes will bring further credibility to the microfinance sector, thus benefiting these institutions. Improving client outcomes will also affect government labour market policies, and will prove to bolster programmes that promote self-employment for low-income people.

It is also important to note that facilitating enterprise sustainability and growth requires interventions that are unlikely to de directed at the very poor. This is a result of clients with more income being willing to take the risks, such as investing in new technologies, that will most likely be needed to realize micro-enterprise expansion and increased income. Very poor borrowers, on the other hand, are more likely to take out conservative loans that protect their subsistence, and rarely invest in new technology, fixed capital, or the hiring of labour (Karnani, 2007).

Put simply, creating self-employment for the poor is a valuable investment. The motives for this assumption are further investigated in the next section, which examines the literature on the benefits of self-employment.

[7] CGAP is the Consultative Group to Assist the Poor and is a consortium of bilateral and multilateral donors, including the Canadian International Development Agency and the World Bank.

3 Self-employment and microcredit

This chapter provides definitions of self-employment and microcredit. Microcredit is a needed tool among the poor in both high-income and developing countries who desire to start or expand a micro-enterprise. In addition, the following discussion demonstrates the importance and the benefits of self-employment.

3.1 What is self-employment?

Self-employed persons are defined as [their] "(…) own account workers, working proprietors and all dependent workers associated with them."[8] This definition of self-employment is broad enough to accommodate dissimilar characteristics of self-employment in high-income and developing countries, as well as changing self-employment practices. For example, new forms of self-employment are emerging, such as part-time entrepreneurship, low-income self-employment, or the combining of income from self-employment with wage employment. In three OECD countries, Britain, Germany and the U.S., self-employment as a percentage of the total labour force is approximately 15% (Blanchflower, 1998).[9] Yamada (1996) cites a study by the OECD showing that the main employment for at least one out of every five members of the urban labour force in developing countries is informal self-employment.

It is important to note that self-employment in high-income economies occurs largely in the formal sector while self-employment occurs largely in the informal sector of developing country economies:

[8] The definition is from a resolution adopted at the 77th International Labour Conference on 27 June 1990 (ILO, 2002a, p. 3). Other definitions of self-employment exist; for instance, "(…) the self-employment envisaged by some national governments and private sponsors includes only the truest form of entrepreneurship. That is, the self-employment opportunity is freely chosen and encompasses a level of productivity that ensures an adequate income for the family. Moreover, the income generated from such a livelihood is superior to unemployment benefits or at least equivalent to the most recent wage earned, while the income-generating power of the self-employed activity relies not only on a particular monopolist supplier or on any one client" (ILO, 2002a, p. 3).

[9] The exact definition of self-employment was not specified.

> "The term informal sector has been used widely to refer to that segment of the labour market in developing countries which has absorbed significant numbers of jobseekers and unemployed workers, mostly in self-employment and in very small production units, which for the most part have a number of features in common: low levels of capital, skills, access to organized markets and technology; low and unstable incomes and poor working conditions; they are outside the scope of official statistical enumeration and government regulations; they are also, almost invariably, beyond formal systems of labour and social protection" (ILO, 1991, as cited by ILO, 2000 p. 1).

Entrepreneurially minded individuals are the driving force behind self-employment in high-income and developing countries. Kihlstrom (1979) identifies some key determinants of entrepreneurship: entrepreneurial ability, labour skills, attitudes towards risk, and initial access to capital required to create a micro-enterprise.

However, not all poor individuals have the resources to become a successful entrepreneur. Even with the growth of self-employment in most Western countries (Quinlan, 1998), a significant number of entrepreneurially minded individuals remain unable or unwilling to make the transition from paid employee to self-employment. Some individuals working in paid employment, as Blanchflower and Oswald (1998, p. 27) note, prefer self-employment. Nevertheless, the statistics from their study are striking; for example, even though 63% of Americans, 48% of Britons and 49% of Germans desire to move from paid employment to the more entrepreneurial category of self-employment, they have done nothing to realize their desire. The question then arises: What makes entrepreneurially minded individuals decide to remain in paid employment instead of becoming self-employed? (Gross, 2001a, p. 22) The answer may be found when we look at the poor entrepreneur in the developing country, whose lack of access to capital is the single largest barrier to becoming self-employed (Metcalf, (2000a); Armendáriz and Morduch, (2005); Balkenhol, (1998)). So, whether the employed worker in the high-income country rejects entrepreneurship due to the belief that necessary startup capital is just beyond his or her reach, or the worker in the developing country fails to pursue entrepreneurship because funds *are* beyond his or her reach, the results are the same. Therefore, there is a need for programmes that deliver financial services to all would-be entrepreneurs who believe they are outside the scope of the formal banking sector.

In summary, Bowles et al. (undated, p. 1) remark that:

> "There are many people in the world who have major difficulties obtaining credit. This can drastically constrain the economic opportunities available to them – they cannot start their own businesses (…). Without access to credit, they are stuck in a poverty trap, but with a small amount of credit, they might be able to dramatically improve their economic standing."

Microcredit can facilitate access to credit for everyone, and spark any individual's goal of self-employment.

3.2 The benefits of self-employment

This section highlights the important role of self-employment in high-income and developing country economies.

3.2.1 The benefits of self-employment in high-income countries

Self-employment in high-income countries is often promoted by pointing to its economic benefits. By promoting a more efficient allocation of resources, "entrepreneurial talent" brings greater benefits to the economy by creating wealth. Further, Murphy et al. (1991) demonstrate through theoretical and empirical research that "(…) when talented people become entrepreneurs, they improve technology (…) and as a result, productivity and income grow" (p. 505). Therefore, the allocation of talented people to entrepreneurship is good for [economic] growth (Gross, 2001b).

The self-employment picture in Canada demonstrates the positive economic and social contribution of self-employment; Gross (2001a) cites similarly positive employment impacts from the creation of new firms in the U.S. and Europe. Industry Canada (2006) portrays an encouraging picture regarding the economic contribution of micro-enterprises and the self-employed. In 2005, the average income of a Canadian micro-enterprise employee was higher than the average income of an employee working for a business with between five and one-hundred employees.[10] In that same year, businesses of one to four employees comprised 57% of all business establishments in Canada, while self-employed workers represented nearly 16% of all

[10] In both cases, the business was operating in the service-producing sector. In both cases, the employee was full-time equivalent.

employed workers. Self-employment also contributed to employment creation. In 2005, 40% of the increase in total private sector employment represented a move into self-employment. This trend does not seem to be diminishing, since the number of self-employed workers has increased by 21% over the past decade.

Findings for the U.S. unearth a similar conclusion. Bednarzik (2000, Table 7) shows that in 1995-1996, more than one-third of the jobs in the U.S. were created by newly established firms. Bednarzik (2000, Tables 4 and 5) also finds that almost 90% of U.S. employees, since the 1940s, work in small businesses with less than twenty workers; small businesses with less than five employees account for 50% of all businesses in the 1980s and 1990s; and between 1990 and 1995 "(…) very small firms (those with fewer than twenty employees) created about half of the net new jobs (…) (p. 6)." Furthermore, job creation by small enterprises compares relatively well against larger enterprises:

> "(…) the rationing out by banks affects most severely those enterprises that have the greatest job-creating capacity. In 1992-96, in the U.S., 5.8 million jobs were created in enterprises with one to four employees compared with 2.3 million in enterprises of between 100 and 499, whilst those with more than 500 employees actually lost 600,000 jobs" (ILO, 2002c, p. 4).

Self-employment programmes also generate other benefits. For instance, in a high-income country, programmes that help large numbers of unemployed individuals become self-employed cuts the costs of other unemployment benefits programmes. Moving a significant amount of individuals off employment insurance dramatically reduces public expenses, and allows funds to be allocated to other productive uses.[11]

[11] In other words, "(…) the cost-effectiveness of microfinance programmes is a matter of comparing per capita subsidies with the welfare transfers that would otherwise be necessary. In industrialized countries, microfinance programmes make economic sense: the budget expenditure is more than offset by savings on welfare allocations, unemployment benefits and other transfers, coupled with increased tax and other fiscal revenues. In the United States, the savings by the federal Government per participant is estimated to be US$8,000 per year. This corresponds to a "return on investment" of between US$2.06 to US$2.72 for each dollar spent on such programmes. In Canada, in 1993-94, start-up businesses also yielded a net economic benefit in the form of gains in tax revenue and a reduction in unemployment insurance and social assistance of C$21 million per year" (US$20.5 million, the exchange rate used is C$1 = US$0.98. The date that the exchange rate was calculated was April 8, 2008) (ILO, 2002c, p. 7).

3.2.2 The benefits of self-employment in developing countries

The benefits associated with self-employment in developing countries occur against a backdrop of often weak or non-existent social safety nets. In developing countries, individual benefits of self-employment most commonly include an increased standard of living and well-being for poor families, an increase in women's participation in decision-making, improvements to family planning, improvements to household nutrition, and raised aspirations for children's education (Cloud and Panjaitan-Drioadisuryo, 1999). These benefits are part of a larger macroeconomic goal of linking the creation of self-employment with economic growth and poverty reduction.

Empowering poor individuals with the resources to engage in small-scale self-employment causes dramatic increases in labour productivity and individual incomes, while also causing reductions in vulnerability (Haley and Morduch, 2002). When self-employment opportunities with rising productivity are generated, the result is a higher rate of economic growth leading to sustained increases in productive capacity (Islam, 2004). This, in turn, allows for the inclusion and integration of the poor into expanding economic activities and significantly contributes to poverty reduction (Islam, 2004). In other words, micro-enterprises that generate additional employment have the greatest chance of contributing to poverty reduction and economic growth, as Karnani (2007, p. 38) notes:

> "Nothing is more fundamental to poverty reduction than employment," states the ILO. And the United Nations Development Programme agrees: "Employment is a key link between economic growth and poverty reduction. Productive and remunerative employment can help ensure that poor people share in the benefits of economic growth."

Helping the entrepreneurially minded among the poor move into self-employment, whether in high-income or developing countries, is a strategy that can realize positive outcomes for individuals, governments and economies. Unfortunately, too often the main barrier to entry for these individuals is access to capital.

3.3 Microcredit

Since this study focuses on policy recommendations concerning microcredit in developing countries, it is necessary to begin with a brief description of the microfinance sector, of which microcredit is part.

The Asian Development Bank defines microfinance as "(…) the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises" (Asian Development Bank, 2008). The goal of microfinance is to meet the demand by low-income individuals for a wide range of financial services that are convenient, flexible, and priced according to a target group's ability to pay. Microfinance is often used to help an entrepreneur start or expand a small business. Some examples of microfinance institutions include non-governmental organizations, credit unions, cooperatives, private commercial banks, and non-bank financial institutions and parts of state-owned banks.

It is important to note the difference between programmes delivering microfinance services and those that are only in the business of microcredit. Microcredit programmes are specialized in only one microfinance service: The distribution of loans.[12]

In both high-income and developing countries, the financial sector is witnessing a credit gap, where the poor often lack access to financial services. This credit gap exists due to asymmetric information. This means that individuals know how credit-worthy they are (and whether they intend to pay back any or all funds borrowed), but it is difficult for banks to know this information (Bowles et al., undated). As a result, banks often tread lightly when dealing with unknown borrowers, because business opportunities cannot be assigned probabilities of success and, subsequently, the likelihood that clients will repay the loan is unknown.

Since banks are profit-maximizing entities and face unknown probabilities of client success, they want to offer only secure loans. For the poor who have no collateral, the likely effect of the information asymmetry problem is not being granted a loan, and this leads to a lack of credit access for poorer people. The solution would be to set a market-clearing interest rate. Under traditional market theory, borrowers who do not receive a loan should offer to pay a higher interest rate to the bank, bidding up the interest rate until supply equals demand. Stiglitz and Weiss (1981, p. 393) provide a justification as to why banks will not charge a market-clearing interest rate:

> "Banks making loans are concerned about the interest rate they receive on the loan and the riskiness of the loan. However, the interest rate a bank charges may

[12] It is important to note that microcredit is not restricted to developing countries. In high-income countries, a micro-loan can be as high as US$25,000 and in developing countries, lower than US$50 (ILO, 2002a).

itself affect the riskiness of the pool of loans by either: 1) sorting potential borrowers (the adverse selection effect); or 2) affecting the actions of borrowers (the incentive effect)."

The result from both scenarios is that the interest rate affects the nature of the borrowers and their incentives.

Adverse selection occurs when the bank lends overwhelmingly to borrowers with low probabilities of repayment. To avoid this situation, the interest rate cannot be raised to the market-clearing rate, since it will attract applicants with riskier projects.[13] As the interest rate rises, the average riskiness of those who borrow increases, which affects the bank's profits by increasing the number of defaults (Stiglitz and Weiss, 1981). Banks do not want to charge a high interest rate to clear the market, because doing that attracts a riskier pool of loan applicants. Thus, from the perspective of the poor, the problem of adverse selection leads to a rationing of loans by commercial banks.

Another reason that banks preclude lending to the poor is due to high transaction costs. These include the costs of identifying and screening the client, processing the loan application, completing the documentation, disbursing the loan, collecting repayments and following up on nonpayment. Given that the poor tend to borrow relatively small amounts, the processing and supervision of lending to them consume administrative costs that are disproportionate to the amount of lending. Since the average microfinance loan size is smaller than most commercial loans, the transaction cost on a percentage basis for a microfinance loan tends to be higher (Shankar, 2007), and higher transaction costs mean less profits and, in turn, fewer requests for small loans granted.

The principal reason why traditional banks are not inclined to lend to the poor is imperfect information. This means that a borrower promises to repay a loan; however, if the borrower is bankrupt when the loan is due, there is little the bank can do to enforce the contract (Bowles et al., undated). From the perspective of the bank, this makes lending very risky. On the other hand, for people with higher incomes, this problem is averted by requiring collateral for loans. If the borrower defaults, the bank seizes the collateral. As a result, it is more likely that the borrower will not default, because the borrower wants to retain his or her assets. But the problem in both high-income and developing countries is that poor borrowers do not often

[13] A riskier applicant implies that the probability of default on the loan is higher, which would negatively affect the profit-maximizing behaviour of banks.

possess assets that can be used as collateral. This severely constricts a bank's ability to lend to poor people, who have a great need for credit (Bowles et al., undated).

In the absence of collateral by poor people, microfinance works by offering innovative individual and group loans as a substitute for collateral. The more well-known group lending models (Grameen Bank in Bangladesh and ACCION International solidarity group lending) facilitate the formation of small groups (five to ten people) and make individual loans to group members. Other group models (the village banking model) use larger groups (thirty to one-hundred people) and lend to the group itself, which then on-lends to individual members. Alternative forms of collateral used in the group loan can include: a group guarantee fund, where group members contribute and cover any loss if one or more members fail to repay; group guarantees (peer pressure), where the entire group loses access to future loans until the loan of any defaulting members are repaid; compulsory savings, where group members are required to contribute a given amount (often a percentage of the loan) to a group fund that acts as a form of collateral; and personal guarantees, where a third party is legally responsible to repay the loan in case of default.

The group loan methodology is an important component of microcredit, as it offers ways to mitigate commercial banks' problems of asymmetric information and high transaction costs. For example, group self-selection helps to ensure that group members only admit individuals who are serious about group responsibilities and about repaying loans, thereby helping the bank avoid lending to risky clients who are more likely to default (the adverse selection problem); and group lending lowers transaction costs associated with loan collections.

From the information presented so far, it is clear that microcredit can be used to facilitate self-employment for would-be entrepreneurs who are negatively affected by the credit gap. Now it is time to examine self-employment programmes that offer credit and other non-financial services to poor people who are aiming to start or expand a micro-enterprise.

4 Self-employment programmes in high-income countries

This chapter analyzes self-employment programmes in high-income countries to identify areas of action that have been successful in strengthening micro-enterprise sustainability and growth. To do so, I chose four institutions that deliver microcredit and that specialize in micro-enterprise development for marginalized groups of people.[14] Each of these four institutions was explicitly established with a mandate to create self-employment through the use of microcredit and non-financial services.

The four institutions – ACCION USA, The Prince's Trust, Bristol Enterprise Development Fund (BEDF) and First Step – are evaluated based on the ability of the clients to run a micro-enterprise that is sustainable and employment generating. However, with this goal in mind, it is important not to lose sight of an institution's target market. It is very important to ensure that each institution serves its targeted clients, since it is only that way that an institution can have the intended impact on micro-enterprises.[15] Further, if the targeted clients are being served, then the microcredit services are effective (Frankiewicz, 2001). For each institution, evidence of impact will be followed by an identification of the practices that are behind the outcomes in these areas.

4.1 ACCION USA

ACCION USA began operations in 1991 and is presently the largest micro-lending network in the U.S. The institution provides microcredit to low- and moderate-income entrepreneurs who are unable to access bank credit for their small businesses. In 2006, the

[14] A wide array of other commonly accepted criteria exists, both qualitative and quantitative, for evaluating components and impacts of microcredit programmes. Criteria are often chosen based on the availability of information and the given topic of study. For a further explanation, see ILO (2002b).

[15] Deciding what group of potential clients to target should be based on individual debt capacity, the design of products and services, and the covariance risk of the target group. It should also be understood that objectives will affect the target market, (for instance, serving urban or rural, working poor or ultra poor) and will determine costs and "quickness" of sustainability. For a further discussion on targeting, see Ledgerwood (1999).

ACCION Network loaned US$31.5 million to 3,553 entrepreneurs and had a total outstanding loan balance of US$39.1 million (ACCION USA, 2008). ACCION USA targets marginalized individuals and evidence from the institution's website shows that its clients have many characteristics that are proxies for economic marginalization.

4.1.1 Impact

Table 1 illustrates the impact of ACCION USA. For example, its clients' businesses exist for an average of approximately four years. This is a better average than numbers for the general business population, according to the U.S. Small Business Administration: "Two-thirds of new employer firms survive at least two years and about half survive three years" (Burrus, undated, p. 13). Clients also increased annual income by 38%, increased average monthly profits by 47%, and increased business equity by 42% (ACCION USA, 2008). Moreover, the Calvert Foundation reports that 53% of poor ACCION USA micro-entrepreneurs moved above the poverty line in 2004 as a result of receiving a loan, while their reliance on public assistance decreased by 61% (Berlin, 2005). In addition, clients created an average of 1.5 FTE jobs (Burrus, undated).[16] In comparison, an ILO study (2002c) found that indirect job creation induced by self-employment programmes is less than one additional job created per self-employed person.

Table 1: ACCION USA – impact

Intended impact	Evidence of intended impact
Micro-enterprise survival	• Clients are typically in business for around 4 years.
	• The survival rates of businesses owned by low-income individuals compare favourably with the rates of other small businesses.
	• In an impact study of 849 borrowers, the group realized a total increase of US$228,000 in monthly business profits and contributed a total increase of US$215,000 each month to their households after entering ACCION-affiliated programmes.
	• A sub-group of 312 clients in the same study received three loans or more and saw the cumulative net worth of their businesses grow by over US$1 million in total.
	• Many clients receive multiple business loans over several years (possibly due to expansion of business).

[16] Full-time equivalent

Intended impact	Evidence of intended impact
Micro-enterprise growth	• Clients who received two to four loans generally created about 1.5 FTE jobs.
	• 29% of the micro-enterprises employ at least one individual other than the owner.

Sources: Evers et. al., (2000); Burrus, (undated); ACCION USA, (2008); Edgcomb and Klein, (2005); Nelson, (2000)

4.1.2 Practices

Regarding impact, the institution offers different kinds of loan products and variable repayment terms (up to three years), all designed to meet different client needs and requirements. An example of micro-loans offered include solidarity group loans; loans of US$500 and US$10,000 for start-up businesses that have been operating for less than twelve months; first-time instalment term loans up to US$15,000; repeat instalment term loans up to US$50,000; business credit lines; contracts receivable or accounts receivable loans; and one- to three-month interest-only loans. In term of non-financial services, the institution offers introductory business training and an extensive range of referral services, including training in bookkeeping, financial statement preparation, marketing, business plan writing, and computer skills.

4.2 The Prince's Trust

The Prince's Trust was established in 1976 and operates throughout England. The Prince's Trust offers micro-loans and business start-up support to individuals who have been refused funding by other sources, and is the largest business start-up agency in the voluntary sector (non-profit) in England. During 2005-06, the institution supported 40,805 individuals, including 9,649 in business start-up (The Prince's Trust, 2008). The Prince's Trust targets the unemployed and other marginalized groups and during 2005-06, over 90% of clients fell under one of the target groups (The Prince's Trust, 2006).[17]

[17] Delivering services to targeted clients at a rate of over 80% is considered quite high, given the experience of a microfinance institution in Canada, which struggled greatly in their attempt to recruit clients in their target group. An excerpt from an impact assessment on Calmeadow's Metrofund in Toronto furthers this claim: "In its first year, the fund estimated that it received 1,800 telephone inquiries and held information sessions for approximately 550 people. Of those, 123 became borrowers. Metrofund has used these numbers to calculate what it calls its "closing success rate," i.e. the number of people to whom it actually made loans as a percentage of the total inquiries it received during a given time period. Technically, its closing success rate was a mere 7% between April 1994 and March 1995" (Frankiewicz, 2001, p. 15).

4.2.1 Impact

With respect to micro-enterprise survival, Table 2 shows that clients of The Prince's Trust average three years. Compare this to the small business national survival rate in England, where the move from unemployment to self-employment results in a one-year survival rate, and where the average survival rate for self-employment for all people is thirty-two months (Metcalf, 2000a). Qualitative studies have revealed similar results. Storey and Wyncarczyk (1989) describe case studies of forty small businesses in North-East London and report that 40% of new businesses had closed within three years of start-up. Regarding micro-enterprise growth, the 0.44 average additional job creation rate for The Prince's Trust clients is comparable to an ILO report (2002c), which found that indirect job creation induced by self-employment programmes is less than one additional job created per self-employed person.

Table 2: The Prince's Trust – impact

Intended impact	Evidence of intended impact
Micro-enterprise survival	• Survival rates of programme participants are high; the average being 3 years.
	• (Pre-tax) take-home pay of The Prince's Trust clients grew.
	• The average sales turnover of businesses grew, over a period of twenty-one months, from £610 (US$1,220) to £1,000 (US$2,000) per week.[18]
Micro-enterprise growth	• Average net job creation per surviving business was 0.44 FTE jobs per business.

Sources: Greene, (2005); The Prince's Trust, (2006); Bainton and Crowley, (2000); Bates and Cowling, (2001)

4.2.2 Practices

Regarding impact, the institution's practices relate to the loan model and to non-financial services. First, loan amounts are variable up to US$10,000, and the repayment term is variable up to three years. In addition, The Prince's Trust offers special test-marketing grants and expansion loans for successfully trading businesses. Under the loan application process, applicants present a business plan to a panel of volunteers from the local business community, who then critique and

[18] Sales turnover is defined as the total sales of a company over a stated period (Guardian, 2008). In this case, the period is twenty-one months. The exchange rate used is GBP1 = US$2.0. The date that the exchange rate was calculated was March 11, 2008.

discuss it.[19] Second, The Prince's Trust also offers practical support including business training; ongoing advice from a volunteer business mentor; a legal helpline; patent, copyright and trademark guidance; insurance; and strategic business memberships.

4.3 Bristol Enterprise Development Fund (BEDF)

BEDF was established in 1992 in the voluntary (non-profit) sector in Bristol, England, under a mandate to create new jobs through micro-loans to small and start-up businesses that were unable to attract funding from traditional sources. The goal of the programme is to help develop economically disadvantaged areas of the city. From 1992 to 2007, BEDF has provided £1 million (US$2 million) in microcredit to approximately 280 businesses in deprived areas. BEDF's target group is the unemployed and Metcalf (2000b) notes that most of the institution's clients are indeed unemployed.

4.3.1 Impact

To my knowledge, no quantitative information exists on the survival of BEDF micro-enterprises. However, related to micro-enterprise growth, since 1992, BEDF has helped to create over 900 jobs, which is an average of about three per business loan. Considering the institution provides loans to approximately eighteen micro-enterprises per year, the numbers suggest that loan recipients create more than one additional job per micro-enterprise.[20] This is better than figures stated by the ILO report (2002c), which found that indirect job creation induced by self-employment programmes is less than one additional job created per self-employed person.

4.3.2 Practices

Regarding impact, BEDF institutes practices related to the loan model and to non-financial services. First, loan amounts are variable up to US$25,000, repayment terms are variable and can stretch over three years, and BEDF requires clients to submit a detailed business plan. In addition, the loan product is structured so that grants of up to £2,000 (US$4,000) can be obtained and a capital repayment holiday of up to three months can be negotiated on a client-by-client basis. Further, all BEDF donors have the opportunity to chair the assessment panels reviewing new loan applications. Similarly to The Prince's Trust, the loan process at BEDF is

[19] There are roughly fifty area panels.

[20] This number is derived from the 280 total businesses helped since 1992.

such that potential applicants can test their business plan on the qualified professionals of the assessment panels, and receive sound advice. In addition, clients also receive mandatory business training and mentorship for the duration of the loan, and are provided with referrals for other business services.

4.4 First Step

First Step began in Ireland in 1990 as a programme seeking to create self-employment for its clients by offering micro-loans. Operations are located primarily in Dublin. Since 1993, First Step has assisted 822 projects and in 2005 had an outstanding loan balance of £3 million (US$6 million) (First Step, 2008). First Step targets individuals with a business idea, but who are unable to access funding from other sources. As such, First Step is seeing an increase in services delivered to minorities. Given that minorities face more difficult barriers in accessing funding to become self-employed (First Step, 2006), this suggests that the institution is reaching at least part of its target group.

4.4.1 Impact

Information on micro-enterprise survival is largely derived from anecdotal information from about twenty case studies of First Step clients (First Step, 2008). Among those cases, the average business survival rate is three years.[21] Compare this to a study by Duggan et al. (2000), which found that the majority of micro-enterprise businesses in Ireland closed during the second year. In addition, the case studies found that approximately one-third of clients had increased the number of employees since the beginning of operations. First Step assists an average of fifty-eight micro-enterprises a year; those businesses create an average of 176 jobs a year. The evidence suggests that the institution is helping clients to create more than one additional FTE job per micro-enterprise, which is greater than the findings of the ILO (2002c).

[21] The cases also included clients who had only started a business within a year. Obviously, these cases were not included in the count of businesses that survived.

Table 3: First Step – impact

Intended impact	Evidence of intended impact
Micro-enterprise survival	• Anecdotal evidence from selected case studies shows positive effects: expansion through a need for more office space, increased trade markets and partners, increased sales, the ability to independently raise financing, employing technological advances, media recognition and awards, etc.
Micro-enterprise growth	• To date has created in excess of 3,000 employment opportunities.

Source: First Step, (2008)

4.4.2 Practices

Regarding impact, First Step uses a number of tools related to the loan model and to non-financial services. First, the amount of the loan is variable up to US$38,500, and repayment terms are also variable, generally being up to three years. The institution also requires applicants to submit a business plan, and loan officers are available to help with the planning phases. Second, the institution places a great deal of emphasis on its mentor programme. The mentor provides advice to help clients identify areas for improvement, and offers guidance in implementing business plans. Mentors have the power to call meetings with the clients and request quarterly progress reports. The institution also provides networking opportunities through information briefings and seminars held nationally.

4.5 Discussion

The purpose of this section is to summarize the practices and tools that enabled the four self-employment programmes to favorably impact their clients, especially in their ability to create sustainable, growth-oriented self-employment. Table 4 provides a summary of tools, grouped by institution. This information will help to establish a set of benchmark areas of action which can be used to inform the tools of microcredit programmes in developing countries.

Table 4: Summary of good practices – high-income self-employment programmes

	Impact -> sustainable, growth-oriented self-employment
ACCION USA	• Loan model: diversified set of products, variable amount, variable repayment • Non-financial services: business training and referral service
The Prince's Trust	• Loan model: variable amount, variable repayment, grants, loan application process (input for client from advisory committee made up of neighbourhood professionals) • Non-financial services: business training, mentoring, and on-site business development services
Bristol Enterprise Development Fund	• Loan model: variable amount, variable repayment, grants, capital repayment holiday, loan application process (input for client from assessment panel), business plan • Non-financial services: business training, mentoring, and referral services
First Step	• Loan model: variable amount, variable repayment, loan application process (client offered help with application process), business plan • Non-financial services: mentoring, seminars, and networking opportunities

4.5.1 Successful impact

Practices that are important for successful impact can be placed into two groups: the loan model and non-financial services. Each of the institutions worked with similar tools regarding the loan model and in terms of non-financial services, each institution offered some variation of tools to help clients.

Common tools related to the loan model that are important include: a diversified set of loan products with variable loan amounts and variable repayment terms; grants; a capital repayment holiday; and a loan application process including a business plan, which strengthens micro-enterprise impact. When these tools are used, the loan model becomes favourable to micro-enterprise sustainability and growth. Developing different loan products and providing the client with variability in terms of loan amounts and repayment terms allows the loan to be tailored to the individual needs of the client's micro-enterprise. Since flexible loan products are offered by all four institutions, to a varying degree, this tool should be considered one of the most important for client success.

Two institutions offer clients grants, and one offers a capital repayment holiday. Grants and a capital repayment holiday are practical tools that increase the likelihood of client success. The former ensures that clients can test their markets and products, and the latter ensures that clients have time to build their micro-enterprise before making the first credit payment.

Two institutions wisely impose conditions on clients. Requiring clients to submit a business plan ensures that clients will be prepared to manage a micro-enterprise. Similarly, three institutions use the loan application process as a way to interact with and provide advice to the client. This counseling helps contribute to the success of micro-enterprises.

Non-financial services primarily focus on referrals and networking services for the client. Three of the institutions offer some form of a referral service that varies from helping develop core business skills to providing specialized consulting. Three institutions provide mentoring services for clients to provide strategic advice and to guide them through difficult business processes. Client training, a good way to teach practical business skills and expansion planning, is also used by three institutions.

4.5.2 Impact and a review of the good practice literature

Balkenhol (1998, p. 7) notes the importance of a given self-employment programme's operations and services, contending that:

> "The individual unemployed person's activity, its sustainability and viability is the centre of analysis at the micro level. Business survival depends on a host of factors, but the key hypothesis here focuses on the quality, scope and intensity of support provided by an intermediary matters. Put differently, it is assumed that the average unemployed person is not able to develop a business idea, plan, mobilize capital, obtain the required papers and struggle through the first three years without the guiding hand of a mentor."

Certain tools focused on by the selected self-employment programmes aim to combat many of the problems listed by Balkenhol. Among the principal documents published on the unemployment-microcredit-self-employment cycle, the loan model and the design of non-financial services figures prominently. Regarding the loans, when products are structured effectively, they work to strengthen the client's future credit position and, therefore, matter a great deal for long-term client sustainability and expansion (European Commission, 2003). Further, the good practice guide (ILO, 2002b) points to the importance of a range of loan products and to watch that changes to micro-enterprises do not warrant a change in loan product. Similarly, the good practice guide identifies the need for loan products to be flexible and adaptable to changing client needs, thus helping to ensure business sustainability and long-term growth. This sentiment is echoed by Bainton and Crowley (2000), who argue that the loan amount should be variable, since different projects require different start-up amounts and micro-enterprise survival is more likely with sufficient funds. Metcalf (2000b) also favours self-employment programmes offering higher level grants. That report asserts:

> "Markets with low capital entry costs are more likely to be saturated and therefore offering higher level grants may enable entry to less saturated markets (…) Providing the grant as a lump sum rather than through several payments has a similar effect of encouraging entry to more-highly capitalised businesses and raising survival rates" (Aucouturier and Daniel, (1993); Meager, (1993); as cited by Metcalf, (2000b), p. 115).

In regards to the conditions of the loan, the European Commission report (2003) stresses that lending techniques and decisions on loan maturity should be made on a case-by-case basis, because financing needs depend on the business sector and the idea. The good practice guide (ILO, 2002b) notes the importance of repayment as a mechanism to catch problem clients' early. This notion may seem obvious; however, the guide suggests that many self-employment programmes should use repayment as a tool to learn more about clients' needs and, consequently, restructure repayment terms to ensure a greater chance of client sustainability and growth. Through her research, Metcalf (2000b) makes the important observation that clients of self-employment programmes find it difficult to start repaying loans immediately. Thus, the potential benefit of a capital repayment holiday: "(…) a payment holiday at the beginning of the loan period for start-up businesses would alleviate the cash flow difficulties of starting to repay the loan prior to the business having got off the ground" (p. 107), which betters the chance for enterprise survival.

In addition, Benson and Metcalf (2000) emphasize the importance of the loan application process, arguing for a simplified and user-friendly approach, since clients often possess little banking experience and can be intimidated by the process. A report by the European Commission (2003, p. 33) also stresses the importance of the loan application process, stating, "The assessment of an enterprise's potential for profitability by the finance provider is a key factor of any microcredit activity and its sustainability." Bainton and Crowley (2000) further this idea by calling attention to the need to strengthen the business plan segment of the loan application process. The study notes that a strong client business plan is a valuable way to increase the probability of business sustainability and growth.

The topic of non-financial services is the most prevalent aspect of self-employment programmes, and is addressed in literature issued by public institutions, private institutions, international organizations and academics. The findings are generally as diverse as the sources but, simply put, this kind of support is key for micro-enterprise sustainability and growth (Benson and Metcalf, (2000); European Commission, (2003); Metcalf, (2000c); ILO, (2002a); ILO, (2002b); McKernan, (2002); Balkenhol, (1998)). The debate on support ranges from the timing, length and design, and delivery of support programmes to the comprehensiveness of services offered. The report by the European Commission (2003) claims that when training is coordinated with access to finance, and is used to support business plan drafting and offers mentoring, the chance of micro-enterprise sustainability and growth increases. The report also signals a need for a clear separation of functions and accounts between financial and non-financial services. Further, Greene (2005) finds that having had mentoring support from a Prince's Trust business advisor has a positive influence on growth. McKernan (2002, p. 97) adds, "By increasing the stock of human capital, microcredit programmes may directly affect profits by providing additional inputs to produce the self-employment output or indirectly by increasing the productivity of other inputs." In other words, if the training component of a self-employment programme improves human capital, spillover benefits such as enterprise sustainability and growth can be expected. The ILO (2002a) argues that non-financial services are crucial, since without them the potential of microfinance would not be properly understood by the client. The good practice guide (ILO, 2002b) notes that training needs to be less curriculum-based and more practical, with discussion included on actual experiences as well as demonstrations and professional development opportunities. Other issues raised by the good practice guide pertain to the need to train clients in business management and the need for self-employment programmes to continuously refine their support services based on client feedback. Lastly, Metcalf (2000b, p. 187) recommends that support be inclusive, detailed and systematically organized:

> "Assistance needs to be offered in modules to be drawn on as appropriate, with guidance given to identify what assistance is appropriate. The modules should ensure that the full range of assistance is available, offering a comprehensive, tailored package, and each person should have an individual advisor/mentor to signpost them to appropriate modules as necessary."

Metcalf (2000b) concludes that particular attention should be given to tools that deal with the loan model and non-financial services, as they greatly impact micro-enterprise sustainability and growth potential.

Using the analysis of the selected institutions examined herein, and observations that are continuously supported by the literature, a list of effective tools can be created based on two benchmark areas of action. Table 5 provides a summary of the findings.

Table 5: Benchmark areas of action and main features

Benchmark areas of action	Main features
Loan model	• Different products, variable principal amounts and variable repayment terms • Grants • Capital repayment holiday • Loan application process and business plan
Non-financial services	• Referral services • Mentoring services • Training programmes

To conclude, many of the self-employment programme tools discussed in this chapter are consistent with information in the good practice literature, and a benchmark set of areas of action to be considered for any microcredit programme include:

- Loan model
- Non-financial services

The next two chapters examine microcredit programmes in developing countries, giving particular attention to one benchmark area of action listed in Table 5. In addition, this question is addressed: Do developing country programmes operate within a framework that is similar to the benchmark, or to what extent are tools different?

5 Non-financial services in microcredit programmes

The preceding chapter established two benchmark areas of action – loan model and non-financial services – that are relevant for micro-enterprise sustainability and growth. However, given space constraints and in an effort to provide a thorough analysis, I have chosen to focus on just one area: non-financial services. Thus, for the remainder of this capstone, I analyze non-financial services in developing countries with the aim of determining how such services can have the largest impact on micro-enterprise sustainability and growth.

5.1 An introduction to business development services

Non-financial services for clients of microcredit institutions have been available since the 1970s, and usually consisted of basic training in credit management, including the development of a business plan (Sievers and Vandenberg, 2007). However, in the 1990s the idea of non-financial services transformed into a conceptualized framework of business development services (BDS), and became referred to as such in the literature. BDS aim to achieve competitiveness through higher productivity, better product design and quality, improved service delivery, and/or enhanced market access (Sievers and Vandenberg, 2007). The main types of BDS are: marketing assistance (for inputs and output); technology and product development; training and technical assistance; infrastructure; and policy (Caniëls et al., (2003); Miehlbradt, (2002); McVay and Miehlbradt, (2008)).

According to Ledgerwood (1999), determining which types of BDS to offer depends on the microcredit programme's objectives, the demands of the target market, the existence of other service providers, and an accurate estimate of the costs and feasibility of delivering additional services. Further, it is equally important to have an understanding of the many systems (cultural, legal, political, macroeconomic, local, and marketplace) within which micro-enterprises operate (Ledgerwood, 1999).

BDS are most commonly provided by: non-governmental organizations that run microcredit programmes; training institutes; networks; universities; private firms (training companies, bilateral aid agency subcontractor); producer groups (or chambers of commerce); and informal networks that provide production training, like apprenticeships (Ledgerwood, 1999).

Before delving into BDS in more detail, a note must be made regarding the quality of staffing in developing country microcredit programmes. Evidence from the literature indicates that managers operate sub-optimally, often a result of limited education and work experience (Barton, (1997); Esim, (2001); Nelson, (1997)). Suzuki (2002); Nelson (1997); and Bennell (1998) worry about the quality of staff at private training institutions, while Ledgerwood (1999); Sievers and Vandenberg (2004); and Fisher and Sriram (2002) address weak managerial capacity. Further, McVay and Miehlbradt (2000) claim that "Staff may become distracted with too many activities, and skills may be diluted if the same staff members are required to be loan officers and trainers" (p. 37); this scenario signals training is carried out by non-specialized or under-qualified staff. Finally, and most importantly, a report by the Department for International Development (DFID) in the United Kingdom remarks that BDS can only be successful with the appropriate staff, not "(...) generalist and volunteer community development workers with limited technical and managerial skills to impart and limited knowledge of local markets and market dynamics" (Abdulla, et al. p. 28).

Suffice to say that a limited supply of experts, highly qualified mangers and trainers exist in many developing countries, and this acts as a major obstacle to the development and improvement of BDS and its delivery. This is a problem overshadowing this analysis; however, I make the assumption that for the recommendations in this capstone, appropriately skilled and qualified staff can be acquired.

5.2 BDS market development paradigm and good practices

A conceptual framework for delivering BDS has emerged since the 1990s, and the approach centres on developing commercial markets for BDS. Under this approach, donors accustomed to providing direct service to micro-enterprise owners are instead now expected to play an indirect facilitating role by fostering the development of private BDS providers that will offer services to micro-enterprise owners at commercial rates (Caniëls et al. (2003); McVay and Miehlbradt (2000); Melin and Sander (2006)).

The literature cites several key principles of good practice that facilitate the transition to market-driven BDS (ILO, 1998), namely that BDS interventions must be:

- Demand-driven: Services must respond to client demand rather than be designed according to what donors *perceive* the needs and demands of micro-enterprise owners to be. Demand-driven services connote a clearly identified need for the service and thus micro-enterprise owners' willingness and ability to pay for such a service. And the willingness to pay for a service indicates the demand for the service (McVay and Miehlbradt, 2000).
- Relevant: BDS must address entrepreneurs' *immediate* needs and be tailored to those needs.
- Participatory: To ensure the relevance of BDS products, suppliers must become familiar with their clientele and base their analysis of needs and subsequent service design on client feedback and on the realities of their clients businesses.
- Cost recoverable: Programmes should charge fees for their services, at a fee equal to or above marginal cost.[22]

However, despite the adoption of a new BDS paradigm and widespread knowledge of good practices, the literature also makes quite clear that BDS are rarely financially sustainable and cost recovery is rarely full (Ledgerwood, 1999 and Nelson, 1997). This concern raises the question of subsidising BDS. A report on BDS by the Swiss Agency for Development and Cooperation (SDC, 2000) argues that while subsidies are needed, they should be given explicit structure. When considering subsidies, the report notes that:

> "Subsidy for direct delivery of services, either by artificially reducing the price that consumers have to pay for a service, or by artificially reducing service providers' cost of delivery, are highly invasive types of intervention. That is to say these types of intervention affect the transaction between supplier and consumer, influencing the motivations, dynamics and price signals that lie at the heart of a functioning market. In doing so they have the potential to distort:

[22] "Although the practice of charging entrepreneurs fees for services is becoming more common, pricing policies linked to costs are uncommon, even among programs with notable experience and market exposure. After eight years of operation, the K-MAP program still sets prices based on estimates of what clients will find reasonable (Wilson and Mwai, 1996)...Although as demand for services grows, fees and income will rise, the extent to which clients can pay the full cost of their training is questionable" (Nelson, 1997, p. 39, 41).

Consumers' willingness to pay: e.g. price expectations are lowered below the market norm.

Providers' ability to develop an offer: e.g. fee or margin expectations are raised if delivery is subsidised; unsubsidised service providers' 'normal' service price becomes unattractive to consumers in the face of subsidised competition" (SDC, 2000, p. 32).

Subsides can therefore be viewed as necessary when the requirement is to stimulate and develop a market for BDS, but caution should be paid to the subsidy's effect on price distortions and the crowding out of private suppliers of BDS. Another decision for donors and microcredit programme managers is how much of a subsidy should be given. If the available money is fixed from a donor, the institution has to choose where to spend that money (on loans or in training); this could create a trade-off between spending more on training and making fewer loans. Nevertheless, for the purposes of this work, I assume that donors are willing to provide targeted subsidies for initiating specific BDS and to offset other operating costs, since programmes are rarely fully cost-recoverable.

A recent article by Sievers and Vandenberg (2007) outlines three types of linkages that microcredit programmes can use for delivering BDS: unified, parallel, and partner. Under the unified approach, the same staff of a microcredit programme delivers both types of services (credit and BDS). In this case, the BDS tends to be in the form of basic training in credit management; it is also compulsory, and the cost is usually embedded in a higher interest rate on the loan or through an explicit fee usually paid with the credit instalment. In this strategy, there is a danger of cross-subsidizing low-demand training services with more profitable credit services, thus compromising institutional profitability (Ledgerwood, 1999, and McVay and Miehlbradt, 2000).

In the parallel approach, an institution has two different organizational units, with separate accounting and staff, delivering two types of services (credit or BDS). Usually with this strategy, the BDS are paid for by the client and payment is not linked to the credit (i.e., higher interest rate). Further, the client is free to choose which BDS services to buy. However, with this design it must be noted that microcredit programmes can be hesitant to establish BDS because of the possible cost and additional resource implications.

The partner approach consists of two distinct institutions operating in the same area that form a partnership by referring clients to each other and by undertaking joint projects.

A possible benefit of the unified and parallel approaches is that a diversification of products (credit and BDS) can lead to a comparative advantage in the microcredit sector leading to repeat business and to an increasing client base (Sievers and Vandenberg, 2007). Microcredit programmes might further benefit by delivering BDS if the result to business owners is increased enterprise success, which would reduce the risk of loan default and improve loan repayment (Sievers and Vandenberg, 2007 and Karlan and Valdivia, 2006). However, a unified and parallel approach also differ; unified is often perceived as a minimalist strategy that performs better in terms of sustainability and cost-efficiency, while parallel is often perceived as an integrated strategy that can be more effective and have more impact, although costing more and requiring subsidies (Kantor, 2000).

Following the methodology of this study, the microcredit programme case studies are all non-profit programmes, and it is therefore necessary to focus on how non-profit programmes can best offer BDS in line with the guiding principles of the market development paradigm. Barton (1997, p. 28) nicely summarizes the challenge for non-profit BDS providers:

> "On one hand, to manage various types of business development services on a sustainable basis, [non-governmental organizations] need to adopt commercial practices and approaches. They need to recruit specialized staff with the necessary technical and business skills and experience. They need to focus on clients that are better able to pay for services. They need to be flexible and willing to respond to client demands. And they may need to limit their activities to specialized service areas or market niches, rather than offering general assistance or advisory services."

The prevailing thought on BDS stresses the idea of a market where demand for services by micro-enterprise owners is met by a competitive, well-functioning supply of quality service providers. Considering this notion of BDS and understanding its guiding principles, the next section examines BDS under the lens of micro-enterprise sustainability and growth.

5.3 BDS and micro-enterprise sustainability and growth

To design BDS that are only focused on micro-enterprise sustainability and growth requires an understanding of current conditions in many developing countries. In the informal sector where the overwhelming majority of micro-enterprises operate, the situation is one of increasingly saturated (characterized by low barriers to entry), highly competitive, low-growth, low-income enterprises and markets (Barton, (1997); Nelson, (1997); de Goys and Dyce, (2001)). Therefore, the goal is to assist selected micro-enterprises in innovating business operations through technical and cognitive channels.

Given the exceptionally challenging environment in which micro-enterprises operate, the impact of BDS on sustainability and growth potential seems significant, especially when measured by increases in income, profits, or sales (Nelson, (1997); Miehlbradt, (2002); Harper, (undated); Sievers and Vandenberg, (2007); Abdulla et al., (2000); Barta and Mahmood, (2003); Karlan and Valdivia, (2006)). For example, Sievers and Vandenberg (2007) cite one paper claiming to be the first study to measure the non-credit aspects of three micro-finance programmes in Bangladesh; the study finds that BDS made a substantial positive contribution to the profits of microcredit users. The increase in enterprise profits from non-credit programme services ranged from 84% to 173% over the three programmes. This translates into an increase in monthly profit of about US$55, which is significant given the monthly household income in Bangladesh at the time of the study was US$73. The authors note that the services provided in the study tended to be designed to address market failures, were specific, and focused more on skills upgrading and market access, instead of basic credit management (Sievers and Vandenberg, 2007).

Evidence also seems to suggest that credit alone will not result in micro-enterprise growth. Chen and Sebstad (1996) reviewed a report by the United States Agency for International Development (USAID) that analyzed thirty-two research and evaluation studies of microcredit programmes, and concluded that few enterprises experience sustained growth, while a majority grow a little and then even out. Lastly, Hulme and Mosley (1996) find that credit did not stimulate growth in terms of an increase in technical ability, output, or employment. The literature review conducted for this study indicates that BDS are required if micro-enterprise owners are going to achieve sustainability and growth potential.

If BDS can be considered a worthwhile investment to solving problems of limited micro-enterprise sustainability and growth, it is necessary to examine specific constraints. First, on the supply side of the BDS market, providers of BDS suffer from the following problems:

- Providers are not skilled in business management and marketing, resulting in micro-enterprises that lack information about available services and their benefits;
- Providers offer a limited range of services;

- Providers lack market information about the service characteristics that micro-enterprises desire, and therefore offer inappropriate service products;
- Risk-averse micro-enterprises that interact with suppliers that are unable to convey the quality of their products result in micro-enterprises reluctance to try services (McVay and Miehlbradt, 2000).[23]

Simply put, when microcredit programmes offer inappropriately structured BDS and inadequate service delivery, micro-enterprises will not benefit. Therefore, this constraint focuses on weak providers of BDS.

A second set of constraints directly face micro-enterprise owners. These problems include:

- Marketing (identifying new sources of demand, finding customers, developing business linkages, and adapting products and services to meet buyer requirements);
- Input supply, including procuring access to raw materials, supplies, and equipment;
- Transportation/infrastructure;
- Legal and regulatory compliance (Barton, 1997).

Without solutions to these problems, the majority of micro-enterprises' will continue to struggle to achieve sustainability and are likely to experience little growth. Therefore, this constraint focuses on a weak operating environment for micro-enterprises. In the literature, marketing problems and access to markets are often cited as the most pressing problems to growth (Barton, (1997); Fisher and Sriram, (2002); ILO, (undated); McVay and Miehlbradt, (2000); Nelson, (1997); Esim, (2001)).

A third set of constraints are cited by Nelson (1997), who provides several barriers that are likely to inhibit sustainability and growth. The author lists:

> "A low incidence of innovation; passive attitudes about marketing and, as a result, weak to nonexistent strategies (more than half of the businesses did not

[23] It is important to note that findings from the literature indicate the greatest effect on enterprise sustainability and growth is often for entrepreneurs who initially believe they will not benefit from BDS. "(...) if the services provided are of unclear value to the more inexperienced entrepreneurs, this approach may create an adverse selection effect: those for whom impact may be highest will be least likely to pay the fee and join the program" (Karlan and Valdivia, 2008, p. 3).

> even have a sign outside their shops to identify themselves); a lower product quality than could be attained using the tools owned by the business; poor tool maintenance; poorly kept or non-existent business records (the most common instrument is the sales receipt, used by just over half of the businesses); and errors in product costing (85 percent of respondents ignored at least one important factor in costing their products, leading to pricing strategies that neither accurately reflect costs nor respond to customers [respondents vary their prices based on their perception of what individual customers can pay])" (p. 10).

The above concerns signal a lack of skills, which could limit the profit maximizing behaviour of the enterprise owner, influence a micro-enterprise owner's technology uptake, or hamper efforts to facilitate product development through improved design or technical skills (Ledgerwood, (1999); McVay and Miehlbradt, (2000); Nelson, (1997)). Fisher and Sriram (2002) similarly remark that clients of microcredit programmes sometimes do not become productive small enterprises because to be sustainable and grow beyond a certain size, weak managerial capacity must be strengthened. Esim (2001) echoes these sentiments by pointing to micro-enterprise owners' poor performance of tasks, such as planning, coordination of activities and progress monitoring. Barton (1997) reaffirms that sustainability and growth is inhibited by human resource development and management problems. Nelson (1997, p. 23) accordingly adds that "Training in production skills and business management in selected subsectors will improve product quality, currently the most important factor inhibiting sales performance in the informal sector." Therefore, poor skills weaken the ability to overcome various practical barriers that restrain micro-enterprise sustainability and growth. As a result, this constraint focuses on weak human capacity and skills.

Both the supply side (BDS providers) and/or the demand side (micro-enterprise owners) constraints are important to recognize and consider, if any BDS intervention is to be effective.

To do this, one must identify strategies that confront these constraints and that have a positive influence on micro-enterprise sustainability and growth; however, selecting clients with growth potential is the first step to delivering effective BDS. A strategy paper by the ILO (de Goys and Dyce, 2001 p. 12) has identified a number of ways for a microcredit programme to target sustainable micro-enterprises with growth potential, such as seeking "(...) enterprises which have grown during the last few years; enterprises belonging to dynamic and growing sectors or lines of business; enterprises presenting a business plan, which involves hiring more than five people; and enterprises with capital to invest."

When seeking to realize business sustainability and growth, there is broad agreement that BDS in the fashion of basic training in credit management is not desirable (Suzuki, (2002); Nelson, (1997); Ledgerwood, (1999); Barta and Mahmood, (2003)).[24] Simply put, this type of training tends to focus on ensuring a microcredit programme's portfolio quality by teaching borrowers proper loan management and the most basic business transactions (Barton, 1997); while useful in achieving financial sustainability for the microcredit programme, this type of training should not be expected to increase enterprise sustainability or growth. A similar argument can be used against generic vocational training; this type of intervention endows someone with the technical skills (for example in tailoring or woodworking) to become self-employed, but it does little to train micro-enterprises to think about sustainability and growth potential.

BDS interventions aimed at sustainability and growth are often tailored, subsector-specific, focused programmes (Barta and Mahmood, 2003 and Miehlbradt, 2002).[25] When programmes are guided by this broad approach, Nelson (1997) concludes from her research, positive outcomes arise such as new product development, access to new markets, and significant increases in client profits. More specifically, practices are often aimed at improving the quality of, and access to, inputs; skills upgrading and value addition; technical training to design and produce higher quality products and new products; and assistance for micro-enterprises to access new, higher-value, higher-growth market opportunities (Barton, (1997); de Goys and Dyce, (2001); Nelson, (1997)). Barton (p. 33) importantly adds that such practices "(...) have to be offered by specialized BDS providers familiar with the specific problems of particular industries, sectors, and product lines." In a comprehensive review of two training programmes in Kenya,

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[24] A DFID report (Abdulla, et al., 2000, p. 30) describes findings which highlight the weaknesses of basic business training: "The Working Group on Business Development Services set up for the Donor Committee on Small Enterprise Development (funded by a number of bilateral and multilateral agencies) (...) identifies the main problems with early training interventions as having been: too generalised relying on relatively standardised material; too supply-driven with impractical subject matter far removed from SME realities; delivered in an inappropriate top-down teaching style; delivered by ill-qualified people; insufficiently aware of cost control; insufficiently aware of the need to encourage trainee commitment to learning; insufficiently concerned with follow-up *in situ*."

[25] A subsector is defined as the full array of businesses involved in making and selling a product or group of products, from initial input suppliers to final retailers. A subsector includes all firms engaged in the supply of raw materials, production, and distribution of the product. Subsector analysis describes the economic system of the businesses related to the final product (Haggeblade and Gamser (1991), and Rhyne and Holt (1994)), as noted by (Ledgerwood, 1999).

Nelson (1997, p. 38) finds that a holistic approach was highly successful: a "(...) combination of interventions (training, product development, and marketing) and its consistent involvement with clients after training have led to measurable benefits (new products, income gains, and new markets) that increase its training's relevance."

It is clear from this section that interventions aiming to realize enterprise sustainability and growth need to help move micro-enterprise owners out of low-price products and services to higher quality products and services (Esim, 2001). Interventions also need to be focused, specific and acutely cognizant of the realities of their clients businesses. Table 6 provides a summary of the most important information uncovered by this literature review.

Table 6: Considerations for micro-enterprise growth in developing countries

BDS good practices	**Constraints to growth**	**Strategies for growth**
• Demand led • relevant • Participatory • Cost-recoverable	• Weak providers of BDS • Weak operating environment for micro-enterprises • Weak human capacity and skills	• Tailored, focused and specific interventions administered by specialized staff • Skills upgrading in: production process, product design/development; and business management • Accessing markets for inputs and output

Fostering BDS to increase micro-enterprise sustainability and growth potential requires interventions that move away from traditional vocational training and from basic training in credit management towards strategies that provide practical knowledge and that analyze markets and subsectors to achieve results. This way, constraints and opportunities to achieving sustainability and growth can be determined, and interventions can be designed in an according manner.

The next chapter uses these strategies and tools in an effort to analyze the BDS of selected case studies.

6 Microcredit programmes in developing countries

This chapter briefly examines four selected microcredit programmes – Alexandria Business Association (ABA), in Egypt; Al-Amana Association and Zakoura Foundation, both in Morocco; and the Bangladesh Rural Advancement Committee (BRAC), in Bangladesh – focusing particularly on their BDS. These microcredit institutions were chosen because they focus on enterprise growth and they operate in the non-profit sector of microcredit. It is important to also note that each programme is in the same region of the world, except for BRAC. I chose to include BRAC because it is one of the largest non-governmental organizations in the world, and is often studied due to its innovative approaches to poverty alleviation. However, since the aim is to establish broad strategies for delivering BDS, the generalization of results could be accepted. Yet, it is also important to note that information generated by microcredit programmes in other regions of the world will likely differ.

In any case, the microcredit programmes noted here are relevant examples of successful and unsuccessful programmes, since each operates within fundamental areas of action that are similar to the findings in chapter five. For each institution, I first present a basic description of its mandate, followed by the BDS strategies presently in place. Such information allows for a critique of the strategies and a comparison to the literature review, including an analysis of found consistencies and gaps.

6.1 Alexandria Business Association

ABA was established in Egypt in 1989 to serve micro-enterprises in Alexandria and other Egyptian provinces that are unable to access credit from the formal banking system. The objectives of the programme include employment creation, income generation, and support for micro-enterprise expansion. At the end of 2001, the institution had an outstanding loan balance of EGP25 million (US$4.5 million), and as of March 2007, had extended over 622,000 loans.[26]

[26] The exchange rate used is EGP1 = US$0.18. The date that the exchange rate was calculated was March 11, 2008.

Further, as of March 2007, the institution had created 59,580 jobs. The average loan size of an ABA loan at the end of 2001 was EGP2,800 (US$504).[27]

The ABA, in partnership with USAID, established the Alexandria Small Business Center (ASBC). This is a technical support facility that focuses on the non-financial needs of micro-enterprise owner's. The BDS of the institution fall under a parallel approach: Credit and BDS are separate organizational units, with separate staff. The objectives of the ASBC include skills upgrading and enhancing access to markets. Four types of services are offered, as described on the institution's website:

- Training: business training in taxation, licensing, social security, bookkeeping, and marketing; technical training in woodworking, garment making and other activities.
- Marketing: sourcing retail outlets for client products, displaying products in the ASBC's showroom, organizing exhibitions, and obtaining supply contracts on behalf of clients.
- Library: maintaining a library of catalogues allowing clients to be aware of new fashions and production techniques.
- Technical assistance: cooperating with international organizations such as USAID, and GTZ (German Technical Corporation) for the sourcing of volunteer experts from various sectors to provide technical assistance to clients.

Two things are important to note. First, for any of the services offered, the client must pay a fee. Second, new clients are informed of the institution's BDS by branch managers during an initial briefing session.

6.2 Al-Amana Association

Al-Amana Association began operations in Morocco in 1997 and offers credit and non-financial services to micro-entrepreneurs who do not have access to traditional financial systems. The programme operates throughout Morocco and to date has served more than 160,000 borrowers (Al-Amana Association, 2008). At the end of 2004, the institution had an outstanding

[27] Information for section 6.1 is drawn from ABA (2008).

loan balance of MAD407.3 million (US$52.9 million).[28] The average loan size at Al-Amana Association is US$180 for a group loan and US$300 for an individual loan.[29]

The Al-Amana Association has designed its BDS using both a unified and partner approach. The institution's unified design includes basic training in credit and business management that uses short videos as the main tool for instruction. The training is delivered by loan officers. The videos are aimed at retailers (the majority of Al-Amana clients) and focus on marketing, such as how to improve the presentation of their products and how to learn from customers in order to better market their products. As well, the institution offers a programme that aims to facilitate clients' access to new markets. Clients pay a small fee to receive any of the trainings.

Through the partner approach, Al-Amana offers a technical assistance programme created and funded by the Government of Morocco. The "Moukawalati" programme concentrates on people with vocational qualifications and is designed to ensure business success. This is accomplished primarily by offering mentoring and guidance, as clients can receive various forms of assistance for up to twelve months after their businesses have been set up. As part of the programme, clients receive diagnoses to assess the strengths and weaknesses of their micro-enterprises.

6.3 Zakoura Foundation

Zakoura Foundation was created in Morocco in 1995 with the mission to use microcredit to fight poverty. The institution finances micro-enterprises with loans and offers support and training to help entrepreneurs develop income-generating activities. Zakoura Foundation operates in almost every region of Morocco and by 2006 had served almost 160,000 clients. In 2000, the institution had an outstanding loan balance of MAD25 million (US$3.3 million), and the average loan size was US$100 for a group loan and US$170 for an individual loan.[30]

Zakoura Foundation offers modules of management training and is also a partner for delivering the government sponsored "Moukawalati" programme. Thus, the institution's BDS feature both a unified and partner approach. Regarding the training, it is primarily focused on the sales and income of clients. Examples of skills taught include how to keep a general ledger and

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[28] The exchange rate used is MAD1 = US$0.13. The date that the exchange rate was calculated was March 11, 2008.

[29] Information for section 6.2 is drawn from Al-Amana Association (2008).

[30] Information for section 6.3 is drawn from Zakoura Foundation (2008).

how to improve sales through marketing. The training sessions are thirty minutes in length and take place as part of weekly repayment meetings. Loan officers deliver the training and clients pay a fee for the service. Training modules cover the following themes: determining sales prices; cost pricing; competitors' pricing; profit margins; market study; sales methods; deciding on products to be marketed; customers' needs and purchasing power; importance of the marketplace; and importance of savings.

6.4 Bangladesh Rural Advancement Committee (BRAC)

BRAC is one of the largest and most comprehensive poverty alleviating agencies' in the world. Its initiatives range in a variety of different areas, including development and support programmes and for-profit enterprises and other commercial activities. The institution's total outreach is 110 million people and its enterprise development programmes have created more than 8 million jobs (BRAC, 2009). BRAC's outstanding loan balance is US$660 million and its average loan size is US$245 (BRAC, 2009).

BRAC offers sector-specific skills upgrading and access to inputs, using a parallel approach. Through private service providers (who charge a fee), staff offer training in subsectors such as poultry, fishery, livestock, sericulture, agriculture, and agro forestry. More specifically, for each of the subsectors BRAC designed an integrated set of services for all actors in the supply-chain. Depending on the subsector, services include training in production/processing techniques, improving technologies, supplying technical assistance and inputs, monitoring and guidance as needed, and marketing of final products.

The objective of the analysis is to uncover which practices of the case study institutions go against the summary findings provided in Table 6. The following chapter then aims to propose policy alternatives to correct these divergences.

6.5 Analysis

A comparison of the findings from the microcredit programmes with the benchmark non-financial services reveals many consistencies, including training, mentoring and networking/referral/partner services. It is clear from the developing country case studies that each institution incorporates these aspects in different practical forms.

The first case study institution has BDS in place that follows many of the same prescriptions for enterprise sustainability and growth. The ASBC focuses its BDS on marketing assistance, training for skills upgrading through specific courses, and making mentors available to provide technical assistance. Focusing on each of these areas is consistent with tools that are going to strengthen enterprise sustainability and growth. However, divergences are also present: Minimal formal training exists for new and existing product development or for improving production processes. Further, Dichter (1997, p. 23) uncovered from his impact study that the clients were not benefiting from at least one form of the marketing assistance:

> "On closer examination the marketing and showroom operation do not seem to be set up to promote enterprise independence and self-reliance. It appears that much of the sales, marketing, advertising, and accounting functions related to showroom products are undertaken by the ASBC staff. The client is told what to make, produces the goods, delivers them, and receives payment from ASBC."

This citation raises concerns that the marketing assistance is not helping clients to access new sustainable marketing channels and that clients are not learning the necessary functions to run a successful marketing operation. Although this institution is concentrating interventions on appropriate constraints (a weak operating environment and weak human capacity and skills), a lack or poor design of some practices are limiting the potential impact of the BDS on enterprise sustainability and growth.

Al-Amana, the second case study institution, offers a unified approach to training. Although it diverges from the typical unified approach in that training is neither compulsory nor focused on simple loan management, it suffers from one major problem: Loan officers with the aid of generic videos deliver the training. This is a key indication that the training is too basic for helping to address management problems, production/processing and product quality problems, and the relatively complex issues of access to markets. Further, Sievers and Vandenberg (2004) reveal that some of Al-Amana's training practices are problematic, such as grouping men and women, as well as clients at completely different stages of business development, in the same session, and sharing resources and facilities with the institution's credit unit:

> "(…) it proved difficult to produce new video materials due to the methodological difficulties for some teaching areas...The piggy-backing on the credit activities was also problematic, as it drained non-staff resources from Al-Amana (computers, facilities etc.)…Focus group discussions with clients after training showed that different client groups expected to be treated differently

> and those women micro-entrepreneurs were feeling uncomfortable being in the same training sessions with men" (p. 15).

Although the institution offers marketing assistance, and in partnership with the "Moukawalati" programme, also offers clients access to mentoring, Al-Amana fails to offer any formal training for improving managerial capacity, production processes or product development. Furthermore, some loan officers did not have the necessary skills or commitment to promote training, even though an incentive scheme was set up. "Al-Amana realized that it had to invest more in the training of loan officers that were successfully marketing the training and to hire a senior staff member specialized in marketing training activities" (Sievers and Vandenberg, 2004, p. 15). This institution's offer of BDS confronts appropriate constraints to enterprise sustainability and growth (a weak operating environment and weak human capacity and skills), but service delivery diverges from what was uncovered as good practice in the literature.

The Zakoura Foundation, the third case study institution, offers a variety of training modules through a unified approach. The modules are primarily focused on improving business management skills and on understanding market dynamics; training courses are aimed at appropriate constraints to micro-enterprise sustainability and growth (a weak operating environment and weak human capacity and skills):

> "(…) the management methods adopted by clients would appear to be better adapted to the situation (…) thanks to the advice and training provided by the programme (…) The programme may have enabled its clients to achieve economies of scale (…) or even adopt less costly modes of production" (Mourji, 2000, p. 53, 55).

However, the drawback is once again the fact that loan officers are responsible for the training. Therefore, the concern is whether the content is adequately in-depth and whether lessons are delivered in a professional and comprehensible way. Lastly, the institution offers no opportunities to improve production processes or product development.

BRAC, the final case study institution, takes a parallel approach. Its training is intended to address weak markets and skills in a holistic fashion, by focusing on all actors in a subsector. This targeted intervention focuses on specific areas of weak human capacity and skills, and a weak operating environment; the exact support received, however, depends on where the client fits into the supply-chain and on the number of opportunities within the supply-chain that the client is willing and able to take advantage of. This institution's BDS help spark income-generating opportunities along a supply-chain, but more importantly it also equips micro-enterprise owners with a real chance to sustain and grow their business by providing a comprehensive set of services geared at skills upgrading, product development and market access. However, BRAC does not offer any type of training course on improving managerial capabilities.

The following table summarizes the information gleaned from the case studies.

Table 7: Summary of programme characteristics – developing country microcredit programmes

Alexandria Business Association	Al-Amana Association	Zakoura Foundation	Bangladesh Rural Advancement Committee
Constraints addressed			
• Weak operating environment (intervention: marketing assistance) • Weak human capacity and skills (intervention: specific training and mentoring)	• Weak operating environment (intervention: marketing assistance) • Weak human capacity and skills (intervention: mentoring)	• Weak operating environment (intervention: marketing assistance) • Weak human capacity and skills (intervention: specific training and mentoring)	• Weak operating environment (intervention: marketing assistance) • Weak human capacity and skills (intervention: specific training)
Problematic strategies			
• Poor service delivery (client not building lasting skills) • Minimal assistance in production processes/ product development	• Poor service delivery (training by loan officers; use of generic videos; environment not conducive to learning; promotion difficulties) • No business management training • No assistance in production processes/product development	• Poor service delivery (training by loan officers) • No assistance in production processes/product development	• No business management training

A breakdown of the case study institutions reveals that each has BDS tailored to address some constraint related to marketing or access to markets. Focusing on this area is a convergence with the findings from the literature. This leads to a first conclusion that programmes are successfully focusing on access to markets. However, for three of the four institutions either loan officers deliver the training or service delivery is problematic for another reason. This leads to a second conclusion: If enterprise sustainability and growth are the goals, BDS must be delivered by specialized staff through methods that truly benefit the client, and be designed according to the good practices listed in chapter five. Examining other convergences from the literature show that all of the institutions offer skills upgrading (through some form of training or mentoring), appropriately addressing the weak skills constraint. However, each does not offer either formal management training or assistance with production processes and product development. This leads to a third conclusion: Skills taught to enhance business management and to improve physical aspects, such as products and production, are key for any intervention aimed at realizing enterprise sustainability and growth.

In sum, comparing the findings from the literature with the case studies reveals a final conclusion. While the case studies indeed focus interventions in line with a number of constraints that affect micro-enterprise sustainability and growth, the strategy, design and delivery of their services could be improved. What are needed are well-designed BDS interventions with the policy tools to affect micro-enterprise sustainability and growth. Several suggested BDS policy alternatives are presented in the next chapter.

7 Policy goals and alternatives

A number of policy goals can be achieved through these proposed suggestions. In the short-term, meeting these goals will increase the chance that micro-enterprises are sustainable. Policies are generally designed to achieve short-run goals and thus put a system on track to generate long-run goals, which are to increase micro-enterprise growth potential, to create additional employment and to foster lasting skills for innovation.

7.1 Policy alternatives

Each policy alternative, excluding the status quo, consists of practices that microcredit programmes in developing countries should implement to ensure an environment that is conducive to clients' sustainability and growth potential. Among and within each policy alternative, proposals are not mutually exclusive; in fact, many practices reinforce each other and could be mixed and matched, depending on the microcredit programme.

7.1.1 Policy option #1: status quo – basic training in credit management

Description: Teach credit management to ensure the institution's financial sustainability.

Client training that focuses on credit management and the most basic business transactions defines this policy option. The objective of this type of training is usually to increase the probability of client repayment. Clients receive this kind of training before or after regularly scheduled group loan meetings. It is characterized by a unified approach, where loan officers conduct the training. As mentioned in chapter five, basic training in credit management is a worthwhile exercise; it is, however, most likely to benefit the very poor (Ledgerwood, 1999). In any case, this type of training is too narrow and does not sufficiently address the basic skills needed to run a sustainable and growing micro-enterprise.

7.1.2 Policy option #2: introductory training for micro-enterprise starters

Description: A mandatory training course bundled with the first loan.

This policy option focuses on microentrepreneurs who are accessing their first loan to start a micro-enterprise. The aim is to teach the fundamentals of how to run a business, thus increasing the chance of sustainability in the early years of the micro-enterprise, and helping to lay a foundation for future business growth. The training course is fee based and taught by specialized trainers. The training course is organized into modules, where each module consists of a given number of sessions. Training sessions are delivered over the period of the loan, and the trainer, in consultation with training participants, sets the schedule of the sessions. Modules cover the following themes: record keeping, financial literacy, business management, sales and marketing. The specific content of the training modules is developed by the microcredit programme managers, in consultation with targeted clients, and contains information that reflects local conditions and needs. The content of each module is not intended to be complex and aims to provide the client with practical ways to deal with the challenges of sustaining a micro-enterprise.

Two key incentives are used to draw clients into this loan plus training package. First, the implementing microcredit programme fast tracks clients who take the training course to larger loan amounts sooner. Second, the microcredit programme showcases to clients concrete results from the training, such as new market opportunities, increases in income, and new or innovative products. This is executed through an up-front investment, by the microcredit programme, in market research and a marketing campaign.

This policy option should especially consider:

- The time allotted for each module depends on the most pressing constraints of clients. It is also necessary to consider location and frequency, the total amount of teaching hours, the number of participants per session and the number of training sessions per module.
- After training sessions have been repeatedly delivered, programme managers and trainers revise the design and content, increasingly improving both in response to client feedback.
- Whether marginal benefits accrue to the target clients and the microcredit programme itself as a result of the training component. Quantify benefits and compare them in a cost-benefit analysis. Use such information to inform the future of BDS offered by the microcredit programme.

7.1.3 Policy option #3: comprehensive assistance for micro-enterprise expansion

Description: Mandatory referral and mentoring services and enrolment in a selected course(s) bundled with a loan, for clients beyond their first loan.

This policy option focuses on growing different types of knowledge and skills for existing clients. The objective of this policy is to increase the chance of successful micro-enterprise expansion. For a client who renews a loan and intends to finance micro-enterprise expansion, the microcredit programme also delivers specialized training courses, as well as mentoring and referral services. The client is required to pay a fee for the package, which includes training and mentoring fees.

Specialized trainers and mentors hired by the microcredit programme deliver the subsector specific courses and mentoring respectively, loan officers deliver the referral service, and the microcredit programme managers are responsible for defining and developing courses, coordinating delivery and defining the exact role of the mentor. Courses are designed to allow trainers to work closely with each participant. The policy works first through the loan officer, who provides an overview of the courses available to clients. As such, the loan officer, in consultation with the client, decides on the most suitable course(s) for the client to follow and on whether any relevant referrals to external BDS would be useful to the client. The loan officer also sets the schedule for meetings between the client and the assigned mentor. The loan officer then refers to the client the relevant course information and contact information. The idea is to steer clients towards the information that most appropriately addresses their identified constraints.

The referral and mentoring service and training courses address the most common constraints to micro-enterprise development, including poor marketing skills and a lack of access to markets; poor access to inputs and equipment; poor management, accounting and legal knowledge; inadequate transportation networks and infrastructure; and a need to improve production processes, product development processes, and product quality. The exact subjects covered by the services and courses however, depend on the specific constraints faced by clients, on their immediate and most pressing business needs, on feedback from client consultations, on the subsector, and on local conditions.[31] As in policy option number two, the same key incentives apply to drawing clients to participate in this loan plus training policy.

[31] I recognize that no microcredit programme can develop and offer courses that address *all* of the constraints to micro-enterprise sustainability and growth. Therefore, choosing the subject for a limited number of courses requires trade-offs and a balancing of the stated demands of clients with what micro-credit programmes *perceive* the demands of clients to be.

This policy option should especially consider:

- The time allotted for each course is determined on a case-by-case situation, depending on transaction and opportunity costs that might affect the client. Consideration is given to course location and frequency, the total amount of teaching hours, the number of participants per session and the number of training sessions per course.
- After courses have been repeatedly delivered, programme managers and trainers revise the design and content, increasingly improving both in response to client feedback.
- The time allotted for mentoring is determined on a case-by-case situation, depending on transaction and opportunity costs that might affect the client. Consideration is given to location and frequency, and the total amount of mentoring hours.
- Whether marginal benefits accrue to the target clients and the microcredit programme itself as a result of the policy. Quantify benefits and compare them in a cost-benefit analysis. Use such information to inform the future of BDS offered by the microcredit programme.

7.1.4 Policy option #4: strategic mentoring

Description: Mandatory enrolment in a mentoring programme bundled with a loan, for clients beyond their second loan.

This policy option is designed for proven clients who intend to expand their micro-enterprise. Such clients have demonstrated time owning and operating a successful micro-enterprise, and likely possess a strong credit record. To facilitate expansion for strong clients, this policy offers mentoring from medium and large enterprises. The policy is organized by the microcredit programme, which coordinates for clients' partnerships and events with medium and large enterprises. Mentoring activities and client groups are subsector specific and events take place at least once a month, over the period of the loan. Clients involved in this loan agreement do not pay a fee for the mentoring programme, as the medium and large enterprises pay into a fund to finance the activities. Events can take many different forms, such as networking opportunities, technical demonstrations, and opportunities to receive one-on-one business consulting and advice. Bringing together micro-enterprises with larger enterprises can bring benefits linked to sustainability and growth, such as sharing information on markets or suppliers, product design specifications, production advice, and advice on how to sell a given product. It can also stimulate innovative ways for larger enterprises to integrate the production of micro-enterprises into their larger supply chains.

For the coordinating microcredit programme, two groups require incentives to participate in the policy: micro-enterprise clients as well as the medium and large enterprises. For the former group, the incentive to participate is simply the opportunity to network and partner with larger enterprises. For the latter group, an investment to strengthen the micro-enterprise sector could yield benefits for this group, such as stronger relationships with the communities where they operate, and the potential to lower business costs by incorporating micro-enterprises into any business transactions.

This policy option should especially consider:

- After events have been repeatedly delivered, the microcredit programme managers and the larger enterprises revise activities, design and content, increasingly improving each in response to client feedback.
- Whether marginal benefits accrue to the target clients and the microcredit programme itself as a result of the mentoring component. Quantify benefits and compare them in a cost-benefit analysis. Use such information to inform the future of BDS offered by the microcredit programme.

The next chapter evaluates these policy alternatives and arrives at a final set of recommendations.

8 Evaluation

This chapter aims to determine which policy alternative is most desirable within a cost-benefit framework.[32] The four criteria chosen to evaluate each policy alternative are "financial cost," "long-term effectiveness," "administrative feasibility" and "donor acceptability." Following a discussion of each policy alternative, the policies are ranked in order of their total score. The policy with the highest score is deemed most desirable.

It is important to recognize that the policy alternatives are not mutually exclusive. Consequently, the key question is: What are the benefits of each policy alternative relative to its costs?

For the purposes of this work, each of the following criterion use policy option number one – basic training in credit management – as a benchmark which can be compared against the other policy options.

*Financial cos*t

Examining the cost of the alternative allows us to measure the monetary impact of different training policies, as well as to determine cost-related pricing policies. The cost criterion focuses on a given policy relative to the cost of its implementation. Since each policy option proposed in the previous chapter is bundled with a loan, it is presumed that the cost of delivering a training service is the additional cost charged to the financial service (Fernandez, undated). For this work, cost is therefore defined only as the expenses attributed to the training service. As such, it is important to consider:

[32] It is important to recognize the limitations that inhibit this evaluation: "Measuring the performance of BDS programs is plagued by typical performance measurement challenges, and some that are particular to BDS programs. Some of the typical challenges that the monitoring and evaluation field is grappling with include: collecting impact data from informal sector firms; even if such data is collected, attributing changes to a specific intervention; developing standard definitions for such things as firms size and location (rural, urban, peri-urban, and "poor" clients); how to appropriately calculate cost-benefit ratios using such weak impact data; balancing the cost of data collection against quality of data; how to interpret findings across vastly different economic, political and cultural contexts" (McKvay and Miehlbradt, 2000, p. 54).

- Development costs: market research/needs assessment; delivery mechanism; curriculum development; programme marketing (to attract clients to a loan plus training package); trainer training; monitoring and evaluation system; and design revisions
- Delivery costs: trainers; venue; per diem; ceremonial costs; equipment; materials; transportation
- Managerial costs: managers, staff recruitment; supervision; reporting (Nelson, 1997)

The benchmark cost used for this work is derived from a study which calculated the above costs for a programme that was delivering a loan bundled with basic training in credit management.[33] Results from the study indicate that integrating training with credit increases the total cost of delivering the credit service by 7%. If a policy does *not change* the benchmark percentage, it is scored as "high" and is assigned a score of "5." If a policy *increases* the benchmark percentage, it is scored as "medium" and is assigned a score of "3." If a policy *significantly increases* the benchmark percentage, it is scored as "low" and is assigned a score of "1."[34]

Long-term effectiveness

In terms of the "effectiveness" criterion, micro-enterprise growth indicates sustainable self-employment for an entrepreneur. It indirectly indicates a greater probability of additional employment creation and a more widespread impact on poverty reduction and economic growth, both of which are main goals of microcredit programmes. For this work, "effectiveness" is defined by the self-employment programmes studied in chapter four. The BDS of the self-employment programmes incorporate three components (training, mentoring and referral/networking/partnership services) and on average clients achieve three or more years of sustainability. A policy that contains all *three components* is therefore most likely to help the micro-enterprise achieve three years of business or more, and is scored as "high." Accordingly, a policy with *two components* will be less effective in reaching three years or more, and is therefore scored as "medium," and a policy with *one component* is likely to be even less effective and is therefore scored as "low." The benchmark policy contains only one component, which is basic training in credit management.

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[33] The institution selected for the study was *Crédito con Educación Rural* in Bolivia (Fernandez, undated). An institution was not chosen from Africa or Asia due to a lack of data on per-client costs (to the institution) of basic training in credit management.

[34] For each criterion that follows, the same scoring methodology applies (high=5, medium=3 and low=1).

It is also important to note the potential conflict or trade-offs between some of the criteria – for example, achieving the desired impact at the enterprise level in BDS may limit outreach (Donor Committee on Small Enterprise Development, 2003).

Administrative feasibility

This criterion measures the policy alternative's complexity in design, implementation and administration. In other words, a policy alternative may not be realistic in terms of the management effort required by the programme managers or trainers to carry out the policy functions effectively. The benchmark defined for this criterion is the trainer-to-client ratio required for basic training in credit management, and the anticipated number of programme managers to plan and administer policy implementation. In the case of basic training in credit management, the loan officer usually delivers the training at group meetings, and typical microcredit groups consist of between 5-100 clients (Ledgerwood, 1999). Taking the approximate average, basic training in credit management yields a trainer-to-client ratio of 1:50 – plus, at least two managers, although this number varies depending on the complexity of the programme and on how many clients are served (Ledgerwood, 1999). If a policy does *not change* the benchmark ratio or number of managers, it is scored as "high." If a policy *lowers* the ratio and *increases* the number of managers, it is scored as "medium," and if a policy *significantly lowers* the ratio and *significantly increases* the number of managers, it is scored as "low."

Donor acceptability

Funding requirements for the microcredit programmes' studied here are fulfilled by international donors. One main aim of these donors is for the programme they are funding to become financially and operationally sustainable.[35] However, since well-designed subsidies are relatively accepted for delivering BDS (even for providers following good practices), this criterion focuses on a different concern of donors: The outreach potential of the policy option. The higher the number of clients that can be impacted by any service, the more likely that donors will support the initiative (Nelson, 1997). The benchmark for this criterion is the outreach potential of basic training in credit management. In this case, it is defined as achieving maximum potential, since this service is often made mandatory by the microcredit programme (Sievers and

[35] "Advocates of business development services argue that financial sustainability as defined by full cost recovery is not an appropriate performance measure for these services. Rather, they argue, BDS programs should strive to perform cost-effectively, maximizing both impact and efficiency. Those programs that achieve an acceptable standard of cost-effectiveness represent good investments for donors and governments" (Nelson, 1997, p. 41).

Vandenberg, 2007). If a policy does *not change* the maximum potential, it is scored as “high.” If a policy *decreases* the benchmark it is scored as “medium,” and if a policy *significantly decreases* the benchmark, it is scored as “low.”

Table 8 provides an overview of the criteria information.

Table 8: Criteria matrix

Criteria	Definition	Benchmark	Score
Financial cost			
	Percentage increase in total cost from delivering training component of policy	Credit *with* training increases the total cost of the service by 7% (Fernandez, undated)	High – no significant change or lower Medium – increase Low – significantly increase
Long-term effectiveness			
	Utilization of three components in BDS – mentoring, training and referral/partnership/ networking services	One component – basic training in credit management	High –policy with three components Medium –policy with two components Low – no change to benchmark
Administrative feasibility			
	Complexity of policy design, implementation and administration	For basic training in credit management: loan officer-to-client ratio of 1:50 (based on size of average group loan meetings), and two programme managers (Ledgerwood, 1999)	High – no change to ratio and managers Medium – decrease ratio and increase managers Low – significantly decrease ratio and significantly increase managers
Donor acceptability			
	Outreach potential	Mandatory basic training in credit management impacts maximum number of clients (Sievers and Vandenberg, 2007)	High – no change Medium – decrease potential Low – significantly decrease potential

8.1 Policy option #2: introductory training for micro-enterprise starters

Financial cost

Compared to the benchmark, this policy option is likely to leave the increase in total cost unchanged. Many of the development, delivery and managerial costs that make up the necessary operational and fixed costs required to deliver basic training in credit management would remain more or less unchanged by adopting this policy option, which uses the same basic infrastructure, but focuses content and approach differently. However, additional costs would have to be included to pay for higher salaries for more specialized trainers and mangers. To finance the costs associated with delivering this policy option, the microcredit programme should initially charge a fee that clients are willing to pay (assuming this price is below marginal cost), thus using donor funds to make up any difference that is required to deliver the service. However, once demand is strong and clients realize the tangible benefits derived from the training, their willingness to pay will increase (Nelson, 1997). At this point, the microcredit programme should charge clients a fee equal to marginal cost.

Long-term effectiveness

This policy option contains only a single training component, so matches the benchmark. As a result, the expected impact of the policy on micro-enterprise sustainability and growth potential is anticipated to be low.

Administrative feasibility

Compared to the benchmark, this policy option should not be expected to change the trainer-client ratio, or require an increase in managers. This is the case, since this approach is delivered in a similar fashion to basic training in credit management, which is a classroom style, and since programme content, although needing to be developed, is not intended to be complex or subsector specific.

Donor acceptability

Outreach potential for this policy option is not expected to change compared to the benchmark, given the policy’s similar structure. In other words, a single training programme for micro-enterprises focused on business success could reach as many clients as will sign-up for a loan plus training package.

8.2 Policy option #3: comprehensive assistance for micro-enterprise expansion

Financial cost

Compared to the benchmark, this policy option is expected to significantly increase a programme's total cost. Implementing multiple course offerings and referral and mentoring services will increase development, delivery and managerial costs. For example, operational costs will expand since this policy requires subsector specific materials and multiple tracks of training equipment. It is also important to factor an increase in fixed costs if additional building space is required to deliver additional training courses and a mentoring service, and since more complex delivery mechanisms and curriculum development requirements translate into higher salaries for additional specialized mentors, trainers and managers. More services also lead to additional market research needs and to additional programme marketing, both of which will increase development costs. To finance the additional costs of this policy, the same pricing model as in policy option number two is applied, aiming in the long-term for programme delivery free of donor subsidies. By working more closely with clients through referral and mentoring services and multiple course offerings, this policy option will cost significantly more than the benchmark.

Long-term effectiveness

By containing all three components (training, mentoring and referral services), this policy is presumed to have the greatest chance of helping micro-enterprises to be sustainable and to grow beyond the first three years of business. When all three components are utilized in different practical ways, the BDS programme is likely to have its strongest impact on micro-enterprise success and on additional employment creation.

Administrative feasibility

The administrative effort required to implement this policy is expected to decrease the trainer-client ratio and increase the number of managers. Regarding the former, the policy will have the effect of spreading clients out among more courses and mentors, thus lowering the trainer-client ratio. The policy also comprises multiple specialized courses, which adds complexity to its organization, and requires programme managers to develop comprehensive and practical course content and to coordinate implementation for multiple course offerings. Further, managers are also required to build and coordinate partnerships for the referral service and to develop and manage the mentoring programme. Consequently, compared to the benchmark, the number of programme managers will increase. More specialized trainers will also need to be hired to teach a larger variety of specific courses and mentors will also need to be sought and trained. However, the exact increase in trainers, mentors and programme managers depends on the number of selected subsectors and courses offered, on how many clients need to be served, and on how many clients can be served by a training course and a mentor.

Donor acceptability

Although this policy option includes mandatory services accompanied with the loan, I believe that it will nonetheless limit outreach potential. To be effective, offering multiple courses and mentoring requires a thorough knowledge of various micro-enterprise constraints, as well as managers, trainers and mentors who have corresponding technical skills to address such problems. The need for such expertise limits the number of subsectors in which any one program can effectively work, thus narrowing the number of people this policy option can potentially reach. In sum, this policy option has a decreased outreach potential compared to the benchmark.

8.3 Policy option #4: strategic mentoring

Financial cost

This policy option is not expected to increase the total cost as compared to the benchmark. The microcredit programme is no longer responsible for delivering training activities (the role is taken over by medium and large enterprises), which eliminates most of the significant development and delivery costs. However, coordinating subsector specific events and activities and managing partnerships is more complex compared to the benchmark, and therefore requires additional specialized managers with higher salaries (Nelson, 1997). For this policy option, events and activities are financed by the medium and large enterprises; the administrative and coordinating costs (primarily salaries), however, must come from the microcredit programme and are therefore financed through donor funding.

Long-term effectiveness

When this policy option is compared with the benchmark, it fares more favourably as it contains two components, mentoring and a referral/partnership/networking service. Through subsector specific assistance that is individualized, practical, and partnership based, clients can expect an increased chance of sustaining and expanding their micro-enterprise beyond three years.

Administrative feasibility

The administrative feasibility of this policy option is defined by no trainers per client and an increase in the number of managers. In terms of the former, the policy option calls for individualized mentorship, networking and learning opportunities, and the chance to engage in strategic partnerships. However, the delivery of these programmes is executed by the medium and large enterprise partners, thus the microcredit programme is not required to hire any trainers. In terms of the latter, the microcredit programme managers must secure and manage the partnerships with the larger enterprises, and coordinate policy implementation; compared to the benchmark, this adds substantial complexity to the policy's organization. However, the exact increase in the number of managers depends on how many subsectors are selected, on the number of partnerships developed, and on how many clients need to be served. Since the policy contains elements of both scores – abolishing trainers but increasing managers – it is scored as "medium-high."

Donor acceptability

A strategic mentoring approach is expected to decrease outreach potential as compared to the benchmark. Although mentoring is mandatory with this loan package, thus keeping outreach as high as the number of participants willing to enroll, one major constraint is likely to prevent such a process. A potential lack of existing large and medium enterprise partners; this factor limits outreach through a fixed supply of partners, and in the short-term is beyond the control of a microcredit programme. This policy option advocates partnerships; however, only as many clients can be served as larger partner enterprises can be sought.

8.4 Discussion

Using a comparative context, the aim is to now determine which policy alternative is most cost-effective at maximizing micro-enterprise sustainability and growth potential. Table 9 provides a summary of the projected outcomes as a result of the criteria analysis of each alternative.

Table 9: Policy alternative evaluation matrix

Criteria				
	Status quo – basic training in credit management	**Introductory training for micro-enterprise starters**	**Comprehensive assistance for micro-enterprise expansion**	**Strategic mentoring**
Percentage increase in total cost from delivering non-loan component of policy	7% increase in total cost	No change, **HIGH**, 5	Significant increase, **LOW**, 1	No change, **HIGH**, 5
Number of components used in BDS	One component – training	No change, **LOW**, 1	Three components, **HIGH**, 5	Two components, **MEDIUM**, 3
Complexity of policy design, implementation and administration	Trainer client ratio of 1:50 and 2 programme administrators	No change, **HIGH**, 5	Decrease and increase, **MEDIUM**, 3	No in-house training and increase, **MEDIUM-HIGH**, 4
Outreach potential	Mandatory outreach, maximum potential	No change, **HIGH**, 5	Decrease, **MEDIUM**, 3	Decrease, **MEDIUM**, 3
Total score		**16**	**12**	**15**

Table 9 illustrates the expected strengths and weaknesses of each policy option. Considering financial cost, introductory training scored highest, while comprehensive assistance for expansion is expected to yield the largest increase in total cost, due primarily to the delivery of multiple specialized courses, as well as mentoring and referral services. Measured by the number of components used in the BDS, comprehensive assistance for micro-enterprise expansion is expected to have the greatest impact on micro-enterprise sustainability and growth. In terms of administrative feasibility, only comprehensive assistance for expansion is expected to decrease the client-trainer ratio *and* require more specialized managers, trainers, and mentors, while introductory training is anticipated to be the most seamlessly implementable. Finally, to gain donor support, introductory training is the intervention expected to have the highest outreach potential, while external constraints could inhibit the other two policy options. In sum, introductory training scored the highest, with sixteen points; strategic mentoring scored fifteen points; and comprehensive assistance for micro-enterprise expansion scored the lowest, with a score of twelve. These results lead systematically to a final set of recommendations.

8.5 Recommendations

The purpose of evaluating the alternatives is so that microcredit programmes can identify the appropriate policy and stem any potential concerns that could blunt the desired outcomes if that policy were pursued. The analysis is summarized below in the form of three recommendations. Microcredit programmes should consider each recommendation in order to implement policies better geared to maximize the sustainability and growth of micro-enterprises.

8.5.1 Recommendation #1

Microcredit programmes should align with policy option number two: Introductory training for micro-enterprise starters should be a service offered by microcredit programmes to clients.

8.5.2 Recommendation #2

Microcredit programmes should engage in strategic partnerships with medium and large enterprises to transfer knowledge and expertise to clients.

8.5.3 Recommendation #3

Microcredit programmes could consider specializing in BDS by offering tailored referral and mentoring services, and a variety of focused courses.

Lastly, what must be taken into consideration are the most significant barriers to implementing any of the policy options. A lack of sufficient funding (high programme costs and donor opposition), a lack of specialized staff or external consultants, and weak institutional capacity (effective managers and leadership within the microcredit programme) are three substantial threats that will severely limit any programme changes. In order to see any of these recommendations implemented, these threats should be further investigated so that practices can be revised according to what is discovered by further research.

9 Conclusion

The most important point revealed in this study is that microcredit programmes could adopt policy changes that would benefit the sustainability and growth of micro-enterprises. However, policy changes focused on client outcomes must come from a commitment by international donors and microcredit programme managers. Without this direction, ensuring clients are better positioned to sustain and grow their micro-enterprise will remain a challenging proposition. Extra effort is required to gain the support of such groups, but if it is possible to convince the decision-makers of the merits of focusing more on client outcomes, positive spillover effects will be seen by the whole microcredit sector. To ensure success, microcredit institutions must frame the problem of micro-enterprise sustainability and growth in a way that captures each perspective involved in the decision-making process.

Self-employment programmes have demonstrated that two policy areas affect clients' ability to sustain and grow their micro-enterprise: the structure of the loan model and non-financial services. The case studies show that a multifaceted approach in both areas is essential to establish a successful environment for clients. These methods include offering effectively designed loan products and processes, and an approach to non-financial services that uses training, mentoring and referral/partnership/networking services. In addition, programmes can gain valuable insight and continue to improve themselves by implementing a self-review strategy based on third party impact assessments, and by collecting data on client outcomes and client feedback.

Microcredit programmes were developed as a response to a credit gap in the financial market, where poor entrepreneurs were unable to access credit from traditional banks to start a micro-enterprise. These programmes now provide clients with the resources to start and expand a micro-enterprise or gain the needed leverage to obtain a commercial bank loan. Many of the programmes use sound financial practices, but a consensus seems to emerge from self-employment programmes, the literature, and from microcredit programmes themselves that suggest more work is needed in terms of offering BDS that focus on business sustainability and growth potential.

Microcredit programmes need to focus on client outcomes and the effect that the programme has on client businesses. When this happens, not only will clients better benefit from the programmes, but donors and programme managers will also be better able to objectively review associated programme costs and other service delivery practices.

Determining the outcome that BDS have on the micro-enterprises of clients is key if microcredit is to play a major role in poverty alleviation and economic growth. Microcredit programme clients must be able to grow their businesses, with the goal of eventually gaining the capacity to hire additional labour. The comparative research herein recommends strengthening one main policy area: Microcredit programmes should, as swiftly as possible, make programmes more focused on client outcomes, and work to bolster the sustainability and growth potential of micro-enterprises through BDS focused on access to markets, business management and improving production and product development. Microcredit programmes should focus particularly on their BDS training methods and service mix, as well as marketing their programmes, establishing credibility with clients, and stimulating demand based on market research.

Striking the appropriate balance between many competing objectives is arguably the most important (and challenging) task for the microcredit sector in the future. The infinite potential of microcredit to help the poor will be lost if microcredit programmes cannot deliver a service that intended clients can use in a manner that strengthens their human potential, financial capital and long-term ability to expand their micro-enterprise. In the developing world, microcredit programmes are too important to not fully understand client outcomes and their potentially larger impacts.

If key stakeholders are committed to making micro-enterprises more sustainable and growth-oriented, they will consider changing certain operating mechanisms. This study has identified flexible loan products and specific business development services as the two most important tools for increasing micro-enterprise sustainability and growth. It is time to bring such changes to the front of the priority list for microcredit programmes.

10 Appendix

A – Comparison of high-income country self-employment programmes

	ACCION USA	Prince's Trust	Bristol Enterprise Development Fund	First Step
General				
Year of inception	1991	1976	1992	1990
Total loans disbursed to date or clients served	Since 1991, the U.S. ACCION Network has loaned US$154 million to more than 16,000 entrepreneurs.	Since 2005, 11,000 people with new and ongoing grants and loans were being serviced.	Since 1992 has provided £1 million (US$2 million) in microcredit.	In 2005, disbursed £3 million (US$6 million) in loans.
Number of businesses supported (new and existing)		Since 1983, has helped over 63,000 young people set-up in business. In 2005, helped 9,649 businesses.	Since 1992, has assisted 280 businesses in deprived areas.	Since inception, has assisted 1,500 projects. Since 1993, has assisted 822 businesses.
Programme				
Programme Description	Provides microcredit and other financial services to low and moderate-income entrepreneurs who are unable to access bank credit for their small businesses.Mission is to foster economic growth in distressed areas.	Offers business start-up support for 18-30 year olds; most are unemployed and have been refused funding by other sources.	Businesses supported will usually be unable to attract funding from conventional sources and will help to develop new commercial and community micro-enterprises in the economically disadvantaged areas of the region. Established to create new jobs	Acts as a last financial resort for entrepreneurs with a business idea but who are unable to access funding (or sufficient funding) from other sources.

			and businesses in the former County of Avon through the provision of low cost loan and grant finance for small and start-up businesses.	
Average loan	US$7,391	Varies between £2,000 (US$4,000) and £3,000 (US$6,000)	£5,000 (US$10,000)	£3,956 (US$7,912)
Annual interest rate	Between 10-16%	Low on loans, with an example being 3% levied over a three-year period.	Low interest rates that are often fixed for the duration of the loan	Range from interest free to low.
Loan repayment rate	93%	91%	79%	90%
Additional support	Business advice and resources that connect clients to an assortment of business services.	Business development, professional and personal development programmes, cash awards, group awards and grants are also tools used to facilitate transitions into more productive livelihoods.	Training, grants of up to £2,000 (US$4,000), contact information for additional business resources and mentorship assistance over the period of the loan.	Offers mentoring and on-going support, such as networking opportunities for its clients, through information briefings and seminars held nationally.
Partnerships and Resources				
	Partnerships with banks, community development organizations and other local groups.	Partners in the corporate and private sectors, in international organizations and in the public sector. In 2006, received over £24 million (US$48 million) from public sector government	Launched with initial donations totalling £300,000 (US$600,000), primarily through public-private partnerships. Annual revenue support to cover the running costs is primarily covered by public	Partnerships with Irish banks and the European Union and has garnered support from national and local government and both the corporate and private sectors.

		funding.	funds.Partners have enabled it to expand geographically and to improve the service it offers.	

B – Comparison of developing country microcredit programmes

	Alexandria Business Association	**Al-Amana Association**	**Zakoura Foundation**	**Bangladesh Rural Advancement Committee**
General				
Year of inception	1989	1997	1995	1972
Total loans disbursed to date or clients served	622,000 (2007)	160,000 (2004)	159,900 (2006)	110 million (2009)
Outstanding loan portfolio	US$10.3 million	US$17.7 million (2004).	US$15.9 million (2000)	US$660 million (2009)
Operational self-sufficiency	335%	130%	172% (2004)	N/A
Financial self-sufficiency	150%	124%	156% (2004)	N/A
Programme				
Programme Description	Seeks to serve small and micro-enterprises located in Alexandria with a minimum of one year's operating experience that are unable to access credit from the formal banking system (Sustainable banking with the poor, undated).	Offers loans and other services to craft and trade micro enterprises in Morocco. Mission is promoting micro enterprises by offering credit and related services to micro-entrepreneurs that do not have access to traditional financial systems.	Financing services through microcredit, with the support and training programs necessary to learn and develop income-generating activities.	Development programmes, support programmes and enterprise programmes

Loan Purpose	Areas of wood and metal works, the production of leather and textile goods, and the manufacturing of building materials.	75% were artisans – slipper makers, tailors, wood-workers and cobblers; 9% were from the service sector, and 15% from commerce.	Loans are granted for financing small capital goods, working capital.	To engage in sector specific activities, along the supply-chain.
Average loan	US$504	US$340	US$135	US$245
Annual interest rate	17%	13%	18%	N/A
Lending methodology	Group and individual products.	Group and individual products.	Group and individual products.	Group and individual products.
Loan repayment rate	97%	99%	99% (2000)	99% (2009)
Additional support	Operates a technical assistance facility and offers training and other programmes.	Offers non-financial services to help develop micro-entrepreneurial skills.	Organizes courses and training on business management.	Technical and training assistance offered to clients.
Partnerships and resources				
	Established links with United States Agency for International Development and other international organizations.	Established links with a number of international partners, such as banks, foundations and public organizations.	Established links with national partners, international partners and national banks.	Has formed partnerships with DFID, USAID, the World Bank and other international aid agencies and institutes.

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