Chapter 5

Creating Productive Employment for Youth in the Household Enterprise Sector

Despite the large share of employment in household enterprises (HEs) and the potential for substantial growth, few governments recognize that "the informal will be normal" or develop effective policies and programs to help youth to create productive enterprises. Young people who lack the education for a wage job recognize the potential in HEs, but they often struggle to amass the savings, skills, and market know-how to enter and consistently succeed in the HE sector. At a time when the formal wage sector is just beginning to gain ground, supportive national strategies are needed to facilitate entry into the HE sector, provide an environment to make it more productive, and realize the corresponding benefits for youth employment and economic growth.

"Because I am not educated, I could not be employed. Therefore, I had no other option than employing myself."
Tanzania

In Africa today, most employment in low-income households comes from household-based activities. These activities include family farming and very small nonfarm enterprises, which we call household enterprises (HEs; see box 5.1). As countries have become richer, the labor force has shifted out of agriculture, but it has not left the household economy. Employment in HEs is growing especially rapidly for those who have not completed a secondary education—the majority of new entrants into Africa's overwhelmingly young, burgeoning workforce. These young people generally lack the education for a wage job but can pursue the economic opportunities that HEs offer—as a full-time activity or together with agriculture in a mixed-livelihood strategy.

Development processes in other regions have included HEs in parallel with large-scale manufacturing, so the growth of HEs in Africa is not surprising (figure 5.1). Such enterprises are still an important source of employment in low-income countries where nonfarm wage jobs have grown rapidly, such as in Bangladesh and Cambodia. In Asia and Latin America, HEs provided an important pathway for surplus labor to move out of agriculture as farm productivity improved. In Africa's low- and middle-income countries, where the modern wage sector has not grown fast enough to absorb everyone who is prepared to leave agri-

Box 5.1

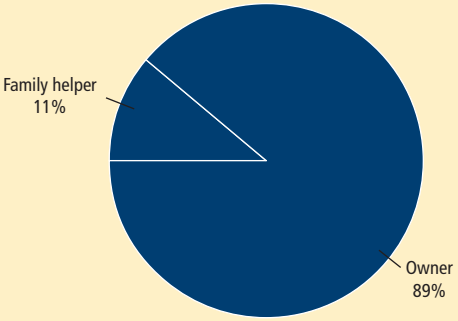
What is a household enterprise?

Household enterprises (HEs) are unincorporated, nonfarm businesses owned by households. From an employment perspective, they include *self-employed people* running unincorporated businesses and *family members* working in those businesses. When employment in the HE sector is tabulated, employees from outside the family are not included in this category; they constitute wage workers. The owners themselves account for most of the employment in the sector. Family helpers make up only 11 percent of employment in the sector (not counting wage workers). From an enterprise perspective, they follow the same pattern. Most HEs in Africa today are pure self-employment, and only 10 percent have hired someone outside of the family (see figures B5.1.1 and B5.1.2). Therefore, employment in the sector grows primarily through the creation of new enterprises.

HEs may also be referred to as own-account workers (another term for self-employed) or as contributing or unpaid family workers, indicating that the family members work in the enterprise but receive no cash payment based on hours worked or output, although they may share in the profits. Some call these enterprises microenterprises, but the term is not used uniformly (for example, in Grimm, Knorringa, and Lay 2012). Some authors categorize both self-employment and larger, more substantial businesses as microenterprises (and may include partnerships and firms that employ workers regularly). In this report, only HEs that hire workers (less than 4 percent of all owners) are classified as microenterprises.

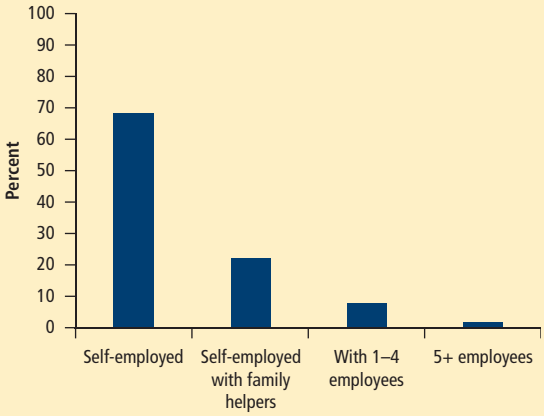
Some refer to HEs as informal enterprises. The International Labour Organization (ILO) considers everyone working in an unincorporated business with less than five employees as having informal sector employment (ILO 1993; see Fox and Pimhidzai 2013 for a discussion). The label "informal sector" ignores the household nature of these businesses, however, and the ILO definition does not distinguish between the family (which gets the profits from the enterprise and absorbs the losses) and outside wage workers (who are paid for a task but not expected to share in profits or losses).

Figure B5.1.1 Most people working in the HE sector are owners



Source: Fox and Sohnesen 2012.

Figure B.5.1.2 Most HEs are family operations

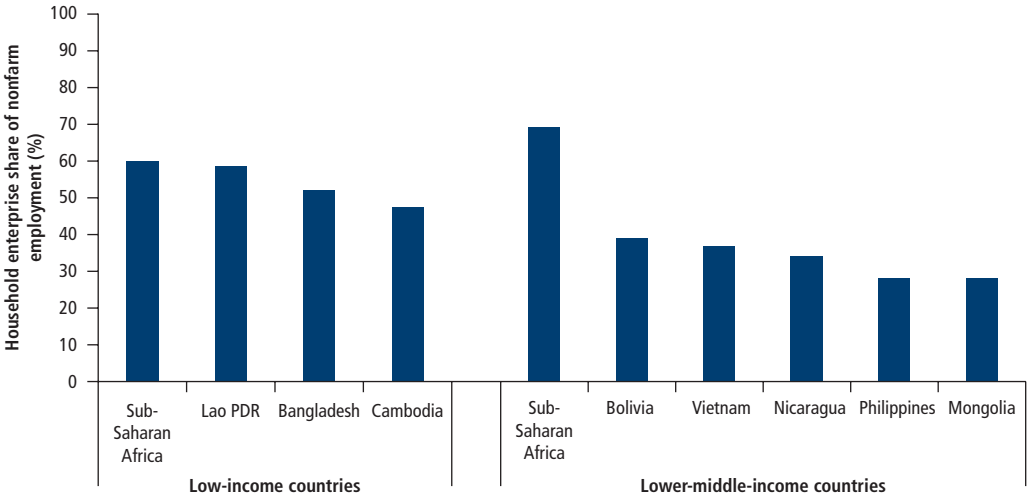


Source: Fox and Sohnesen 2012.

culture, the HE sector is larger than in comparator countries. The HE sector has generated the majority of new nonfarm jobs in most low- and lower-middle-income countries of Africa, even during times of high economic growth (figure 5.2). This trend is expected to continue.

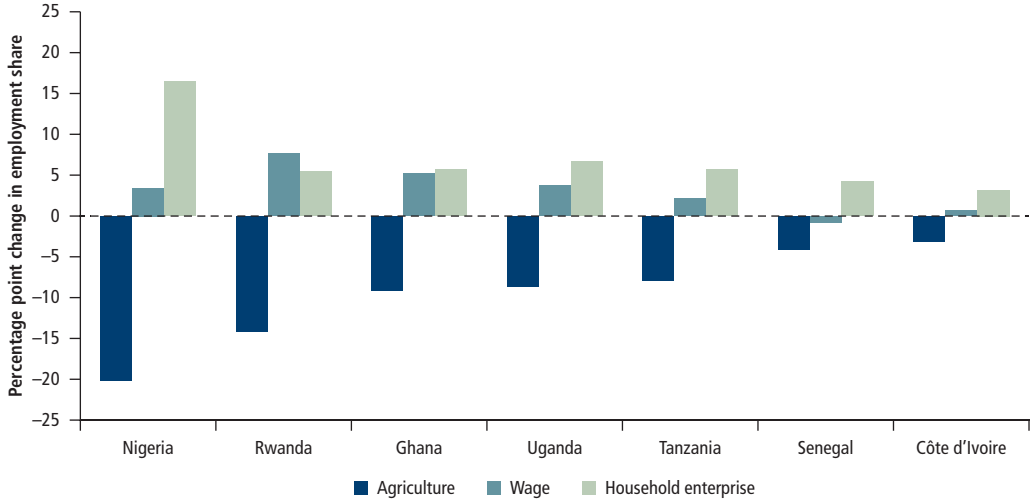
HEs are an important way for households to move out of poverty. Strong correlations between higher rural HE income and lower poverty have been observed in several Asian countries (Haggblade, Hazell, and Reardon 2010; Lanjouw, Quizon, and Sparrow 2001). The shift in primary economic activity out of agriculture—including day labor—and into running a nonfarm business contributed substantially to poverty reduction in Bangladesh

Figure 5.1 **Household enterprises are an important share of nonfarm employment in low- and middle-income countries**



Source: Based on standardized and harmonized household and labor force surveys for Sub-Saharan Africa (most recent data available) and on household and labor force surveys for countries in other regions (see appendix).

Figure 5.2 **In Africa, as labor moved out of agriculture, more people moved into the HE sector than into private wage employment**



Source: Based on standardized and harmonized household and labor force surveys (see appendix).

and Uganda over the last decade (see Inchauste and Olivieri 2012 on Bangladesh; Fox and Pimhidzai 2012 on Uganda).

In Africa, most government strategies overlook the HE sector, partly because policy makers may know little about the sector or its role in creating youth employment and supporting economic growth. Urban policies often actively discourage HEs, making it challenging for youth to take advantage of the opportunities these businesses present. Youth often lack even the small amount of savings needed to start a trading business, and banks and microfinance entities rarely lend to start-ups. A small-scale processing or service venture could require more capital than a trading venture, as well as some technical skills that school leavers may not have. Young people may also need to

develop business and behavioral skills, if they have not acquired them in school or through experience. In short, it is difficult for youth to find pathways into the HE sector.

Facilitating entry into the HE sector and providing an enabling environment to make it more productive are fundamental policy challenges. Research across Africa and other regions shows that these challenges can be met; *the key is to recognize the potential.* By changing the fragmented approach to the HE sector into a coherent, coordinated approach—with a strong focus on sustainable employment for youth—government, donors, nongovernmental organizations (NGOs), and other stakeholders could lift the constraints on productivity and open opportunities for sustainable employment for everyone in this sector.

This chapter outlines the opportunities and challenges facing HE owners in Africa today. It explores why young people often struggle to enter the sector and describes policies and programs that could change this reality and make the sector more productive.

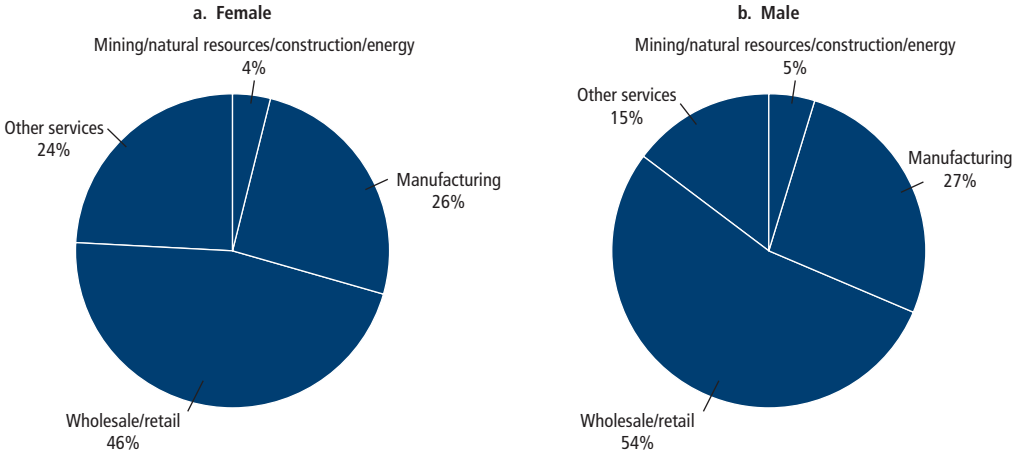
"One who does not have a nonagricultural enterprise stays idle for most of the dry season when agricultural activities are few. Therefore, I started my enterprise of selling soft and alcoholic drinks."
Tanzania

The Household Enterprise Sector Today

HEs have been an important part of the recent shift of value added and employment out of agriculture and into the services sector, as the majority of HEs engage in trading (figure 5.3). At the same time, HEs have contributed to employment in the industrial sector, where they engage in manufacturing (primarily transforming agricultural goods or natural resources into products such as charcoal, flour, roof thatching, or bricks) and artisanal activities (producing custom furniture and ironwork, dressmaking and tailoring, or construction). In the services sector, HEs engage in food services (making and selling snacks or meals), transport, and personal services (barbering and hairdressing). Partly because of local opportunities to process agricultural products, manufacturing is a common activity for rural HEs. Although street vendors and local markets are the most visible signs of HE activity, many businesses operate out of the owner's home.

HEs survive and grow because they provide low-cost goods and services demanded in a growing but less developed economy that lacks a modern services sector. In urban areas, mobile retail traders and HEs in market stalls provide the services found in convenience stores and malls in richer countries. The lower-quality goods manufactured by HEs typically will not be demanded as incomes rise and mass-produced or higher-quality goods enter the market. For this reason, services tend to dominate the sector and to persist longer than manufacturing.

Figure 5.3 Most HEs are in the trading sector



Source: Fox and Sohnesen 2012.

Although HEs account for a larger share of employment in urban areas, 60 percent of HEs in Sub-Saharan Africa are located where the population is—in rural areas. HEs are different in rural and urban areas (table 5.1).[1] It is quite common for rural households with an HE to operate a farm, either for subsistence and food security or as a commercial venture. The majority of these households consider the HE to be a secondary activity. Most HEs in rural areas operate during at least 10 months of the year, but for less than 30 hours a week. Often rural HE owners can do business only on weekends, when markets are open and foot traffic is heavier. Owners in rural areas are more likely to operate their business at home; in rural areas without electrification, HEs usually cannot operate after sunset.

Urban HEs are almost always the primary activity of the owner, but some owners have multiple businesses or lines of work. When HEs are a secondary activity, the primary activity is usually a wage job. As a result, urban owners work long hours; 47 percent work more than 50 hours a week. Almost all of those who hire paid labor are based in urban areas. Women are as active in the urban HE sector as men, but they are slightly underrepresented in rural HEs. Women and men clearly gravitate toward different types of enterprises. For example, females are more likely to do tailoring, and men are more likely to work in construction (Fox and Sohnesen 2012). The result of this gender segregation is that women are less likely to work in the sectors where earnings are higher (box 5.2).

Basic education is a key pathway for youth to transition into the HE sector. Individuals who enter the labor force with a completed primary education are the most likely to become an HE owner, and primary education is the main formal opportunity for developing skills that most young people now entering the HE sector will ever have. Whereas 35 percent of young adults (ages 25–34) who work in agriculture have never been to school, 79 percent of those in the nonfarm HE sector have at least some schooling. Although the majority of HE owners in Africa do not have primary education (reflecting the low levels of education among the older generations), as the level of education has risen in the labor force, so has the level of education among HE owners. Figure 5.4 shows that the youngest owners are much less likely than their parents' generation to have no education. Still, only 29 percent of young adults (ages 25–34) employed in the HE sector have completed more than primary school, much less than the 59 percent in the modern wage sector.

Table 5.1 Rural versus urban household enterprises

Indicator	Urban	Rural
Share of households owning an HE	53	36
Share of HEs as primary activity for owner	82	42
Share of HE owners working more than 30 hours a week	79	45
Share of HE owners operating their own business at least 10 months a year	69	61
Share of HE owners operating their business at home	30	43
Share of HE owners who are female	55	47
Share of HE owners with hired labor	8	11

Source: Fox and Sohnesen 2012, based on data from Cameroon (2001), the Republic of Congo (2009), Ghana (2005), Mozambique (2008), Rwanda (2005), and Tanzania (2005).

"All of us have the maximum of primary education, and this cadre represents the majority who are roaming in the streets. It is impossible for such people to get employment because there are better educated individuals."
Tanzania

The Business: Constraints and Opportunities

As businesses, Africa's HEs are quite heterogeneous. Even in the trading sector, some are very small-scale operations, using little human or physical capital, whereas others sell higher-value products, have a substantial inventory, and provide a much higher income. For example, a study of female HE owners in Accra, Ghana, found "high-profit" females, who had much higher average profits and capital stock, working in roughly the same sectors as low-profit females (Fafchamps et al. 2011).

Profits vary by sector as well. An analysis of data from seven capital cities in West Africa found monthly profits ranging from US$70 for petty traders to US$107 for construction workers (Grimm, Krüger, and Lay 2011). That same analysis found very high returns to capital for many self-employed and family businesses, especially at low levels of investment (Fafchamps et al. 2011 found similarly high rates in Accra). Monthly marginal returns on capital are estimated to be about 70 percent for those with capital stock valued at less than US$150. Although most businesses report capital con-

Box 5.2

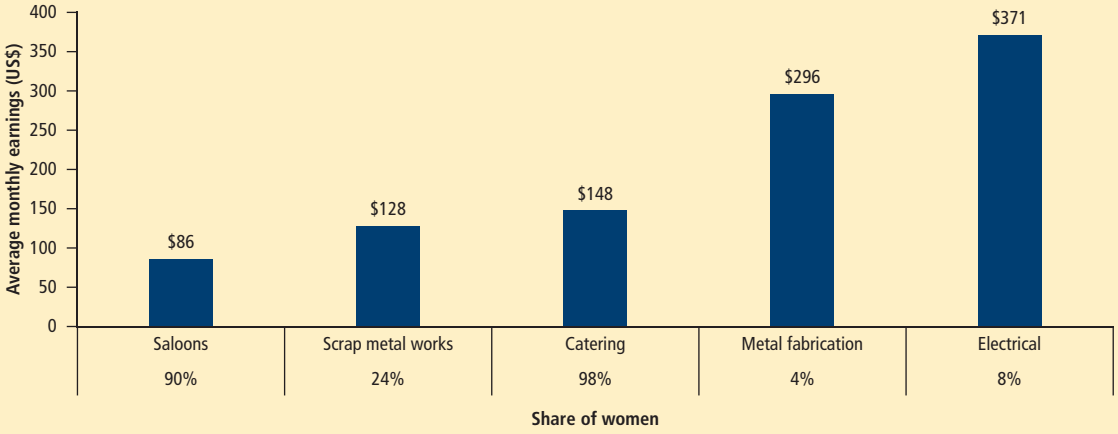
Why do females earn less? Occupational segregation in the household enterprise sector

Gender segregation is common among HE owners. Both women and men are likely to engage in trading, but women are much more likely to do tailoring or catering (lower-paying activities) and men to engage in carpentry, metalworking, and repair (higher-paying activities). For example, owners of HEs surveyed in the Kassida workshop area of Kampala, Uganda, indicated that even in metalworking, males almost completely dominate the higher-earning fabrication activities, while more females engage in scrap metal processing, where earnings are lower. One of the sectors with the lowest earnings—selling drinks—is almost completely dominated by females.

The reasons for this gender segregation are complex. They include social norms, the lack of female role models who have entered occupations traditionally performed by men, and constraints on time and money, which can be more binding for women than for men. For example, studies in South Asia and Kenya found that when women choose to work outside the home, they spend more time traveling on slower modes of transport, which limits them to employment options that are closer to home (Uteng 2011; Gulyani, Talukdar, and Jack 2010). Regardless of the cause, women tend to earn less than men from HEs (Fox and Sohnesen 2012).

Evidence also suggests that men and women have different information or expectations about particular enterprises. In Kenya, a recent experiment with vocational training vouchers found that prior to enrollment males overwhelmingly preferred traditionally "male-dominated" courses such as motor vehicle mechanics, whereas women almost exclusively chose traditionally "female-dominated" courses such as hairdressing (Hicks et al. 2011). The program administrators randomly provided half of the participants with information on the actual returns to training, highlighting the higher returns in male-dominated trades and using "soft persuasive" methods, such as a video of female auto mechanics, to encourage females to pursue more traditionally male-dominated trades. Females exposed to the information were almost 9 percentage points more likely to express a preference for a male-dominated course, and they were 5 percentage points more likely to enroll in one. Younger and more educated females were especially likely to prefer male-dominated fields. This experiment suggests that efforts to provide information and encouragement have potential to reduce occupational segregation and increase women's earnings.

Figure B5.2.1 Earnings are higher in male-dominated subsectors than in female-dominated subsectors

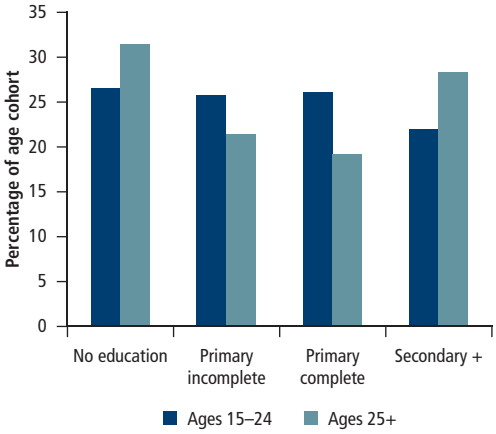


Source: Campos et al. 2013.

straints, returns do not appear to increase with the level of capital stock.

People need savings to start an HE, because it is virtually impossible for them to get credit. Banks and microfinance institutions in Africa rarely lend to start-ups. Almost all owners report that they started their business with their own savings and a loan or grant from their fam-

Figure 5.4 **Younger HE owners tend to have more education than older ones**



Source: Fox and Sohnesen 2012.

ily or friends (table 5.2). Very few applied for a loan after starting their enterprise. To the extent that these enterprises have access to financial services, those services tend to be informal. Suppliers' credit (informal loans at high interest rates) is common for trading enterprises. Other sources include informal local systems such as rotating savings and credit associations and village savings and loan associations, which pool savings within a village and lend small amounts for a short term, usually no more than one year (see focus note 3). Microfinance has not yet reached this sector, even for working capital. Despite the high returns to capital, current owners, those who did not start a business, and those who closed a business all reported that limited access to capital is the most important business constraint they face.

Completing primary education is a key driver of profits for HE owners. Compared to having no schooling at all, having only a few years of education does not add to earnings in the HE sector. This outcome reflects the fact that in many African countries a few years of basic education fail to provide basic skills such as literacy and numeracy. Because 45 percent of young adults in the HE sector have not completed basic education, the lack of basic skills contributes to their low earnings. By contrast, youth who have completed primary school and reached functional levels of literacy and numeracy can add as much as 40 percent to their earnings, controlling for sector, location, and other characteristics (see the discussion in chapter 3; Fox and Sohnesen 2012). While some of this earnings premium probably reflects other characteristics of primary school completers, it suggests that the basic skills acquired in primary school—such as literacy and numeracy—matter for productivity in HEs. Development policies and programs often confuse HEs with small and medium enterprises (SMEs) or micro, small, and medium enterprises. This is a mistake (box 5.3 explains why). Even though there is substantial heterogeneity among HEs, a fundamental difference between HEs and SMEs is that while HEs often persist for a long time (more than five years), they are not oriented toward employment growth (Fox and Sohnesen 2012). Even if productivity improves, these businesses rarely grow beyond HE status. Data from West Africa show that capital grows quickly to a steady state, and even after 10 years of operation, the capital stock of the business

Table 5.2 **Sources of capital for household enterprises: Start-up and credit for operations**

Source	Male	Female	All
Start-up capital[a]			
Personal savings	79.9	71.6	75.1
Official or formal	1.3	0.8	1.0
Relative or friends	6.6	13.9	10.8
Microfinance, NGO, cooperative	1.3	1.3	1.3
Informal	3.0	3.2	3.1
Other	7.9	9.2	8.7
Total	100.0	100.0	100.0
Credit for business operation[b]			
Official or formal	17.0	15.8	16.3
Relative or friends	39.9	43.0	41.7
Microfinance, NGO, cooperative	28.7	21.4	24.7
Informal	10.3	13.1	11.9
Other	4.0	6.6	5.5
Total	100.0	100.0	100.0

Source: Fox and Sohnesen 2012, based on World Bank harmonized household surveys.
Note: "Official or formal" includes commercial banks and public programs. "Other" includes loans from employers and other unspecified loans. "Informal" includes credit from customers or suppliers, informal moneylenders, rotating savings and credit associations, village savings and loan associations, and savings and credit cooperatives.
a. Includes Cameroon (2001), the Republic of Congo (2009), Ghana (2005), Rwanda (2005), and Uganda (2005).
b. Includes Ghana (2005), Rwanda (2005), Tanzania (2005), and Uganda (2005).

Box 5.3

Small and medium enterprises are not the same as household enterprises

Policies and programs to encourage business start-ups often place HEs and SMEs under one umbrella, often called micro, small, and medium enterprises. But HEs and SMEs have important differences.

Differences in where they locate:

- HE are usually not located in a building (establishment) in a business or commercial area. They may locate in a regular market stall, on a usual corner, or in the owner's house. Many have no fixed location.
- SMEs operate from a fixed location. They may be a sole proprietorship or have multiple owners, but they usually do not operate from the household, and they separate the business from the household accounts.

Differences in number of employees:

- Most HEs do not hire labor.
- SMEs by definition hire labor. Definitions of size vary, but in Sub-Saharan Africa a business with 5–20 employees is considered small, and a business with 21–50 is considered medium. However, some global studies classify businesses with less than 250 employees as small (see, for example, Ayyagari, Demirgüç-Kunt, and Maksimovic 2011). Differences in classification often lead to confusion in policy discussions.

Relationships between the enterprise and the state with respect to registration and payment of taxes depend in part on the rules and practices in each country.

Differences in registration and taxation requirements:

- In many countries, it is legal to run HEs without any business registration or license. However, local governments may require HEs to get a trading permit or license or to register for a place in a public market stall.
- Most countries require SMEs to have a business license, and their hiring is subject to national labor laws. At the same time, SMEs are known for hiring workers informally—that is, without paying payroll taxes or enrolling them in a mandatory social insurance system. In part this practice reflects the lower labor productivity in the SME sector, which calls for lower real wages.

Differences in access to financial services:

- HEs usually combine household and business finances. The HE is part of the household's livelihood portfolio, in which funds move back and forth between the HE and other activities (such as purchasing farm inputs).
- SMEs are likely to have a relationship with a bank or microfinance institution (as a saver or borrower), but they depend on their own and their family's savings for capital as well.

remains the same (Grimm, Knorringa, and Lay 2012). Most enterprises never hire another worker (Fox and Sohnesen 2012).

This steady state is not simply the result of capital constraints. It arises for multiple reasons. First, consistent with their growth-oriented approach, SMEs tend to start not as HEs but as SMEs, with more assets and employees at the beginning. From the start, they are a different type of business. The owners have demonstrated that they have an important skill—the ability to hire and manage labor outside the family. Managerial skill is often considered a key indicator of entrepreneurial potential (De Mel, McKenzie, and Woodruff 2012b; Gelb et al. 2009).

Second, almost all HEs rely on households, not other businesses, as their customers. HEs are rarely connected to larger value chains. The exception occurs when large wholesalers use informal retail networks, including HEs, as vendors to reach consumers (for example, selling bottled beverages or mobile phone cards). Depending on location and sector, the market for their product may be limited, which restricts growth.

Third, HEs tend to operate in sectors that are relatively easier to enter, so they face a lot of competition. Expansion would require more capital and constitute a big risk. HE owners report having to work hard to keep customers and stay ahead of the competition. In a West Africa study, 60 percent of HEs reported that competition and lack of customers are major threats to their existence (Grimm, Knorringa, and Lay 2012).

Fourth, even if the market for their product has growth potential, expansion for a self-employed HE owner means taking on employees, with associated management costs that

owners usually do not want to handle. HEs are likely to take on apprentices, but not full-time employees.

Fifth, HEs operate in a risky environment, with limited opportunities to hedge their risk. Given the retail nature of their sales, HEs depend on growth in income both from agriculture and from wages and salaries to survive. This dependence means that their incomes are pro-cyclical; a negative shock to the local agricultural sector can hurt them as well. Expansion may only increase risk.

Seventh, in addition to business risk, HEs face household risk. In surveys, business risk tends to be listed as more important, although females tend to cite household events such as an illness in the family as a reason for exiting the HE sector. In addition, HEs rarely separate the business accounts from the household accounts.

Finally, HE owners have other responsibilities (in farming or the household, for example), so they do not have additional time to devote to their business. In their risky environment, giving up subsistence farming to devote more time to the business may not make sense for the household.

For creating employment, the implication of these differences is that employment grows in the HE sector because an individual or household seizes a business opportunity and creates a new enterprise, not because HEs hire a young person looking for work.

Even though HEs will not transform themselves into SMEs, they are often a good business opportunity in Africa. In African countries they tend to be found in richer areas, and households with these enterprises are less likely to be poor—they tend to be clustered in the middle quintiles (Fox and Sohnesen 2012). Stronger evidence from recent panel data in a few Eastern and Southern African countries indicates that adding an HE does make household income and consumption grow faster regardless of wealth level, suggesting that HEs help to reduce poverty.

For many rural households, the hourly income from an HE is higher than the hourly income from the agricultural sector. One reason for this discrepancy is that agriculture in Sub-Saharan Africa is still mostly rain-fed, resulting in substantial seasonal underemployment. Another reason is that farmers still use very basic production techniques, which make it hard for them to get ahead.

In urban areas, some HE owners earn more than they could expect to make in a wage job, either because their lower education and skills limit their access to a wage job or because wage rates are still low in Africa. It is usually the roughly 10 percent of HE owners who have the managerial skills to hire workers whose earnings exceed those from wage employment (Fox and Sohnesen 2012). Other benefits cited by HE owners include the opportunity to be their own boss and flexible hours (Falco et al. 2012).

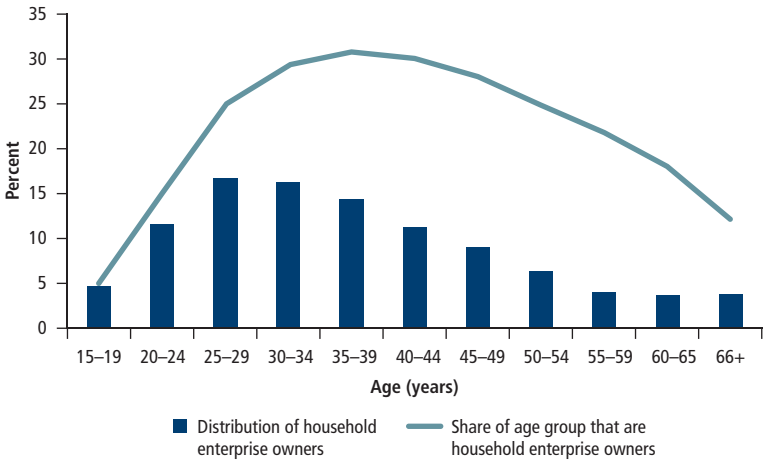
"Despite the difficulties … in a day's work, I make as much as a civil servant does in a month."
Madagascar

Constraints for Young People to Enter the HE Sector

Owners of HEs tend to range between the ages of 25 and 40 (figure 5.5). Despite having more education than older workers, young people struggle to enter the HE sector. They are held back by multiple constraints, including insufficient capital or savings, inadequate information on markets and input supply, and the lack of a range of skills, such as literacy, numeracy, and business, behavioral, and technical skills. Often the most important constraint is lack of capital. Young people may leave school with the aspiration to start a business, but without savings, they find it very difficult to start a business.

Many young people, including those still in school, work in the HE sector, but not as business owners. They contribute work to a family business without receiving a regular wage. This experience can be a pathway to sustainable employment in the sector (see chapter 2). Working in a family business can provide essential on-the-job training—in business or technical skills—and build the informal networks necessary for success. These young people may also be earning the trust of their family, who might eventually supply start-up capital for an enterprise. Studies in West African capital cities show a strong correlation between having a

Figure 5.5 Household enterprise owners tend to be over 25 years of age



Source: Fox and Sohnesen 2012.

self-employed parent and being self-employed (Pasquier-Doumer 2013).

Another common way for youth to enter the sector is to gain skills and experience. Technical skills are not a prerequisite for starting an HE. Some occupations, including trading (the most common business), do not require specific technical skills, but some do (for example, construction, manufacturing, repair, and personal services such as hairdressing). Young people acquire these skills through training or apprenticeships, mostly supplied by private providers rather than public institutions. Governments need to recognize that, just as *informal employment* is normal, *informal training* is normal for youth in the HE sector. Most such training consists of private courses and apprenticeships, as discussed extensively in chapter 3 and summarized in box 5.4.

Two issues related to apprenticeship have a bearing on young people's ability to enter and remain in the HE sector. First, the skills offered through apprenticeships are often quite narrow, limited to a specific production technology, and difficult to transfer to another occupation. Second, the time spent in an apprenticeship can make it challenging for young people to accumulate the savings they will need to apply their new skills in an enterprise of their own.

Box 5.4

Informal training is normal for youths seeking to operate a household enterprise

Young people working in HEs are substantially more likely to have gone through informal skills training or an apprenticeship than formal vocational training. Among 25- to 34-year-olds employed in the HE sector, 32 percent have been an apprentice at some point, but only 6 percent have gone through formal vocational training.

Private, informal training is the primary source of technical skills for HEs. The spectrum of providers includes for-profit private institutes and firms, NGOs, religious and community organizations, and individuals. The vast majority of these providers develop their own teaching programs, are self-financing, and operate on a very small scale with little government oversight or support. Training is generally short and intensive, and it may offer a certificate. In some countries, informal private training providers enroll more trainees than public institutes providing formal vocational training.

Apprenticeship, in which an experienced enterprise owner (master) teaches skills on the job, is by far the most common and important institution providing training. Apprentices generally have at most a junior high school education. The scope and content of apprenticeships are heavily focused on a basic, narrow set of technical skills—such as tailoring, carpentry, vehicle repair, or hairdressing—that are used primarily in the HE sector. In addition to being specific to the sector of activity, such skills may be specific to the technology used by the master (Frazer 2006). Ghana's highly developed apprenticeship system is a good example (Monk, Sandefur, and Teal 2008).

Apprenticeships take many forms and vary in duration. If a family lacks cash to compensate the master, the master may take on the apprentice for a lower fee but require more time (labor) from the apprentice in return. Many apprenticeships are informal, although some are based on a contract. To enforce this contract, the first year of the apprenticeship often involves little training, just unskilled labor. The time spent in an apprenticeship without earning money may account for the lower payoff to apprenticeship that is observed in countries such as Ghana, where this practice is common. Unless young people can save money during their apprenticeship, they still face barriers to entering the sector. After completing an apprenticeship, youth often report that a lack of capital prevents them from applying their newly acquired skills.

In addition to capital and skills, a third barrier to entry is young people's general lack of information about opportunities in the HE sector, especially relative to wage and salary jobs. Young people participating in a small survey in urban Tanzania in 2005 reported that they had spent an average of five years idle or doing odd jobs while seeking a wage or salary job in an enterprise. Three-fourths of the respondents ended up self-employed (Bridges et al. 2013). Could this search time be reduced by providing better information about opportunities for self-employment or programs to help young people to enter the HE sector?

The short answer is that the large number of public and nongovernmental projects undertaken in Africa to help young people to enter and remain in the HE sector have provided little evidence on the best ways to facilitate entry and raise the earnings of HEs (box 5.5 presents examples from Rwanda). In particular, there is little guidance on which interventions could work on a large scale—that is, beyond small-scale pilots. What is clear is that, although young people encounter specific constraints in the HE sector, reducing the multiple obstacles that all HE owners encounter in entering and earning a living in the sector can generate productive employment for many. The next section focuses on how governments and policy makers can support productive employment for the large numbers of people who will spend their working lives outside of the wage economy in the HE sector.

Creating and Sustaining Productive Employment in Household Enterprises

The HE sector has developed with little public support. Public policy has neglected this sec-

Box 5.5

Rwanda: Many programs to support household enterprises, but little information on results

In 2010 the World Bank and Government of Rwanda inventoried the major public and nongovernmental programs to support HEs and then conducted focus group discussions around the country to elicit HE owners' perceptions of the programs. Of 19 NGO and 7 government programs identified, most government programs targeted SMEs, not HEs; most NGO programs targeted HEs and emphasized training. Some NGO programs combined training with small grants to start a business. NGO programs tended to support specific groups, such as women, youths, people with human immunodeficiency virus/acquired immune deficiency syndrome (HIV/AIDS), and so on, which meant that many participants felt excluded. Few participants had received any support, but those who had were generally appreciative. Most programs focused on providing support to set up a business; participants felt that assistance is also needed after a business is started.

Given the huge number of HEs operating in Rwanda, the demand for assistance is high, but support is relatively modest because funding is limited, as reported by many nongovernmental and civil society organizations. These limitations partly reflect the tremendously fragmented effort to support HEs. While this fragmentation is common in low-income countries, it means that the whole is less than the sum of its parts.

Several organizations contacted for the inventory complained that their products were not being taken up. Programs directed at women noted that social attitudes limiting the scope of women's activities hindered participation. Some NGOs may not be providing a product appropriate for the majority of the clients or government policies may not be supportive of their efforts. Training cannot be effective if it cannot be used productively.

Since systematic evaluation of many of these projects is rare, it is difficult to measure their effectiveness. Some programs could not even provide assessments of beneficiaries or basic monitoring data. A few had evidence on outcomes, however. The literacy programs had data on the number of women who passed the test. Better monitoring and evaluation would help the government to identify which programs might be scaled up effectively and to help the NGO or agency involved obtain financing to do so.

Source: World Bank and IPAR 2012.

tor—both by failing to support youth to enter it and by failing to provide the business climate to sustain incomes and productivity. Government strategies tend to identify the SMEs as a source of employment, but not the HE sector.

Often the main obstacle to supporting the HE sector is an implicit bias against HEs, which are not necessarily attractive in the eyes of public authorities, who sometimes even chase them out of business areas in capital cities. The perception of HEs as unworthy of public support renders systematic efforts to support them politically challenging. In some development circles, HEs have been criticized for not offering the income and benefits of wage and salary employment, so national governments hesitate to include them in their strategies, despite the evidence that they contribute to growth, reduce poverty, and provide better opportunities than other occupations such as agriculture. Recognizing that "the informal will be normal" is the first step in developing effective policies and programs to help youth to create sustainable enterprises.

Analysis of the sector and its multiple constraints yields five key areas where public policy can be effective in supporting the creation and growth of HEs:[2]

- *National strategies* that recognize HEs, encourage the sector, and give HEs a voice in developing national and local strategies
- *Urban policies* that provide adequate locations where HEs can work and sell their products, along with essential support services such as lighting, water, sanitation, and security
- *Financial sector policies and programs* that encourage private providers and NGOs to improve household access to financial services, including savings and credit
- *Support for programs* that tackle multiple constraints, either by building a range of skills (technical, business, and behavioral skills) or by combining skills with capital
- *Support for programs* that improve access to markets by integrating HEs into value chains

In many cases, public support is needed only to facilitate entry and to encourage the private initiatives that already serve the sector. In other cases, information gaps or market failures indicate a need for public intervention in the form of regulation or targeted financial support.

National Strategies

Employment policy, including youth employment, is embedded in national growth strategies. In Africa, most national strategies explicitly recognize that private enterprise is the key agent in economic growth and job creation, but they focus on farms, SMEs, and larger firms, despite the large share of employment in HEs and the potential for substantial growth. Limited national support for the HE sector as an agent of economic development trickles down to subnational governments, which often exclude HEs from local development (box 5.6). Mechanisms to organize the sector and give its constituents a voice are not developed, and national institutions lack channels to provide support to HEs. Because national and local policies, programs, and projects that could support productive HEs are not designed with the sector in mind, governments miss opportunities to improve the incomes and prospects of HEs and encourage entry into the sector for many who could benefit from it. The result is that HEs and the employment they provide are invisible to policy makers.

To the extent that HEs are even on the strategic radar screen, they are seen as entities to be transformed into SMEs and "formalized." In Tanzania, a law from 1972 outlawing businesses that operate without a fixed premise is still on the books. This law effectively makes more than 80 percent of HEs illegal (a fact conveniently ignored when the government collects taxes or fees from HE owners). The objective of national economic policy (2008)—"to empower the informal sector to become formal in order for them to access finance, training, or any other business development service"—runs directly counter to HEs' own aspiration *not* to be transformed into an employer, but rather to survive and bring sufficient cash income into the household. It is not clear how a sector that

is virtually regulated out of business by law could become "formal" in the sense of complying with the law.

Rwanda's development strategies (Vision 2020 and the Economic Development and Poverty Reduction Strategy), while supportive of the informal sector in general, do not recognize HEs as key economic actors. HEs either are not differentiated from SMEs or are excluded entirely from government support (for example, the SME policy is limited to enterprises with hired labor). The disconnect between Rwanda's national strategies and the characteristics of the HE sector creates a poor business environment in which HEs are largely overlooked and their specific needs are not addressed. Even so, the fact that HEs are legal in Rwanda gives the government large scope to broaden national policies specifically to include them.

Ghana, where HEs have been included in the national strategy and institutions for many years, provides a positive example of what can be achieved (box 5.7). Its rich history as a trading economy, dating back before colonization, is one of the reasons why it has some of the most developed public and private institutions to support informal enterprises. For example, one objective detailed in the national Poverty Reduction Strategy Paper of 2006 is to "enhance productivity and income/wage, with equal opportunities for men and women in all sectors of the economy, including the informal economy" (Republic of Ghana 2006). The National Board for Small Scale Industries (NBSSI) explicitly includes the self-employed within its mandate and has used technical assistance and donor funding to pilot, refine, and scale up locally developed programs to support this sector. Rather than shunning HEs, the trade union movement in Ghana opened its doors to them, taking in nascent organizations such as the Ghana Traders Association (which at the time primarily covered Accra City) to give a collective voice to this important economic group. In 1996, the Ghana Trade Union Congress adopted a policy to encourage the organization of informal enterprises and informal economy workers and to support their integration into the organized consultative mechanisms between the government and the private sector. Aside from providing mechanisms for dialogue at the strategic level, the development of HE associations helps to improve information flows and access to technologies and markets, allowing national and international distributors to integrate informal agents into their value chains.

Box 5.6

Need for a comprehensive approach

In 2007 Victor Tokman, one of the first researchers on informal enterprises, published a seminal article called "Modernizing the Informal Sector" (Tokman 2007). He observed,

> There is general agreement over the need to pay attention to the informal sector because of its importance to employment and poverty issues. There are also an increasing number of programmes aimed at supporting similar informal activities in highly diverse national contexts . . . Nevertheless, to the extent that it fails to embrace a shared strategic vision, this is a limited consensus that hinders the effectiveness of policies implemented in this area. While often adequate on an individual basis, they are insufficient and produce limited effects by failing to respond to a more comprehensive approach.

Urban Policies and the Household Enterprise Sector

HEs are much more common in urban areas, and urban residents are more likely to identify their business as their primary and only activity (although rural HEs are an important pathway out of agriculture, as detailed in chapters 2 and 4). Youth unemployment and idleness are also more frequent in urban areas. Yet the business climate for HEs in urban areas is rarely supportive and often hostile. The most frequent complaint relates to the lack of functional space in which to do business. Other complaints refer to authorities' petty corruption in the context of enforcing regulations or collecting taxes and the lack of services such as security.

Urban authorities have five responsibilities that affect the entry and productivity of HEs:

- Controlling the use of public space (sidewalks, streets, parks, and the like)

Box 5.7

Ghana's integrated approach to HE development

Ghana's development strategy explicitly acknowledges the contribution of HEs to employment absorption, income growth, and local economic development. The strategy places a growing emphasis on enabling youths and women to obtain the skills and capital they need to succeed in business. The approach is sustainable because it is decentralized. Local officials support HEs' growth because they recognize that their political survival and the generation of internal revenue depend on a vibrant local economy that includes HEs. At the national level, the government collaborates with donors to provide supportive programs and policies that create a consistent framework, disseminate lessons learned, and provide targeted funding. The approach has been developed in phases since the late 1990s, largely through the Rural Enterprise Programme of the Ministry of Trade and Industry, with funding from the International Fund for Agricultural Development and the African Development Bank.

The local business advisory centers are the cornerstone of the system. Overseen on a technical basis by the NBSSI, they receive financial support from local governments (the municipal or district assemblies). The NBSSI funds up to two staff members, whose responsibilities include monitoring and liaising with the NBSSI. The business advisory centers match donor and government projects and programs to the needs of local clients and help to strengthen local associations of household, small, and medium enterprises. The associations have several important roles: expressing members' needs, organizing training, liaising with authorities, disseminating information, and in some cases assisting authorities in managing markets and collecting market fees.

One lesson learned as Ghana has sought to target youth self-employment more forcefully is that too many initiatives, with too little coordination, are under way in various ministries and nongovernmental programs. In response, the Ministry of Employment and Social Welfare, with support from the World Bank, has developed a National Strategy and Action Plan for Informal Enterprises. The plan establishes a national policy framework, identifies strategic areas for action by every ministry and agency from within their own resources and programs, and provides for coordination through a National Committee on the Informal Economy. Although the process of submitting the action plan to the cabinet was interrupted by the recent election, consultative validation with key stakeholders has disseminated some of its key messages and principles. The following areas are identified for concerted, coordinated action:

- Continue to work with local governments to improve the policy and business environment, especially the legal, regulatory, and fiscal environment and mechanisms for dialogue
- Reduce vulnerability, particularly through infrastructure and secure sites for business
- Improve access to finance and business development services
- Raise productivity and widen access to markets, especially by upgrading the apprenticeship system and standardizing the skills and qualifications system
- Use social protection to reduce household vulnerability

"The authorities are harassing us and confiscating our assets. I have decided to open my business at night. I do business when the government is asleep. I earn a living for my family by doing this." Tanzania

- Developing and enforcing rules on the use of private space (zoning regulations)
- Providing urban services to support local economic development, including local roads, street lighting, public transport, and security
- Vetting businesses in order to protect consumers (for example, ensuring that taxi drivers know how to drive, professionals have required training, and restaurant kitchens are hygienic)
- Setting and collecting fees and revenue to support local activities

Authorities have to balance many interests in executing these responsibilities, and HE owners complain that their interests are not being adequately addressed.

For HEs, the lack of secure premises (a problem frequently exacerbated by outright legal or extralegal harassment from local authorities) delays start-ups, which especially handicaps youth. In a survey of tailors and dressmakers in capital cities in West Africa, 43 percent of enterprises in operation for less than one year reported the lack of an adequate locality for their business as a major problem (Grimm, Knorringa, and Lay 2012). This problem also prevents businesses from expanding. The most common and violent conflicts occur when police exert control over the space where

hawkers and other traders attempt to reach potential customers. These conflicts usually erupt because local authorities fail to recognize the importance of these trading businesses to the local economy and do not provide adequate space for them to operate. Local authorities do not always consider how rapidly HEs can be expected to grow as urbanization increases. In some cases, authorities have attempted to develop markets or other work space for HEs, but without consulting them, so the space developed has been unsuitable. Different businesses have different needs. Traders and personal service providers need premises with foot traffic, not outside of town but in central business districts (on sidewalks, especially through the creation of pedestrian-only streets), at bus stops and terminals, near major road intersections, and other places that are convenient for people to shop and transact business. Repair shops and manufacturers such as metalworking operations need to cluster to realize agglomeration efficiencies and share technology, and urban areas need to provide suitable sites for them to do so. Industrial estates designed for large firms can include HEs in planning and space allocation, for the convenience of workers and the firms.

Cities that fail to anticipate the growth of HEs and proactively identify locations for their activity enter destructive cycles of "decongestion." The precipitating event is usually a forthcoming political or sporting event that will swell crowds and heighten security concerns. Authorities "decongest" the city by mobilizing police or other security forces to evict traders from the city center and other lucrative areas, sometimes confiscating their inventory and other assets, or demolishing their temporary business structures. Eviction is rarely permanent. HEs retreat, but many gradually amass the capital to return to their trading location until the next eviction.

Forceful eviction from the more lucrative areas where traders make spot sales presents a compelling case for the failure of local governments to support HEs (box 5.8 presents an example from Tanzania). Even though local authorities are simply enforcing the law, their operations are counterproductive: they increase rather than reduce poverty and heighten the sense of insecurity and vulnerability among HEs (as borne out by Lyons and Msoka 2007; Liviga and Mekacha 1998; Sisya 2005).

Overlapping and insecure land rights complicate the problem of finding space. In Dar es Salaam, the local government is not allowed to develop its own rules on the use of land next to national roads because it does not own the land—the Ministry of Transportation owns it. The local government is therefore required to enforce rules set by the Ministry of Transportation and not allowed to develop and enforce rules that might support local enterprises in using the land. Land tenure systems based on a combination of customary and common law restrict the development of efficient land markets and can prevent HEs from obtaining land. In Nairobi, efforts to establish secure land tenancy for slum dwellers who run HEs are complicated by multiple land rights and land disputes (World Bank 2013).

Another problem limiting HEs' productivity is the poor quality of urban services they receive. The construction and maintenance of markets, where traders and service providers can congregate to sell and customers can gather to purchase, is one of the most important urban services needed by HEs, which pay a fee to locate in the market. In most urban areas, governments are simply not creating markets fast enough to keep up with population growth. In addition, although fees are paid, security and sanitation may not be provided as expected. As demand for valuable urban land goes up, developers pressure local governments to close markets rather than to develop higher-density, multiple-use solutions. In the end, HEs lose customers. Other key services that can affect their productivity are transport (taken by HE owners to reach markets and by customers to reach HEs) and water supply.

A common perception is that HEs do not pay their fees and taxes, so they do not deserve these services. Nothing could be further from the truth. Analysis suggests that although HEs may be exempt from national corporation taxes or value added tax registration, the majority of HEs pay local business taxes at a higher rate than large businesses (Fox and Sohnesen 2012). Taxes, fees, and local rules regarding land use are reported to be sources of petty corruption,

"I did well before the local authority moved the market. Now I have difficulty feeding my family and cannot afford to send my children to school."
Rwanda

Box 5.8

Weakening the local economy by perpetuating the *machinga* cycle in Dar es Salaam

Dar es Salaam has limited business premises in its high-rent, lucrative commercial areas. Owners of HEs take to the streets at the borders of these areas as mobile operators (*machingas*), crowding sidewalks and roads, even if zoning laws prohibit them from doing so. The proliferation of cars, foot traffic, and traders, especially during rush hours, is more than city authorities can manage. To curb the congestion that mobile vendors and service people bring to towns and cities, the authorities, especially in Dar es Salaam, Arusha, and Mwanza, regularly engage in "clean-up" operations, in which mobile traders are especially vulnerable targets. Faced with eviction, some HE operators abandon their business. Local authorities deploy disproportionate force to drive out those who remain. HE owners cite harassment by local government and law enforcement officers as their biggest problem. More than 60 percent of 622 operators interviewed for one study said that forceful eviction is their most vivid experience of government intervention. The same study catalogues *machingas'* losses from local eviction and relocation policies: physical capital (kiosks), operating capital (fines, confiscation of inventory), customers and supply lines (through increased distance), and trading time (through jail sentences or time spent rebuilding capital to return to business). Repeated cycles of loss and hardship resulting from these policies increase the poverty and deprivation of household members.

Local officials also subject HEs to inspections to check compliance with licensing, taxation, and other regulations, even though most such regulations apply only to formal enterprises. HEs have little knowledge of the tax code or registration requirements and no place to complain. Many report paying large sums to unscrupulous officials to avoid having their merchandise confiscated.

In response to the lack of market space, the city of Dar es Salaam recently took out a loan and built a seven-story building for use by itinerant traders. Dubbed the "*machinga* complex," the project was estimated to cost T Sh 13 billion (approximately US$13 million), but it does not meet the needs of the *machingas*, who were not consulted in its design. Among other issues, the building has no elevators to move customers or merchandise. No parking is available. The building was designed to provide 10,000 work spaces (compartments or stalls), but in the end, only 6,500 rooms were built. Fewer rooms increased the average cost, requiring city authorities to raise rents to repay their loan. When the complex opened, only the bottom floor was filled by vendors, who then complained to authorities that the *machingas* selling on the sidewalk were undercutting them. Eventually, the upper floors were rented out to other tenants who prize the downtown location but do not need to locate goods on-site for sale. Meanwhile, the *machinga* problem has not been solved.

Source: Kweka and Fox 2011.

especially by police. Failure to pay the requested bribe can result in disproportionately negative consequences (such as confiscation of inventory). Often owners of HEs do not even know the current fee schedule or how much they should pay. Corrupt local officials can then take advantage of them.

Two overarching factors contribute to the poor business environment in urban areas for HEs: national policies and strategies exclude HEs, and local governments are not accountable to their citizens. In Rwanda, national policies that exclude HEs and strictly limit their locations in urban areas create indifference to HEs' needs among local authorities. The authorities see their job as enforcing national regulations to control HEs, not to support their development. In Ghana, the cooperation between HEs and local authorities is poor in Accra, where the government is not elected by the citizens, but it is stronger outside the capital, where local authorities are elected and responsibility for local economic development has been decentralized. Outside Accra, local authorities focus more on creating space for HEs to operate and less on controlling space to exclude them (box 5.9). Improvements in the organization of HEs at the local level, facilitated by the locally recruited and managed business advisory officers, have reportedly enhanced communication between HEs and elected local officials.

Easing Access to Credit to Start and Sustain a Household Enterprise

HEs need capital to start a business and working capital to maintain it. Most HEs struggle to obtain capital. Over and over in surveys

Box 5.9

Clustering household enterprises for the benefit of all

In the city of Bechem, Ghana, national commitment and public-private-donor collaboration supported the establishment of a mini industrial site for metalworking, car repair, and carpentry workshops. Prior to the project, these workshops were scattered around the city, some occupying valuable downtown locations. The city endeavored to obtain a suitable parcel of land outside the most congested areas and to develop it for the HEs, allowing the workshops to form productivity-enhancing clusters and the city to assign use of the valuable city-center land to higher-density, higher-value projects.

The project, which required multiple consultations with HE associations, took nearly four years to develop, but it finally opened in 2012 with 37 masters and 68 apprentices. The rest of the space is being filled as new HEs move in. The site provides work space, electricity, and water. Once the site was open, seven spare parts dealers and some food vendors (also HEs) moved in behind the main tenants to supply support services. Organizations offering training in areas such as basic engineering skills and electronic engine servicing have also reached out to the HE owners, as they can easily reach a critical mass for their services.

When done with adequate prior consultation and preparation of facilities, such sites achieve mutually satisfactory objectives.

For the businesses:

- They gain a secure location.
- Through clustering, trades find it easier to obtain common services and participate in value chains (particularly if project-funded support services such as training or finance are located on-site).
- Access to business development services improves, because training providers easily reach clustered clients.
- Access to electricity, water, sewerage, and garbage removal improves.
- Business associations become stronger.

For local authorities:

- Activities that local governments prefer to locate outside the town center, such as metalworking, carpentry, and auto repair, are moved and clustered.
- Businesses are easier to tax and less prone to avoid taxes, because they see value for money in the public services they receive.

For clients:

- Suppliers concentrate in one location, giving easier access to regional as well as local markets.

Source: William Steel, personal communication.

asking about the major constraints to starting or expanding a business, HE owners list capital constraints at the top (see Fox and Sohnesen 2012; Grimm, Krüger, and Lay 2011). In Mozambique, in a survey of HE owners who had to close their business, 56 percent reported lack of capital or liquidity as the primary reason (Fox and Sohnesen 2013).

Unable to obtain credit through formal sources, they use their own savings and informal sources of credit to meet their needs (box 5.10). A complicating factor for HEs is that business and household finances are often linked, so efforts to smooth household consumption (to pay for lumpy expenditures such as school fees or home repairs) may compete with efforts to maintain business liquidity and potentially undermine the sustainability of the business. Access to credit would help to balance these competing needs. The gap between credit needs and supply is widest for young people looking to start an HE.

At the root of this problem is the lack of financial inclusion for households in Africa (see focus note 3). Most households in Africa do not have access to a bank or microfinance institution (MFI), either for saving or for credit. Many households rely on informal savings groups to help them to save for business or household emergencies and to obtain short-term credit when savings are not enough. Young people have started to join these groups, and it is one of the reasons why more than 25 percent of youth in the low-income and lower-middle-income countries report having saved some funds in the last 12 months (FINDEX data).

Young people with access to a bank still have trouble getting a loan for start-up capital. Even MFIs in Africa, which target a lower-income population than banks, prefer to lend to indi-

Box 5.10

Sources of credit used by households to start a business in Tanzania

- I got my capital, amounting to T Sh 250, from my mother in 1986 and started by selling local brew known as *wanzuki.*[a]
- I started with a capital of T Sh 50,000, which I obtained from my father in April 2007.
- I started with a capital of T Sh 20,000 in 1994. I got the capital from selling maize which I had produced.
- I had accumulated a capital of T Sh 50,000 from my wages as I was formerly employed.
- I started with supplier's credit (*mali kauli)* to sell goods: 1 kilogram of sugar, 2 kilograms of rice, 1 liter of cooking oil, tea leaves, salt, and firewood that I collected from the bush.
- I started by hiring a sewing machine for T Sh 5,000 per month in 2007. I worked with that machine until I got enough money (T Sh 120,000), which I used to buy my own sewing machine.
- I obtained the initial capital amounting to T Sh 5 million from selling cashew nuts, and the profit from our shop. We then bought a milling machine.
- My initial capital of T Sh 5,000 was given by my husband, and I started selling vegetables.
- I started selling cooked food and local brew with locally borrowed money (T Sh 10,000). From this business I obtained a capital of T Sh 30,000. Then I decided to change business by opening a *genge* (fresh food stand).
- I am operating a grocery where I am selling beer and soft drinks and had started with an initial capital of T Sh 200,000, half of which was given by my mother and the other half was obtained from agricultural production.
- I borrowed materials for starting cooked food vending: 3 kilograms of rice, 2 kilograms of meat, cooking oil (a half liter), and salt. I obtained my initial capital amounting to T Sh 8,000 from my uncle, and I decided to do a business of keeping and selling guinea fowls.

Source: Kweka and Fox 2011.
a. Wanzuki is a local brew made of honey and yeast. Sometimes sugar, tea leaves, and yeast are used to make it when honey is not available.

viduals with a salary so that they have a better chance of repayment. Some MFIs will lend to households based on collateral (such as household assets) or the guarantee of a relative or friend who has a salary. In this case, an initial savings deposit is often required.

If young people are not creditworthy because they do not have enough savings or a track record with a formal savings institution, are grants an option to help them to start a business? Most of the NGO-led pilots in Africa that help people to start a business use grants instead of loans, and grants have been tried in South Asia and Latin America as well. In almost all cases, they facilitated entry into the sector. But in no cases did the experiment use only grants for start-up capital—either business training and support services or vocational training was supplied as well. Other experiments used matching grants plus financial education to encourage *saving* so that youths would have start-up capital. These approaches also produced positive results, but the target groups were quite well off by African standards. Grants provided to existing businesses in Sri Lanka helped to improve sustainability, providing evidence of capital constraints both at start-up and during operation (De Mel, McKenzie, and Woodruff 2012b).

The main problem with the pilot grant programs for youths to start a business relates to the availability of funds: funds are not available to provide the 5 million or so youths who are expected to start a business every year in Africa over the next 10 years with a grant of US$100 (about the average size of grant used in the pilot programs). And even if youth grants on that scale were affordable, what about adults who want to start a business? Excluding them could be politically difficult. In Tanzania, government involvement in grant programs to support business creation led to poor targeting, suggesting that governments should tread carefully in this area (Kweka and Fox 2011). A more broad-based strategy would be to expand financial inclusion (especially savings) by reducing the costs of financial services and improving the range of products available to HE start-ups.

What Should Governments Do to Help Equip Youth with Skills for the HE Sector?

Training programs are the most common government and donor intervention to support HEs—both for facilitating entry and for improving incomes—whether targeted at youth or not.[3] Programs provide technical training in a specific sector (such as tailoring, metalworking, operating a bakery), business or financial literacy skills (such as basic accounting or money management), behavioral and life skills, or a mixture of skills. Programs targeted specifically to youth focus primarily on the skills needed to enter the sector and may include all four types of skills listed above. Programs targeted at existing HEs tend to focus on the business skills needed to strengthen or expand an enterprise, moving toward the goal of improving earnings and productivity. The good news for youth employment is that programs designed to facilitate entry appear to have had some success (more than those targeted at existing entrepreneurs), so there are some positive models.

Despite the large number of training programs, evidence of their effectiveness among HEs in Africa remains thin. Most training programs operate on a small scale, do not collect monitoring data on dropout or graduation rates, and are unable to track outcomes, let alone outcomes for a comparison group. Even the larger programs have not systematically documented success (or failure). Analysis of household survey data on HE earnings is not able to isolate specific returns to training, for several reasons:

- Participation in training programs is poorly captured in household survey data, particularly for the more prevalent types of apprenticeships or private training.
- The product itself is very heterogeneous, even in the same sector or skill.
- The majority of existing HE owners did not participate in any training, and training is not needed to start a business in, for example, trading. Training is needed to enter specific sectors, which often do provide higher incomes (car repair, metalworking). But the effect of the training and the effect of other, unmeasured personal characteristics associated with choosing the sector are so comingled that the returns to the training are hard to identify.
- Many people who take training do not practice their skill for various reasons, including the inability to finance an enterprise.

As a result, more systematic and careful evaluations are needed, including impact evaluations that measure outcomes among program participants and a relevant comparison group (chapter 3, box 3.9). Only a few programs designed to foster self-employment were subjected to an impact evaluation in the past decade. More high-quality impact evaluations are needed, including studies that specifically evaluate the best ways to design youth employment programs (especially the best components to package together and the most effective agencies for delivering programs), the cost-effectiveness of those programs at scale, and their general equilibrium effects.

Despite the limited evidence, information from recent impact evaluations and other studies offers a starting point to guide policy and identify promising approaches to help youth to enter and stay in the HE sector. This section reviews evidence on the effectiveness of three major types of training—technical skills, business skills, and behavioral skills. It concludes that programs combining multiple interventions—different types of training or training plus capital—are more successful than programs offering one intervention. None of the combined interventions has been scaled up, however, and cost is an issue. Finally, we consider what the limited evidence suggests about the potential role for government and public policy in building skills for more productive and sustainable HEs.

"With some training the future will be better. Instead of simply resoling shoes, I would like to start manufacturing them." Uganda

Building Technical Skills

As discussed here and in chapter 3, technical training, through apprenticeships and other types of private training outside of the formal education system, is the most popular form of training for HEs. Informal training is very het-

"Our landlord had a wood workshop, and I passed in front of it every day when going to school. I started stopping there to play, and the owner introduced me, little by little, to "the profession."
Madagascar

erogeneous. Training can be just a few months of on-the-job learning with a skilled HE owner, or it can last for years; it can combine classroom instruction with on-the-job learning. Many informal training programs or apprenticeships build narrow sets of technical skills (for example, in tailoring, carpentry, mechanics, or hairdressing). Little is known about which modalities are the most effective and about the best way of promoting them to ensure that they improve skills and productivity.

Household survey data show an association between private apprenticeships and increased employment and earnings—for example, in Nigeria, Rwanda, and Tanzania (Van Adams, Johansson de Silva, and Razmara 2013). Apprenticeships in Ghana offer a return in specific activities, such as construction, especially in rural areas, but not in other activities, such as tailoring (Fox and Sohnesen 2012). Apprenticeships also offer returns to workers who apprentice in a firm and then leave to found their own business. The former apprentice basically replicates both the technology and business practice of the firm, but as a self-employed individual (Frazer 2006). These former apprentices earn about 49 percent more a year than those who stay on as employees. Even though primary school completers are the group most likely to get an apprenticeship, returns to apprenticeships appear to be higher for individuals with lower levels of academic achievement, suggesting that apprenticeships can provide technical skills even to those without a basic education. Among currently employed people who have no formal education but who have had an apprenticeship, earnings are 50 percent higher (Monk, Sandefur, and Teal 2008).

The only impact evaluation of an apprenticeship program in Africa comes from a small-scale pilot that was part of a national apprenticeship program in Malawi. The pilot program targeted 1,900 low-income school dropouts. The great majority (84 percent) had completed primary school or less. Masters (with their own HE) selected through the Technical Education and Vocational Education and Training Authority (TEVETA) provided training to participants in occupations such as bricklaying, vehicle repair, tailoring, and hairdressing. The apprenticeships lasted 3.3 months on average, including a week of life skills and business training; 63 percent completed their apprenticeships, and a small number received start-up capital. The estimated cost per participant was US$800. Participants were encouraged to start their own business upon completion of the apprenticeship. Results showed no improvements in labor market outcomes or returns in the short term, although the training did develop skills and improve business practices (Cho et al. 2012).[4]

Building Financial Literacy and Business Skills

Evidence suggests that financial literacy and general business skills are weak in the HE sector. According to a 2008 survey of micro, small, and medium businesses in Zambia, just 27 percent kept up-to-date financial accounts (FinMark Trust 2011). In a sample of tailors and dressmakers in Ghana, only 17 percent reported keeping any written financial records, only 7 percent said that they had spent money on marketing their services during the previous year, and only 30 percent rated their shop as very organized (Karlan, Knight, and Udry 2012). In a sample of microfinance clients in Tanzania (most of whom were SMEs, not HEs), two-thirds kept records, but only half engaged in marketing to attract customers (Berge, Bjorvatn, and Tungodden 2011).

The fact that many operate in the HE sector without strong financial literacy and business skills might suggest that young people do not need those skills to enter. Yet the lack of those skills could limit the sustainability and productivity of the enterprise, including those run by young people. Can business or financial literacy training boost the creation and productivity of HEs? The evidence on programs providing *only financial literacy* or *general business skills* is mixed. Very few studies have been done in Africa (see McKenzie and Woodruff 2012 for a review).[5]

Basic financial literacy is the most fundamental business skill for HEs (see the review in Xu and Zia 2012). Financial literacy can encompass many concepts, but among HEs in low-income countries it entails the most

basic levels of financial awareness, the ability to understand the financial aspects of the business, and the ability to access financial services. Substantial inequalities in financial literacy prevail. Women and less educated people consistently measure lower (on average) on tests of financial literacy. Poor financial literacy could contribute to low access to the formal financial system—banking in particular.

There is very little evidence that interventions to build financial literacy in low-income countries affect the earnings of HEs or the capacity of youth to enter this sector. Evaluations are under way for generic programs (including some in Ghana, South Africa, and Uganda), but results are not available. One study from Indonesia found that financial literacy had no effect on promoting saving of trainees overall, although impacts were detected on trainees with the very lowest levels of initial financial literacy (Cole, Sampson, and Zia 2011; Xu and Zia 2012, 27).

General business skills training ranges from very basic "rule-of-thumb" programs to more advanced classroom programs designed to help small businesses to grow, which are often called business development services programs. One problem with such programs is that they are usually aimed at SMEs, not at the types of businesses found in the HE sector in Africa. Often the programs target microfinance clients, meaning that other constraints, such as start-up capital and access to work space, have already been surmounted. For these reasons, it is important to sift through the growing evidence on this training to determine if it is applicable to youth employment in African HEs.

Several programs piloted in other regions have facilitated entry into the HE sector for youth, but these programs were designed for more educated individuals, not for young people with only a primary education, which is the target group in Africa. Hands-on business training and coaching provided to university students in Tunisia increased their entry into self-employment, although the impact was small in absolute terms (Premand et al. 2012).[6] The training also improved business and behavioral skills. In contrast, comprehensive business training and financial literacy had no significant effects on business start-up in Bosnia and Herzegovina, in a sample where 85 percent of the participants had completed secondary school (Bruhn and Zia 2011). In a lower-income context, a "Start and Improve Your Business" Program in Sri Lanka for urban women ages 25–45 with a secondary education increased their likelihood of launching a business (De Mel, McKenzie, and Woodruff 2012a). An eight-day business training course in Pakistan, targeted to new microfinance clients with much less education, yielded no impacts on business creation among households that did not operate an enterprise at baseline (Giné and Mansuri 2011). Efforts to evaluate the integration of entrepreneurship training in secondary school are under way in Uganda.

The record on general business training for existing HEs is even weaker. While evaluations show that business training has changed business practices, it has rarely improved productivity or survivorship of the typical small businesses in the HE sector. Studies show that some programs have changed business practices and knowledge, such as recording sales and recording money taken for household needs (HEs in Pakistan); keeping records of withdrawals from the business, reinvesting profits into the business, and innovating in business (HEs and SMEs in Peru); improving business practices among the "Start and Improve Your Business" Program participants (HEs in Sri Lanka); and separating personal and business expenses, keeping accounting records, and formally calculating revenues (both HEs and SMEs in the Dominican Republic).[7]

More "intensive" programs have somewhat larger impacts. In Peru, intensive personalized business training for microfinance clients (most of whom had businesses larger than an HE) improved business practices and outcomes, whereas simple classroom-based instruction yielded no impacts (Valdivia 2011). The evidence that "more is better" does not always hold, however. In the Dominican Republic, a rule-of-thumb approach that taught simple rules for financial decision making was compared to a more formal approach that focused on the fundamentals of financial accounting.

All of the program's impacts came from the rule-of-thumb training. In both the Dominican Republic and Pakistan, follow-up visits yielded no additional impacts (Drexler, Fischer, and Schoar 2010 for the Dominican Republic; Giné and Mansuri 2011 for Pakistan).

But changes in business practices do not always translate into improvements in productivity or business survivorship. In none of the studies just mentioned (the Dominican Republic, Pakistan, Peru, Sri Lanka) did changes in business practices measurably increase sales, revenues, profits, or employment. In Pakistan, some impacts were measured among men, and in Peru some impacts were measured in particularly bad months, but overall the evidence is weak that training improved business performance. In Ghana, a program delivering business skills training and support to existing tailoring businesses did not lead to higher profits, despite short-term improvements in business practices (Karlan, Knight, and Udry 2012).

One exception to this pattern comes from Sub-Saharan Africa, but not from HEs. An evaluation of a high-quality intensive business training program in Tanzania targeted to SME microfinance clients (who already had employees) yielded profits that were 29 percent higher among males but had no effect on profits for females. The effect came mainly through business expansion but also through better management of employees. In this case, simply graduating clients to a larger loan did not improve outcomes (Berge, Bjorvatn, and Tungodden 2011).[8] Still, it is not clear that this type of intensive training would pay off even for male HE owners (or that they would have the time to attend such a program).

Clearly the heterogeneity in results across settings suggests that much remains to be learned about building business capacity—both how to do so and for whom. Positive impacts suggest that the lack of business skills may be a constraint in some settings and that interventions may improve practices—and sometimes business outcomes. At the same time, the results confirm that growth-oriented businesses are rare in the HE sector, so perhaps sustainability, not growth, is the better outcome to target. The studies also suggest that skills may not be the only constraint or even the binding constraint. Given the expense of these programs for both the providers and the beneficiaries, it may not be justified or feasible to expand this kind of program to HEs. At least, more careful cost-effectiveness is required.

Building Life Skills for Work

Limited socioemotional, or limited behavioral skills, or even low aspirations can prevent potential entrants from finding and seizing opportunities in the HE sector. Among other hurdles, the lack of these skills or aspirations may make it hard for youth to attempt to enter the sector or take up interventions designed to overcome barriers to entry, such as skills training or capital. Because behavioral skills are still malleable among young people, various programs have been shown to affect them. Changing the mind-set and attitudes of young people (especially young women) seems to help them to transition into the HE sector. Changes in behavioral skills may be part of the benefits of apprenticeship or other on-the-job training.

Young females face specific challenges in entering the HE sector (see chapter 2), and there is some evidence that behavioral skills training, combined with social support, can help them to overcome those challenges by teaching skills, influencing attitudes toward the future, or unlocking aspirations. These particular components, included in a broader program, may reduce risky behavior or early pregnancy in females and allow them to develop a plan to enter the HE sector while they are young.

Partly because behavioral skills training is often one part of a comprehensive program, there is little evidence that programs focused *only on building behavioral skills* can improve labor market outcomes. However, programs that aim to shape *behavioral skills together with other skills* have shown promise.

Building a Range of Complementary Skills

Youth often face multiple skill constraints in entering the HE sector. Programs attempting to build one skill at a time may have limited impact, but evidence from pilots that *build a range of complementary skills together* is more promising. These programs include "bundled

interventions" that deliver behavioral, business, and technical skills training as part of a comprehensive package of support.

For example, in Uganda, BRAC delivered training in *behavioral skills and technical skills* targeted to adolescent girls ages 14–20.[9] The program increased employment 32 percent, mainly through entry into self-employment, and it shaped life skills and reduced risky behavior (Bandiera et al. 2012). The direct cost per participant was US$18 per eligible girl, or approximately US$85 per participating adolescent girl.

In Liberia, a program for adolescent girls and young women combined either *technical and behavioral skills* or *business and behavioral skills*. The program was highly effective in increasing employment and income among adolescent girls, most of whom had some secondary education (World Bank 2012). The training package combining business and behavioral skills was more effective at facilitating entry into self-employment than the training package combining technical and behavioral skills.[10] Direct cost per participant was US$1,221 for the business and behavioral skills training, leading to an increase in monthly income of US$75 on average (a 115 percent increase).

The rural enterprise projects of the International Fund for Agricultural Development (IFAD), operating in several African countries, finance demand-driven, privately provided technical training to improve the productivity and sustainability of existing enterprises and to help new entrants to start an enterprise (box 5.11). While no impact evaluation is available, tracer studies on beneficiaries in Ghana suggest that both objectives can be achieved at very low cost. Although the project specifically targeted employment growth through business expansion, most of the employment created was through start-up self-employment.

Combining Skills and Capital

Consistent with the evidence that multiple constraints hinder entry into the HE sector, bundled interventions combining skills training with capital are also promising.

To stimulate economic development and employment in northern Uganda following the cessation of hostilities, a program delivered cash grants to youth groups for *investment capital and vocational training*. The program had large, sustainable impacts on employment and earnings, especially for male participants.[11] Monthly real earnings increased by U Sh 17,785 (about US$9.88) after two years and U Sh 19,878 (US$11) after four years, corresponding to increases in income of 49 and 41 percent, respectively, relative to the control group. The average grant was US$374 (U Sh 673,026) per group member, so the estimated return to the average grant was 35–39 percent.

Another pilot program in northern Uganda targeted to very poor women provided four days of *business skills training*, an individual *start-up grant* of US$150, and *regular follow-up* by trained community workers. The program led to a large increase in income of 98 percent, or US$6.50 a month. The program was particularly effective for the poorest women. Additional technical assistance through follow-up had little additional impact (Blattman et al. 2013). The program cost US$688 per beneficiary.

These results have two main implications for designing programs to facilitate productive employment for youth in the HE sector. First, to facilitate entry, integrated strategies tackling multiple constraints—such as building a range of skills or combining skills with increased access to capital and urban space—are more promising.[12] Both behavioral skills and business skills are best included in these integrated packages. Second, it is not clear that current HE owners need more training to raise their productivity or sustainability. Most operators do not list skills—business or technical—as their main problem. They are much more likely to mention the need for finance or customers (access to markets, market information, or work space). But when technical or business training is offered at little or no cost, participation is substantial. For privately provided, demand-driven technical training, the tracer studies on the Jua Kali Program in Kenya (chapter 3, box 3.7) and the IFAD program in Ghana (box 5.11) suggest that benefits can accrue to trainees. For business training, the outcomes on productivity are elusive, especially for owners of HEs.

Box 5.11

Rural enterprise projects bolster skills and business development in Ghana and Senegal

The International Fund for Agricultural Development (IFAD) supports rural enterprise projects to provide the skills and other resources that help rural people, especially women and young people, to create and develop local businesses that provide income and employment off the farm. Projects may include the following components:

- *Business advisory centers* provide a range of business development services, including business orientation seminars, community-based skills training, small business management training, literacy and numeracy training, and information and referral services.
- *Rural technology facilities* support master craftspersons, traditional apprenticeships, and the promotion, dissemination, production, and repair of technology for rural HEs and microenterprises.
- *Rural financial services,* offered in conjunction with financial institutions, include credit for on-lending to small rural businesses and training for financial institutions to provide financial services to vulnerable groups.
- *Support for rural household and microenterprise organizations* includes support for local trade associations to build partnerships with stakeholders and support for formulating and strengthening polices through a working group on enterprise development.

In Africa, IFAD has implemented rural enterprise projects in Ghana, Madagascar, Rwanda, and Senegal. Impacts and challenges of projects in Ghana (the longest-running project) and Senegal are highlighted here.

The *Rural Enterprise Project* in Ghana was implemented in two phases between 1993 and 2012. During the second phase (2003–12), the project collaborated with Ghana's NBSSI and the Ghana Regional Appropriate Technology Industrial Service to develop 53 business advisory centers and 13 rural technology facilities in 24 districts at a cost of US$30 million, financed by IFAD, the African Development Bank, the Government of Ghana, and contributions from project beneficiaries (62 percent of whom were women). Almost half (47 percent) of participants reported that they had increased their profits as a result of better record and bookkeeping practices, and 37 percent reported that they had improved their management and marketing skills. Following technical training in skilled occupations such as processing palm oil, producing tie-dyed and batik cloth, and making leather goods and soap, 22,000 new enterprises were established, 63 percent headed by women. About 15 percent of the start-ups later became inactive because they lacked a market, working capital, or raw materials; their processing equipment failed; or they had personal reasons for closing the business, such as moving to another area. About 4,300 loans were disbursed through participating rural banks and MFIs; 87 percent were repaid. But the participation of banks and MFIs in the credit component was low owing to creditworthiness issues with the start-ups. (Typical reasons for such low participation are discussed in focus note 3.) Microenterprise subcommittees established within local governments help to sustain project gains (see box 5.7). Although the second phase specifically targeted employment growth through business expansion, most of the employment created was through self-employment in a start-up (sometimes following a paid apprenticeship). This result reinforces the point that targeting start-ups is the most promising avenue for creating employment.

The *Promotion of Rural Entrepreneurship* (PROMER) Project in Senegal, implemented by IFAD in 2006, sought to reduce rural poverty by fostering and consolidating profitable rural HEs and microenterprises capable of offering stable jobs. PROMER focused on strengthening and professionalizing rural entrepreneurship and improving the overall political, legal, and institutional environment for such enterprises. For its target population—rural youths and women ages 18–35 who were poor, unemployed, and out of school and who either operated or wanted to start an enterprise—PROMER provided a combination of technical and management training and funding. Technical skills training primarily involved agribusiness, including food processing, and provided skills to 700 entrepreneurs in metalworking, equipment manufacturing, textile and clothing production, and hygiene and quality monitoring. Management training was provided to about 500 entrepreneurs. The project cost CFAF 10 billion from 2006 to 2013.

PROMER helped to create 240 enterprises, consolidate 665 enterprises, create 3,750 jobs, and teach 458 people to read. It usually takes enterprises three to five years to reach their full potential, and finding a niche in the economy can be critical for success. Through the project, for example, a baker started to make traditional bread, which was in high demand in periurban areas but not supplied by modern bakeries. Apprentices trained informally by the baker opened 20 enterprises of their own and created about 84 jobs.

Other rural enterprises were not as successful. Some developed products that succeeded in rural markets but not in urban markets because of high transport costs, poor marketing, or poor quality. Most entrepreneurs reported challenges in maintaining quality and continuous production. Rural enterprises had trouble finding an urban location in which to present their products, a result that highlights the problem of multiple constraints. Exhibitions have played a major role in bringing some rural products to a wider market, especially furniture, and have attracted better contracts that have led to modest job creation.

Sources: IFAD 2011; Senegal Ministry of Agriculture 2011.

Government's Role in Building Skills

The role of public policy in building young people's skills for productive employment in the HE sector needs to be considered carefully. The accumulating evidence that building skills can help to facilitate entry and raise earnings in HEs, along with the fact that a range of skills matters for productivity, does not constitute a case for public financing or provision of skills training. Not every type of training is cost-effective, and the private sector routinely provides many types of training. For all of these reasons, governments must carefully assess and justify whether there is scope for directly financing or providing specific training opportunities. The rationale for public intervention needs to be informed by well-identified market failures and assessed against risks of "government failures" in providing or financing training.

If young people cannot afford to finance their training, governments may need to help. Youths from the poorest households have the least access to training. For example, young people from the richest quintile of the welfare distribution are three times more likely to apprentice than those from the poorest quintile (chapter 3). Gender patterns in participation in training and the types of training selected are also strong. Females are less likely to pursue training; when they do, they often choose training that builds a narrow set of skills, such as tailoring or weaving. In this context, public policies to facilitate inclusion can be put in place. Government interventions have shown that financial barriers to training opportunities can be overcome through interventions such as vouchers (see box 3.7 on the Jua Kali Program in Kenya) or cash grants targeted to youth groups (the Youth Opportunities Program in northern Uganda; Blattman et al. 2013).

Information failures lead not only to underinvestment in training but also to investment in suboptimal types of training. Poor information can also contribute to a misalignment of aspirations, expectations, and attitudes toward self-employment among young people. In this context, government involvement in providing better information on existing training options and employment opportunities is warranted. For instance, information on training opportunities or on earnings in different occupations can influence women's choice of training. As mentioned in box 5.2, young people in Kenya had misperceptions about the returns to vocational training.

There is limited justification for governments to provide directly the type of training in basic technical skills that is delivered routinely by private providers active in countries today. Governments should not create additional distortions in training markets. Attempts to limit or overly regulate the many small training providers have proven ineffective and should be avoided. However, private providers rarely provide other relevant skills such as behavioral or business skills. There may be scope for public policy to encourage the provision of these complementary skills, which are particularly relevant for the HE sector (curriculum development is one option for doing so).

Overall, the appropriate role for government is likely to be greater for financing than for providing training. Governments can leverage the private sector, including NGOs, to deliver the most promising models. The range of training delivered by private providers is very diverse, and so are the content, duration, and quality of that training. Given the lack of data on the full range of privately provided training, the degree to which training prices accurately signal the quality of training opportunities remains unclear. When governments finance training, they should strongly consider performance-based contracting of private providers based on outcomes or at least key indicators of quality. For instance, Liberia's Economic Empowerment of Adolescent Girls and Young Women Project (EPAG) Program for adolescent girls achieved a dropout rate of less than 5 percent through innovative design elements that ensured high participation and training quality (see World Bank 2012; and box 3.7 in chapter 3). Training providers were incentivized through performance bonuses, and the program included frequent and unannounced monitoring visits to check on the quality of provision.

National Skills Strategies

Many governments develop national skills strategies, but too often they focus exclusively on the formal labor and training markets. Often these strategies fail to recognize the importance of the nonfarm HE sector and fail to acknowl-

edge the prevalence of private providers and the existence of training markets.

The strategies could identify areas where failures exist in the HE training market, such as failures in information provision, and consider the role that government programs and policies could play in addressing them, mindful of the cautions noted earlier. Governments could also use these strategies to provide information about market needs and successful approaches to the multitude of donors and NGOs active in this area. In developing these strategies, governments could consider the following options:

- *Focus programs for youth on the transition into the nonfarm HE sector.* Programs appear most effective at facilitating entry into the nonfarm HE sector, including programs that enable young people to transition out of agriculture. Evidence is weaker on how to raise the earnings of those who already operate HEs. Policies aimed at facilitating entry are more likely to yield the highest earnings and productivity gains.
- *Adopt an evidence-based and learning-based approach.* At the very minimum, encourage all programs to track and report outcomes. This monitoring should be done through provider organizations, not through expensive and bureaucratic registration and certification processes. Overall, the government's role in building skills in the HE sector needs to be selective, performance driven, and evidence based. As discussed, packages or integrated interventions show the most promise, although many design questions remain, especially with respect to scalability, cost, and cost-effectiveness. Therefore, governments should use a learning-based approach to design, pilot, and evaluate models to find cost-effective and scalable interventions. The evidence discussed in this chapter can guide the initial choice of models.
- *Encourage the delivery of "bundled" interventions that tackle multiple constraints.* Specifically, these interventions include programs that deliver behavioral, business, or technical skills training as part of a comprehensive package or programs that combine skills training with increased access to capital.
- *Experiment with demand-driven financing for training.* Such experiments would include using techniques that have shown some results in other programs, such as vouchers.
- *Prioritize financial assistance and programs targeting the poor and women.* Targeting the poor and women should be a priority for reasons of efficiency and equity. Recent impact evaluations found that programs for the poor and for women may have high returns (Macours, Premand, and Vakis 2013). Programs that are simply offered "on demand," however, may not reach the poor or women. Indeed, those groups might not aspire to participate in such programs, and they are more likely to lack the social networks that facilitate access to them. To design inclusive programs that reach the poor and women, explicit efforts are required, as well as close attention to the barriers that females face in entering the HE sector and earning an adequate return. Pilot programs such as BRAC's program in Uganda (targeting females) should be encouraged as a means of identifying the most effective and scalable approaches.
- *Finance the development of a curriculum and learning materials to teach very basic business skills in local languages and incorporate training in those skills into education and training programs.* As part of this effort, the use of existing modules—tested and evaluated in the local context—should be encouraged.[13]
- *Consider providing information to primary school students and their parents on economic opportunities in the HE sector and on the types of training that have had the best outcomes.*

Market Access and Voice

Current and prospective HE owners report that poor access to input and product markets is a serious constraint. Although traditional private sector development approaches assume that HEs' exclusion from defined markets and

large value chains cannot be remedied, new research is challenging that assumption. HEs can participate in international value chains if producer associations can be created and markets structured to include them. Recent analysis by the Monitor Group highlights how imaginative new "bottom of the pyramid" business models in low-income Sub-Saharan Africa can include HEs (Kubzansky, Cooper, and Barbary 2011). Three distinct business models are identified:

- *Distribution and sales through informal shops.* In this model, enterprises develop a route to market that leverages (and sometimes upgrades) informal distribution and sales channels to sell products through multiple fragmented or unorganized shops.
- *Contract production.* This system sources produce directly from a large number of small-scale producers in (often rural) supply chains. The contractor organizes the supply chain from the top and provides critical inputs, specifications, training, and credit to suppliers. The suppliers provide assured quantities of specialty produce at fair and guaranteed prices.
- *Direct procurement.* Direct procurement setups bypass traditional intermediaries and purchase directly from large networks of low-income producers, often providing training to meet quality and other specifications.

The first model, the *producer-led* model, is probably the best known. It has been used by Coca-Cola, Bayer, mobile phone companies, and the M-PESA mobile money system, for example. These companies have been able to forge links with HE traders, using simple methods of distribution to benefit from access to the wide marketing channels that petty trading provides for their products or services. Kottoh (2008) found that the proliferation of trading in mobile phone credits by hawkers for MTN, Vodafone, and other telecommunication giants in Ghana is providing above-average income to the HEs while benefiting the companies. By training small-scale traders to be its agents in rural and periurban areas, M-PESA quickly gained a dominant market share of Kenya's money transfer and e-money market.

The second and third are *buyer-led* models, because the buyer helps to organize the value chain so that producers can access a bigger or more secure market. These models require HE producers to organize in associations or cooperatives, with which the buyer works to obtain a product for a market defined by the buyer. For example, the buyer provides output specifications and the necessary training to the association or cooperative and manages and monitors the quality of the output. The contract production model has been successful in the handicraft sector (box 5.12). It relies on a dedicated entrepreneur at the top of the value chain to organize both production and export into existing distribution channels. The deep procurement model relies on existing large contractors to reach out to HEs as subcontractors to supply their value chains.

Young people are well placed to participate in these initiatives. They more easily adopt new technology and methods brought to the HE sector by the large companies; this was especially true for the mobile phone and mobile money value chains, where many youths got their first job as sellers of air time or pay-per-use phones. Governments have usually not played a direct role in facilitating these efforts, as private sector expertise is required. However, by encouraging partnerships and donor financing of technical assistance and initial risk capital as well as providing the enabling environment, governments can support these efforts. For example, the Rwanda government was a key partner in scaling up the Rwanda basket initiative. Challenge grant funds from the Department for International Development in the United Kingdom helped to develop M-PESA in Kenya, with the support of Kenya's central bank.

Associations

HE associations are critical to successful development of the sector. As millions of individuals operating millions of very small, scattered businesses, HE owners lack a unified voice and struggle to be heard alongside the multiple players in the development process. Individually, HEs are an easy target for predatory

"My main challenge is stiff competition, made worse by customers who take long to pay or don't pay, including the subcounty government, whose failure to pay compelled me to lay off workers."
Uganda

Box 5.12

Taking a household business to the international market: Gahaya Links and Rwanda's peace baskets

A basket-weaving tradition made its way from the villages of Rwanda to American households, changing the lives of thousands of Rwandan women basket weavers. For decades, women in Rwanda have produced distinctive, cone-shaped baskets that are traditionally used to carry wedding gifts. The baskets are handcrafted from enzyme-washed papyrus and banana leaf. The traditional zigzag design tells an ancient story of friends walking together, visiting neighboring villages along the way. The women who weave the baskets at home used to hawk them on the streets in tourist locations. In 1995, Janet Nkubana, who was managing a hotel in Kigali, decided to set up a shop on the hotel premises to market the baskets to hotel guests. She also took some baskets to sell in the United States when she visited her sister. Their popularity there encouraged the two sisters to set up a factory with the women weavers and market the baskets worldwide. The baskets were renamed "peace baskets," because the weaving groups include Hutu and Tutsi women, who find that working together is a healing process.

Gahaya Links initially started with 27 weavers as employees. It gained international exposure after a *Marie Claire* feature on reconciliation through peace baskets brought orders for 1,000 baskets. This order was a huge challenge for Gahaya Links, but it provided an opportunity to identify and remedy flaws in their products and to develop a new business model. The sisters worked with the weavers to develop uniform designs and use stronger materials. To expand rapidly, the company recruited women through churches, villages, and word of mouth to serve as contract weavers. They established a rigorous training program starting with master weavers, who could then train others in the area to meet high standards of quality. The Government of Rwanda helped by organizing the self-employed women weavers into cooperatives and building local training centers. Rwanda also joined the African Growth Opportunity Act, which allowed Rwandan crafts to enter the United States market duty free. Participation in a New York trade show in 2005, sponsored by the U.S. Agency for International Development, facilitated connections with international retail stores.

Gahaya Links reported annual sales of US$300,000 in 2007; that same year, it contracted with approximately 3,200 women in household basket-weaving enterprises across Rwanda to make their product. Gahaya Links issues purchase orders based on standard designs, and the weavers receive one-third of the proceeds from basket sales. The company thrives because it focuses on quality, training weavers to supply a product consistently valued by international consumers.

Source: World Bank 2008.

officials or economic agents (box 5.13). Their contribution to the local economy may not be recognized. Because policies and regulations are developed without their input, these businesses are often over- and underregulated (Roever 2006). HE associations make it possible to manage the consultation required to develop and implement successful projects to supply public goods that benefit HEs and the local economy (such as development of the workshop cluster in Ghana, described in box 5.9). Economic agents seeking to work with HEs to strengthen value chains also need effective producer organizations as partners. HE associations can provide the necessary channels to transmit information about support programs and can be used by private sector operators seeking to integrate HEs into their value chains. For example, Procter and Gamble works through the hairdressers' association in Ghana to distribute information about new products being brought to the market.

Effective participatory organizations are rarely created by governments, but governments can easily undermine them. National strategies should recognize the need for effective associations. Local government policies and regulations covering the use and disposition of public space should recognize the need to consult with HEs and encourage the formation of local associations to facilitate this process. Donors and other international actors can be helpful in encouraging and supporting associations. Donor financing for associations of HEs through the Trade Union Congress in Ghana was helpful in building the capacity of these groups, and support for creating local HE associations was included in the terms of reference for the business advisory centers supported by IFAD's Rural Enterprise Project in Ghana.

Box 5.13

Reducing isolation and exploitation through self-help associations

Gaining a voice in the national policy dialogue is especially challenging for Africa's youth, whose livelihoods depend overwhelmingly on activities outside traditional wage employment (and will do so for the foreseeable future). These activities are inherently vulnerable to high volatility in earnings, lack of legal recourse in case of expropriation or theft, and limited access to safety net programs. These vulnerabilities are compounded by an inability to influence the policies that affect their working conditions. For women and youths, who are overrepresented in most forms of "vulnerable employment"[a] in Africa, the need for formalized channels that allow access to policy makers and afford a measure of visibility in the public sphere is especially pressing.

These conditions are not inevitable. Over the past few decades, new models for collective action have emerged, enabling workers to advocate for their interests directly with buyers, sellers, and the state (often at multiple levels—local, national, and international). These "worker associations" occupy a unique space somewhere between an NGO, which provides services to its members, and a labor union, which represents workers in negotiations with employers. Associations in Africa and other regions are growing in number and establishing this form of organizing as a viable means of improving conditions in nonwage work.

The world's largest and probably best-known worker association is in India. The Self-Employed Women's Association (SEWA), established in 1972, broke traditional barriers to form organizations representing cigarette rollers, head porters, and others who did not have "employers" to bargain with and hence were excluded from the trade union movement. After decades of developing innovative organizing modalities to negotiate with municipalities, buyers (such as cigarette and garment factories), and other actors (such as forest management councils), SEWA has established itself as a leading force in India's trade union movement. SEWA's activities include obtaining official identification cards for workers to allow them to access state social protection programs, programs to develop and upgrade members' skills, bargaining over piece rates paid to contract workers, provision of space and licenses for vendors in marketplaces, and lobbying for better access to forests and markets for gum collectors. SEWA representatives participated in crafting national legislation on sexual harassment in the workplace in 2010, a law that explicitly covers domestic workers, and in developing a national policy on vendors and hawkers in 2004.

Given that nonwage work is likely to persist in Africa and given its strong gender and youth dimensions, finding ways to support active engagement offers a better way forward than ignoring them, "formalizing" them, or suppressing their activities. With rare exceptions (Ghana's Trade Union Congress is one), including trade unions in the policy dialogue is unlikely to suffice, because traditional trade unions usually exclude nonwage-earning participants in the labor force. Policies on issues as diverse as natural resource management, urban zoning, sexual harassment and discrimination, the minimum wage, and social safety nets affect all workers, not just the minority with a formal contract or registered business. Without associations that legitimately represent their interests, the voices of informal workers are unlikely to be heard or taken seriously.

Although an organization of SEWA's breadth and experience has yet to develop in Africa, several organizations are applying similar models. The results of these efforts can be as straightforward as improving the visibility of HE owners and casual workers in national statistics and as far-reaching as including HE owners and casual workers under public health insurance programs. Associations of street vendors have been among the most successful to date. For example, they have enabled street vendors in Ghana, Kenya, Liberia, and South Africa to receive literacy and skills training, organize child care and informal schooling, rehabilitate markets, finance their operations, and arrange to source, transport, and store merchandise.

a. The ILO defines "vulnerable employment" as self-employed and contributing family workers. Those pursuing such activities "are less likely to have formal work arrangements and are therefore more likely to lack elements associated with decent employment such as adequate social security and recourse to effective mechanisms of social dialogue. Vulnerable employment is often characterized by inadequate earnings, low productivity, and difficult conditions of work that undermine workers' fundamental rights" (ILO 2010).

Conclusion

Governments need to give serious consideration to the HE sector's potential to create jobs for youth. Even exceptionally high economic growth in nonfarm sectors has not and will not generate enough new nonfarm wage employment to absorb both the new entrants and those who seek to leave agriculture. HEs are growing as a share of the labor force not because of failures in regulation and economic growth, but because households that manage to stay in the

sector make money—more than those working only in agriculture or as casual laborers.

Young people see these opportunities and are trying to enter the sector, but they are frustrated by the lack of capital, information on markets and opportunities, productivity-enhancing skills, and locations to work. Because the HE sector grows when new businesses arise, the strategy for increasing employment in this sector is to encourage business creation, support higher earnings, and increase sustainability. Initiatives that address the most important constraints on creating a business—lack of finance and space to work—will be the most effective.

Most countries have no such strategy for the HE sector. Instead, they have a fragmented youth employment strategy focused primarily on the wage sector and a strategy for SMEs. This set of strategies is not working. Initiatives for SMEs rarely reach HEs. Boutique NGO projects cannot reach enough prospective HE owners to make a difference.

A comprehensive national HE strategy should focus on approaches that are demand driven and address the main constraints to start-up and sustainability. Elements of a comprehensive national strategy for the HE sector, based on a shared vision of the sector's potential to generate productive employment, include the following:

- *National strategies.* Growth and employment strategies need to recognize the sector's potential and propose a supportive policy framework. The strategy should endorse the creation of independent HE associations to reduce the costs of reaching individual enterprises and to give this sector a voice in government decision making. The specific outcomes to be attained in the sector should be to expand the number of businesses and increase their productivity.
- *Urban policies.* HEs also need to be recognized as an important element in local economic development. Local governments must be accountable to HEs and include them in decisions related to planning, zoning, and land use, land markets and land tenure, and infrastructure. HE associations should be encouraged at the local level so that HEs can have a voice.
- *Better financial access for households.* Regulatory reform is needed to reduce the costs of retail banking, encourage savings, and develop youth-focused products. NGOs should be encouraged to expand low-cost strategies to help youth to save start-up capital, such as village savings groups.
- *More effective skills strategies.* Governments should focus their efforts on market-enhancing programs, such as programs to disseminate information about opportunities and facilitate access to existing training for disadvantaged youth and not attempt to deliver training directly. They should also invest selectively in good-quality training programs that tackle multiple constraints, either by building a range of skills such as technical, business, and behavioral skills or by combining skills with capital.
- *Development of value chains.* This activity resides primarily with the private sector. Governments should encourage social entrepreneurs to include HEs in value chain development.
- *Associations.* Associations are especially important at the local level. Regulations on consultation prior to land use planning or implementation should encourage local governments to work through independent HE associations. Donors and NGOs should extend support to these associations, helping to develop their capacity.

Notes

1. In many countries, rural households include households in market towns or periurban areas. They are often designated rural because agriculture is still the predominant economic activity.
2. This section draws from World Bank studies of HEs in the Republic of Congo, Ghana, Kenya, Rwanda, Tanzania, and Uganda as well as broader reviews of the literature and evidence.
3. At the time of writing, the youth employment inventory included 86 youth employment projects in Africa, of which 79 provide skills training. In a review of interventions to support young workers in Sub-Saharan Africa, Rother (2006) found, "In most cases, these programs

include elements targeted at helping young people to start their own businesses, combined with elements of skills development and training."

4. Outside Africa, few studies offer evidence that technical training by itself can facilitate entry into self-employment. For instance, skills training had no significant impact among a sample of workfare participants in a welfare-dependent region of Argentina (Galasso, Ravallion, and Salvia 2004).
5. While the number of programs providing business skills or financial literacy training has been increasing in Africa (see Messy and Monticone 2012; Xu and Zia 2012), only a handful of recent impact evaluations analyze the effect of such programs on entry into self-employment. For instance, most evaluations quoted by Messy and Monticone (2012) analyze the effect on intermediary outcomes (such as knowledge of financial literacy or savings behavior), but not on employment outcomes (such as entry into self-employment) or earnings.
6. In developed countries, Oosterbeek, van Praag, and Ijsselstein (2008) studied the impact of entrepreneurship education on students' competencies and intentions. They found that the program did not have the intended effects: the effect on students' self-assessed entrepreneurial skills was insignificant, and the effect on the intention to become an entrepreneur was significantly negative.
7. For Pakistan, see Giné and Mansuri (2011). For Peru, see Karlan and Validivia (2011). For Sri Lanka, see De Mel, McKenzie, and Woodruff (2012a). For the Dominican Republic, see Drexler, Fischer, and Schoar (2010).
8. The business training course consisted of 21 sessions, each lasting 45 minutes, and covered topics such as Entrepreneurship and Entrepreneurial Character, Improving Customer Service, Managing People in Your Business, and Marketing Strategies. Overall, these results suggest that insufficient human capital among poor micro and small business owners may be the more important constraint to increasing productivity. The results also highlight the need for more comprehensive measures to promote development among female entrepreneurs.
9. The program was implemented in urban and rural areas through local "adolescent development clubs" in which a female mentor led the activities. The program targeted girls ages 14–20 who were still in school or had dropped out. Of the girls in the target communities, 21 percent participated in the training; of those who participated, 85 percent took part in the life skills training and 53 percent took part in the vocational skills training (primarily in dressmaking or tailoring).
10. The latter package was designed primarily to help females to attain a wage job. The main reason for the low impact is that there was little demand in the wage employment sector for the graduates.
11. Cash grants targeted to youth groups can affect occupational choice and improve income. Blattman, Fiala, and Martinez (2013) evaluate the impact of a Youth Opportunities Program implemented by the Ugandan government in the context of the northern Uganda Social Action Fund. The program targeted youth groups of 10–30 persons, who received grants averaging US$374 per group member. (Participants were poor by most measures, but the average applicant was slightly above the average wealth and education level in the region. For instance, 93 percent had completed some primary school, 45 percent had completed some secondary, and only 7 percent had no education.) Of those who received the cash transfer, 80 percent enrolled in vocational training, and most invested heavily in business assets. The program was effective in changing the type of work that youth perform in an environment where most employment is outside the modern wage sector: 68 percent of grant recipients were working in a skilled trade, compared with 34 percent of the control group. Income was also higher for grant beneficiaries. On average, grant recipients had net income 50 percent higher than the control group, a return on the initial transfer amounting to 35 percent a year.
12. Another example of integrated intervention can be found in rural Nicaragua, where beneficiaries from a cash transfer program also received either technical training or a business grant. The business grant packages led to entry into self-employment as well as higher average income and consumption. The vocational training package led to entry into self-employment for the poor and higher wage income for the nonpoor, but had no impacts on income or consumption on average (Macours, Premand, and Vakis 2013). Both the training package and the business grant package also helped households to protect themselves against shocks by allowing them to smooth income through diversification (Macours, Premand, and Vakis 2012).

13. Examples of modules in wide use include ILO's Start and Improve Your Business Program (see http://www.ilo.org/empent/areas/start-and-improve-your-business/lang--en/index.htm) and various materials produced by the Peace Corps (http://www.peacecorps.gov/library/pubindex/); for example, see the Microenterprise Training Guide (http://files.peacecorps.gov/multimedia/pdf/library/M0068_microent.pdf).

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Financial Inclusion and the Transition to Sustainable Livelihoods for Young People

FOCUS NOTE 3

"Financial inclusion" means that individuals can obtain a range of financial products—savings, credit, insurance, and payment systems, including systems to send remittances—at a reasonable cost and on a sustained basis (Gardeva and Rhyne 2011). Financial inclusion remains elusive for many African households, which generally develop their own strategies for saving and rely on loans from family, friends, and informal lenders to meet their need for credit. The gap in access to savings vehicles is at least as important as the gap in access to credit. Closing these gaps is challenging for most households, especially for young people, whose access to formal financial services is often limited by banking regulations, the lack of products designed to meet their particular needs, and the difficulty of establishing their creditworthiness. Across Africa, technology is reducing the cost and increasing the accessibility of formal financial services; at the same time, informal savings and credit groups are expanding. These informal groups may offer a promising venue for integrating the delivery of youth programs in communities, including programs to foster savings behavior, build business and soft skills, empower females, and expand financial inclusion, with the goal of enabling young people to pursue sustainable livelihoods.

Gaps in Access to Savings and Credit

The ability to save is intricately linked with the ability to obtain credit. Without the habit of regularly setting money aside, individuals have difficulty repaying loans. In addition, lenders will always require borrowers to use a portion of their savings to pay for part of a proposed investment (the down payment). Savings can also serve as a form of self-insurance when households take out a loan to make potentially high-yielding but risky investments.

Agricultural households need to save and borrow for a range of reasons—to obtain and sustain land to farm, to buy or rent equipment, and to acquire other inputs that make their efforts more productive. Households that operate a nonfarm enterprise also need to save and borrow to start and maintain their business.

A complicating factor for farm households and households operating nonfarm enterprises is that the finances of the farm, household enterprise (HE), and household itself are often linked, so household income smoothing and credit needs (for example, funds to pay for lumpy expenditures such as school fees or home repairs) may compete with farm or business liquidity needs, potentially reducing the sustainability of the business. For this reason, the gap in access to credit occurs at both the household and the enterprise level.

Young or aspiring farmers and HE owners can have the most difficulty mobilizing capital, because their capacity to save and borrow is often so constrained. In many countries, young people cannot access the formal banking system even if they want to, because laws prohibit opening a bank account before age 18.[1] Even where no legal obstacles stand in their way, young people can be frustrated by the lack of products designed to meet their particular needs as savers and borrowers of small amounts.

"It is not easy for us to access credit like the adults." Uganda

Despite these limitations, low-income youths in various situations (at home with parents, living away from home, or living on the street) persist in saving for school, emergencies, and less often, to start a business (USAID 2009). Saving not only is important for meeting those needs, but having financial assets by itself has positive behavioral effects for young people, "increasing future orientation, long-term thinking, planning, and self-efficacy" (Kilara and Latortue 2012). Research shows

that behaviors such as saving and exercising financial discipline are best developed at a young age. If young people do not develop the habit of saving, they will have trouble starting and sustaining farm and nonfarm enterprises later on.

Formal Savings Services: Issues and Options

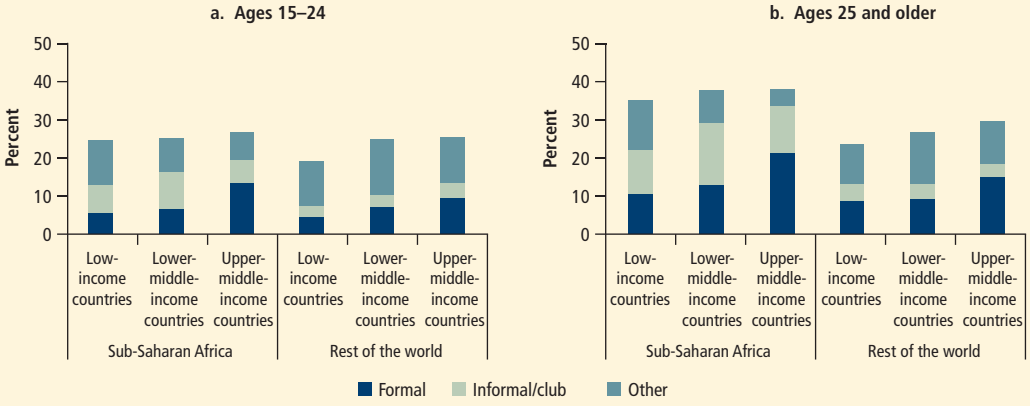
A secure place for savings allows people to improve their planning, financial decisions, and risk management by keeping their money out of temptation's way (Mullainathan and Shafir 2011; Collins et al. 2009). Although low-income households and individuals may have very little cash on a given day, a savings habit can transform that cash over time into a larger sum, which can then be used for lumpy expenditures such as school fees or investment in inventory or tools for an HE. But when people lack a secure place to put their money, they are much less likely to save, as the difficulties of daily life for the household and the extended family demand a short-term financial focus, and multiple requests for cash reduce self-control. Access to a secure place for savings is particularly important for women's ability to build up capital for a business, because women are especially subject to pressure for funds from other members of the family (Dupas and Robinson 2009). Women sometimes go to extraordinary lengths to set money aside. For example, in the absence of other mechanisms to save, market women in India with more established businesses report taking loans from informal moneylenders at very high interest rates just so they will be required to put funds aside every day. They resort to this strategy even though they could accumulate much more capital and profits if they were to save a part of their profits every day to self-finance the next replacement of inventory (Karlan and Appel 2011).

African Households Save, but Rarely at the Bank

African households are no different from households elsewhere—they know the value of savings. Controlling for national income, African adults are actually more likely to save than non-African adults, especially in low-income countries (figure F3.1). African youths in lower-income countries also report saving more than their counterparts in countries with similar income levels. In some countries, more than 20 percent of individuals ages 15–25 reported that they had been able to save some funds in the last year.

Although youths and older adults say that they save, they do not use a bank account for that purpose. Some use informal savings groups in the village or neighborhood, but many simply keep their cash at home, the least

Figure F3.1 Percentage of population ages 15 and older who reported saving any amount in the last 12 months, by savings mechanism



Source: Based on FINDEX data.

safe place. In surveys, young people and adults express a desire for an affordable, convenient, safe place to keep their money—a service usually provided by a bank.

Access to banking services rises with income and urbanization. Banking is an industry with economies of scale, so banks go where the money and the customers are (unless special provisions are made; see box F3.1 for an example of rural banking from Ghana). Given the low incomes and low population density prevalent in Africa, it is not surprising that few households use formal banking services: only 24 percent of households in Africa have access to a bank account.[2]

But the lack of a bank account is far from the whole story in Africa. As in the rest of the world, in Africa's banking industry, technological innovation and regulation interact in complex ways to influence how much it costs to provide financial services and who can obtain them.

Box F3.1

Rural banks in Ghana: Reaching clients who are underserved by other banks

Ghana's rural and community banks (RCBs) were established by the government in the late 1970s to facilitate Cocoa Board payments to farmers. The banks were privatized and became microfinance institutions in the 1990s, and today they provide various affordable savings products (savings accounts, current accounts, daily deposits collected by agents who go door to door, and fixed or time deposits), credit products (microfinance loans, personal loans, salary loans, and overdraft facilities, for example), and money transfer and payment services. Ghana's RCBs reach 2.8 million depositors and 680,000 borrowers, consisting mainly of farmers, government employees, and small and microentrepreneurs—clients often underserved by formal financial institutions. They are now the largest providers of formal financial services in rural Ghana. With some additional outreach, they could benefit young people—another underserved population.

Source: IFPRI and World Bank 2010, brief 5.

Options for Lowering Costs and Expanding Outreach

At the firm level, the high fixed costs of operating a bank office (building, machinery, banking staff, security), the need for reliable infrastructure and services (electricity and communications), and customers' unwillingness to use a bank that is far from their work or home mean that high population density is a prerequisite for traditional banking services to spread.[3] Given the fixed costs associated with maintaining customer accounts (recording transactions, processing fees and interest), small account balances can be a losing proposition for the bank and for the customer, to whom those costs are passed in the form of account and transaction service charges. Regulations can compound the cost problem when they require proof of identification (birth certificates and similar documents), which many low- and moderate-income individuals lack and which are difficult to acquire. In Kenya and India, to cite just two examples, technology is helping consumers to bypass these problems (box F3.2).

Recent technological applications such as mobile banking have sharply reduced the costs of retail banking, offering a major new opportunity to increase household access to secure savings and payment mechanisms. Low population density makes brick-and-mortar branch banking unprofitable, but the construction of cell phone towers and networks has opened opportunities to bank through a mobile phone, ATM, or point-of-sale device. In branchless banking, the costs of savings account and bill payment services are as much as 50 percent lower, and the costs of money transfers are about 20 percent lower, than they are in traditional banking by microfinance institutions (MFIs) and other banks oriented toward the poor (McKay and Pickens 2010).[4] The rapid spread of M-PESA in Kenya, which increased household access to formal finance by 10 percentage points in three years, shows the potential (King 2012). The use of mobile phones and other new technology to expand access to formal banking is particularly attractive for young people, who are always early adopters.[5]

At the same time, banks need to use these new channels for connecting with young people—to offer products attractive to youths and bring them in as customers early—even if the benefits are more likely to materialize over the long term. This effort may require support as part of financial sector development.

"Even if you have 100 shillings, you can save your little money."
Uganda

Box F3.2

Use of technology: Bringing secure financial services to new markets in Kenya and India

Just as the cellular telephone revolution has lowered the cost of communication and allowed poor countries in Africa and elsewhere to leapfrog over the problem of building a landline phone network, branchless banking using mobile phones and "micro automated teller machines (ATMs)" that read unique bioidentifiers could be used to extend financial access to the vast "unbanked" population. Already, Africa is the second-largest mobile money market, in part because remittances are so important in this region. But as with the rollout of mobile phones, regulatory policy will be as important as innovation in determining the outcome.

Kenya's Venture into Mobile Money

Since its launch in Kenya in 2007, M-PESA, a mobile phone–based banking system run by Safaricom, has dramatically changed the financial services landscape. M-PESA allows registered users to store money in their account by buying phone credits, to transfer money to or receive money from other registered users through their mobile phone, as well as to transform their credit balance into cash at any authorized dealer. By building on its existing cell phone record-keeping infrastructure and agent network, Safaricom has been able to offer basic banking services at much cheaper prices than a branch bank (about 50 percent cheaper, depending on the service and size of transaction). It has doubled the share of the population with access to a secure place to store cash, and, by operating as a debit card (or electronic wallet), it has reduced users' vulnerability to robbery.

M-PESA differs from a bank in two important ways. It does not offer loans (although M-PESA customers can use the system to link with banks, receive loaned funds, and make the required loan payments), and it does not pay interest on its accounts. Given that the interest earned on small savings accounts in commercial banks is usually eaten up by account fees, small savers are better off using M-PESA, even without the interest. In 2012, an analysis concluded that M-PESA's branchless banking system had brought banking to previously unserved low-income populations and had "flattened the geographical constraints to access" across Kenya (King 2012, 28). Despite being a low-income country, Kenya has one of the highest levels of financial access in Africa, with mobile money transactions equivalent to 60 percent of Kenya's gross domestic product (GDP) in 2012 (Blycroft Ltd. 2012).

At least as important as Safaricom's product innovation and successful implementation was the stance of the bank regulator, the central bank of Kenya. When M-PESA was launched, Kenya had no law regulating nonbank e-money issuers and e-money transactions. Rather than simply blocking Safaricom from operating the system, the central bank negotiated an agreement under which Safaricom would operate the system. The agreement stipulated that the e-money on deposit with Safaricom through M-PESA would be separated from the company's accounts and cash flow (in the same way that other nonbank financial institutions, such as stock brokerages, are required to isolate customers' assets from the assets and accounts of the company). The central bank kept a close watch on the system's operations, including sporadic checks to see that at the close of the day the amount of funds that e-money customers had stored with Safaricom in their phone accounts was equal to the amount of funds that Safaricom had placed in its trust account at its partner bank. After three years of this "test-and-learn" supervision, the central bank began work on a set of e-money and e-payment regulations.

India's Solution to the High Cost of Verifying Bank Clients

For low-income populations, a major obstacle to interacting with the formal banking system is the lack of verifiable identification. Banking systems need to be able to identify their customers to ensure that financial transactions are secure; in addition, they have to comply with supervisory reporting requirements on transactions, some of which are set internationally as part of global anticorruption and antiterrorism regulations. Low-income countries are less likely to have reliable national identification systems, and these databases are unlikely to cover lower-income populations and people in rural areas. Faced with the high cost of verifying the identity of such clients, banks often choose not to serve them at all.

The Government of India is finding a way around this problem through the Unique National Identification project, in which identification is based on biometrics rather than standard approaches such as birth certificates and postal addresses. At a very small cost per participant, more than 300 million people registered in the first two years. Banks have responded enthusiastically to this system, investing in basic biometric readers, which are linked to the database and can instantly identify and verify account holders. Agents in rural areas have been equipped with "micro ATMs"—point-of-sale devices—that read the client's biometrics (usually fingerprints) and record the transactions in the bank database, reducing the need for customers to travel to bank branches. Government agencies are using this system to disburse cash transfers to households through low-cost bank accounts, and citizens can also pay school fees and

(continued)

Box F3.2

(continued)

utility bills through this system. Initially envisaged as a way to simplify administrative procedures and reduce the costs of service delivery (including leakages), the system is set to transform the financial services landscape in India, paving the way for dramatically increased access by providing financial services at a much lower cost.

Sources: King 2012; Lauer and Tarazi 2012.

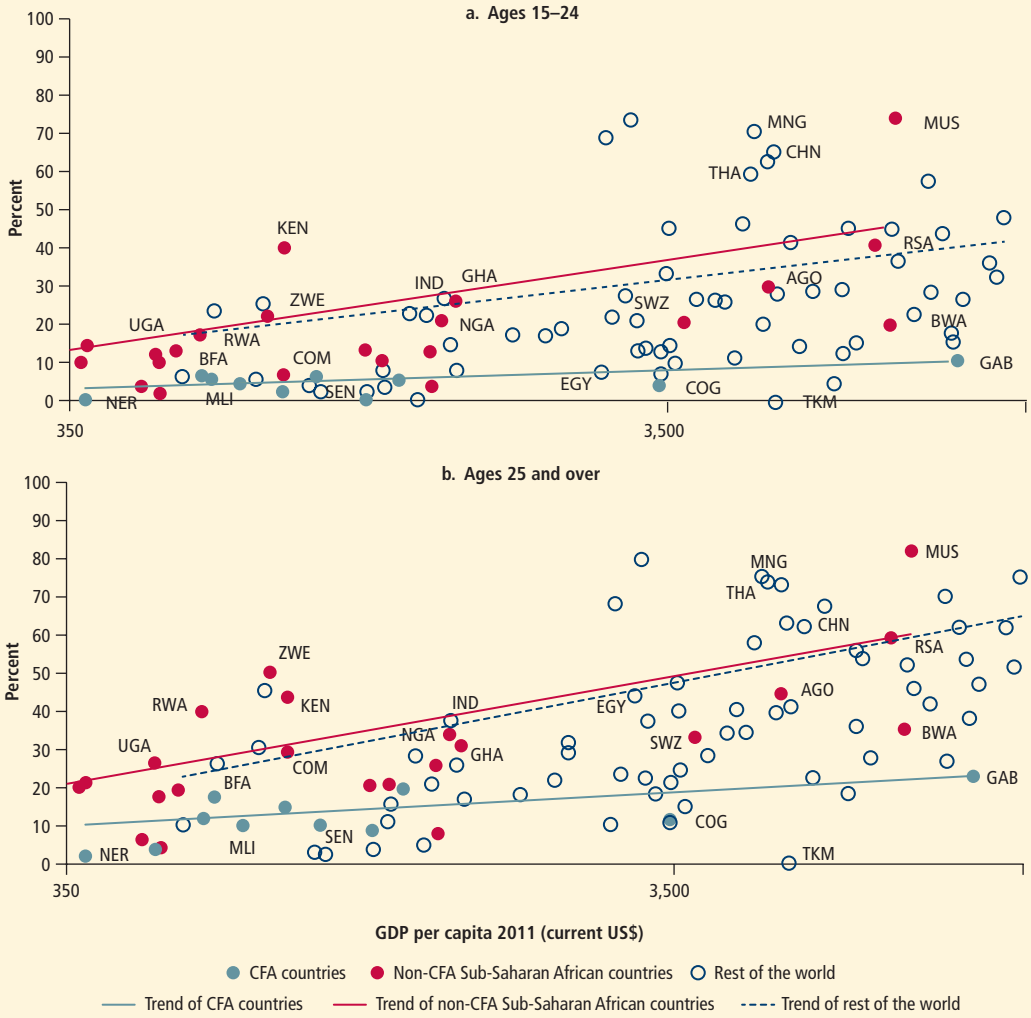
Regulation to Increase Financial Inclusion and Encourage the Use of New Technology

As figure F3.2 shows, even at the same income level, national policies for the financial sector can produce very different results. Countries such as Kenya, Mauritius, and Rwanda in Africa and China, India, Mongolia, and Thailand in Asia have achieved much higher financial access than other countries at similar levels of income. And given income levels, Africa is not doing badly. Among poor countries (with GDP per capita under US$1,000), the majority of African countries for which we have data are actually above the trend line of the rest of the world. The exception is countries in the CFA (Communauté Financière d'Afrique) zone, which tend to lag the rest of the world in extending bank accounts to households.

Countries with high household access to finance tend to have one or more of the following features: (1) a competitive banking sector, which encourages banks to look for customers; (2) a vibrant microfinance sector, which tends to specialize in products tailored to the needs of lower-income households; (3) proportionate supervision, including a "test-and-learn" approach, which encourages innovation; and (4) a national strategy. The national strategy encompasses the first three characteristics. It can also include policies to encourage banks to offer products that are appropriately designed and priced for low-income people, along with policies that require all government payments to individuals (G2P payments) to be electronic, which encourages financial inclusion. For example, Kenya has both a vibrant microfinance sector and a policy environment that encourages innovation (box F3.2). Rwanda's national strategy to encourage financial inclusion is reflected in policies to encourage microfinance expansion and mobile banking as well as programs to support the growth of affordable credit to nonfarm businesses in rural areas. Mongolia has used a dynamic mobile network system and a G2P payment system to broaden access. Given the rapid evolution of banking technology and its potential to change the financial landscape, countries need to develop a regulatory structure that encourages the spread of the technology, while protecting consumers through interoperability and other regulations (see Dias and McKee 2010; Lauer and Tarazi 2012; World Bank 2013).

In the CFA system in Western and Central Africa, regulation has restrained innovation in the financial sector. Regional central banks are involved in financial regulation, and changes to the system require the agreement of all participants. This arrangement has kept competition in the formal banking sector low, and household financial inclusion well below the trend for the rest of Africa and the world. It has benefited insiders at the expense of new entrants (World Bank 2013). The penetration of MFIs is low, and regulations to facilitate their growth were not adopted by all countries of the West African Economic and Monetary Union until 2012 (Riquet and Mbenge 2013). Mobile carriers such as Safaricom (Kenya) cannot start mobile banking initiatives—only banks have the right to do so, and they have no incentives to serve low-income customers. Ideally, a regional regulator could spur the development of a large market for mobile banking by developing harmonized cross-border payment systems, but that has yet to happen. There are signs that the regulatory environment is adapting, however. It is hoped that the new MFI regulations will help to create a trustworthy system interested in serving the currently unbanked population. A new financial inclusion strategy, which will

Figure F3.2 Percentage of individuals with an account at a formal financial institution



Source: Based on FINDEX data.
Note: The x axis of this figure is on a log scale.

require all financial service providers to offer a basic bank account with a package of free services, is scheduled to be adopted in 2013. Thus the prospects for improved household financial access are high in this region.

Formal Credit Services: Challenges in Expanding Options for Smallholders, Household Enterprises, and Young People

Even if retail banking costs fall and savings accounts become cheaper, the costs of lending to smallholders, HE owners, and young people will remain high. There are fixed staff costs in loan appraisal. Because most loans are for such small amounts, even the best MFIs report that they must earn an average of 19 percent a year on their loan portfolios just to cover operating costs of US$114 per loan (see MIX 2008). Large nonprofit MFIs such as BRAC and Grameen Bank in South Asia cover part of these costs through donations, but the commercially oriented MFIs that are more common in Africa, such as Ecobank and Equity Bank, have to charge high interest rates to cover these costs.

For banks, lending to smallholders is risky. Agricultural cycles are unpredictable. The clients are in remote locations, are often unfamiliar with financial services, and have few

assets to use as collateral. Young smallholders can offer few assurances to formal lenders, but they are likely to need capital to acquire the agricultural technologies, land, and equipment that will allow them to pursue more productive and often more commercial agricultural livelihoods. Chapter 4 discusses constraints on financial services in agriculture and details several ways in which banks and nongovernmental organizations (NGOs) are innovating to provide them. Financial services alone may not be a strong springboard for smallholders to improve agricultural productivity and commercial activity. Some approaches combine the provision of financial services with the provision of agricultural information (planting and marketing advice, for example; see the discussion of BASIX in chapter 4). Other approaches recognize that integrating smallholders with agribusiness—domestic supermarkets, agroprocessors, or (further along the supply chain) exporters—may reduce some of the risk in providing financial services to smallholders. Kenya's DrumNet Project is one example of a supply-chain approach to agricultural lending (box F3.3).

Lending to HEs has similar problems. HEs face high risks of doing business (ranging from fluctuating demand to seizure of goods by authorities), and they are vulnerable to shocks and demands for cash within the household (sickness, for example) and community (funerals). HEs may be unable to generate the rates of return required to pay back a loan. Lenders have to assess these risks and price loans accordingly. HEs that can generate the returns to pay the loan back may not maintain a business account, however, and thus may not be able to present themselves as creditworthy, even to financial institutions oriented toward serving low-income households.

Microfinance programs use group liability lending to ameliorate some of the risk and high cost of lending to people with very limited assets. Because the group guarantees the credit of the individual members, it acts as a support mechanism for the farmer or enterprise owner and as a risk reduction mechanism for the lender. The lending methodologies applied by leading MFIs have succeeded in holding their portfolio at risk (more than 30 days) below an average of 3 percent (MIX 2008).

"We form groups to borrow money to engage in petty trade, pay school fees, and to build or improve on our houses."
Uganda

Box F3.3

Linking smallholders to supply chains to improve their access to financial services

DrumNet (a project of PRIDE AFRICA, a microfinance nonprofit) sought to improve Kenyan smallholders' access to financial services through a pilot program that integrated them into the supply chain for oilseeds. The pilot, which lasted from 2007 to 2009, involved Equity Bank and Bidco, a large manufacturer of vegetable oils, fats, margarines, and protein concentrates in East Africa. Bidco required an assured supply of sunflower seed. Farmers were recruited to grow sunflowers instead of their typical crop. The other partners were input suppliers and AgriTrade (which recruited farmers and managed sunflower production, harvest, and collection). DrumNet brought the parties together, negotiated the contracts on which their collaboration was based, and managed the flow of information and financial transactions among them, earning revenue for those services.

Farmer groups (usually about 20–100 farmers in the same area) opened an account with Equity Bank, through which all payments were made. Each farmer contributed to a Transaction Insurance Fund, which was 25 percent of the value of the input credit and served as security for the loans. After signing a fixed-price contract to supply sunflower seed to Bidco, farmers received credit for inputs from Equity Bank. Farmers obtained no cash from Equity Bank; instead, the bank paid input suppliers directly for inputs that farmers purchased with the credit. When farmers delivered their produce to Bidco, Bidco paid them through DrumNet, which deducted the cost of the loan and transferred it to Equity Bank. The remainder was deposited in the farmer's account with Equity Bank. DrumNet facilitated the financial transactions and communication via mobile phones, text messages, and e-mail.

More than 2,000 smallholders participated in the sunflower pilot. The arrangement between farmers, buyers, banks, and retailers, although complex, brought smallholders into the formal financial system, integrated them into a supply chain for a commercial crop, and improved efficiency throughout the oilseed supply chain.

Source: World Bank 2011.

Box F3.4

Shifting from group to individual liability lending as a positive microfinance innovation: Evidence from the Philippines

A central decision in designing credit programs for poor people is whether to rely on group or individual liability. Individual liability places more responsibility on the lending institution, so borrowers prefer it (Karlan and Appel 2011). Although individual liability lending is becoming more common in microfinance, little empirical research has compared the two approaches. Between 2004 and 2007, two randomized controlled trials with Rural Green Bank of Caraga, an MFI in the Philippines, examined how loan monitoring and repayment differed under group liability and individual liability lending. All of the loans (roughly US$18–US$90) went to female owners of HEs to expand their businesses.

The first trial converted group liability lending programs to individual liability, while retaining the group structure. No increase in defaults or loss of profits was found for centers that switched. Individual liability centers gained more clients (new clients were more likely to remain in the program), but because clients' loans were smaller, the individual liability centers disbursed about the same amount as the group liability centers. Groups that switched to individual liability spent less time monitoring repayment by other group members. The finding that monitoring decreased but repayment was stable suggests that the screening process changed without worsening repayment. One possibility is that the removal of group liability may have induced credit officers to increase screening and monitoring, although their workload did not increase.

The second trial offered new borrowers group liability in some areas and individual liability in others. No statistically or economically significant difference was found in repayment rates. The move toward individual liability lending appears to have distributed the burden for screening, monitoring, and enforcement more equitably between clients and credit officers. The level of institutional enforcement seen in the two trials was sufficient for the lender to recover loans without group liability and, in some cases, to attract and retain more clients. Although the experiment was limited to one MFI in one setting, the results imply that other microfinance innovators that are pursuing strategies for individual (and more flexible) lending to the poor may be moving in the right direction.

Source: Giné and Karlan 2013.

Yet microfinance groups can require substantial time and financial guarantees from participants. The time required to participate in the group may deter smallholders or owner-managers of an informal enterprise from using MFI services. If the group is not formed properly and someone defaults, the downside shock to smallholders and HE owners, whose margins are already low and who have their own loans to pay off, is high (box F3.4). The combination of group liability with low flexibility on the part of the lender excludes borrowers who want to finance risky projects or investments that will take some time to pay off, creating a bias toward small, safe projects. In short, microfinance group lending methodologies that help to solve the problems of high cost and risk to the financial institutions effectively impose part of these costs on the clients; therefore, they are suited only for particular types of customers.

Alternative strategies, such as lending to individuals on more flexible terms but requiring them to pledge key assets such as land (especially for farmers) or business equipment as collateral, also have downsides. Smallholders and HE owners could lose critical assets just when they need them most. MFIs using these strategies in Africa are more selective; they prefer to lend to households where a wage earner can act as a cosigner for the loan. These requirements help to explain why HE owners and farmers, who constantly face liquidity problems because of low and uncertain cash flow, rarely borrow from banks or MFIs and remain within their informal financial networks.

Informal Services to Fill the Savings and Credit Gaps

Although their scope is almost always small, informal financial services have sprung up in Africa to fill the gap in savings and credit services for households. These various savings and credit services have a long history and have developed rules for participation that ensure success (box F3.5). They meet a need that cannot be met through more formal financing

arrangements, owing to the small amounts and numerous small transactions involved, as well as the lack of information on the participants' creditworthiness. Informal services are a valuable bridge to financial literacy, a widespread savings culture, and, eventually, formal financial inclusion and more productive enterprises, as African countries continue to develop their formal financial sectors.

As seen in figure F3.1, savers in Africa use formal financial services more than savers anywhere else in the world, especially in Africa's lower-middle-income countries, where the overwhelming majority of households no longer suffer from extreme poverty. The use of informal savings mechanisms is more common among adults over 25; almost half of adults in lower-middle-income countries who save use these groups. These groups also help young people to save, and they may explain why the youth savings rate in Africa is the highest in the world.

A key tenet of savings groups that also provide credit is that members must save before they can obtain other services. This practice screens out borrowers who are less likely to repay loans. Members in effect pledge their savings deposit as partial collateral against the loan. To ensure that members save, some groups employ a member or other person to collect funds daily or weekly from members at their homes (a *susu* collector). Informal

Box F3.5

ROSCAs, VSLAs, SHGs, and SACCOs: Examples of informal savings and credit systems

Rotating savings and credit associations (ROSCAs) form when individuals agree to save together. They have evolved throughout the world—witness West Africa's *tontines,* Nepal's *dhikuti,* and Indonesia's *arisan.* Members meet regularly, and all deposit the same amount of money into a common pot at every meeting. At each meeting, on a rotating basis, one member gets the whole pot. ROSCAs have advantages. They require no bookkeeping (an asset where literacy is limited), everyone witnesses the transactions at every meeting, and the sums involved are small. Their accessibility and simplicity make ROSCAs an important source of financial services even where specialized MFIs operate. ROSCAs empower their members (the majority of whom are women) and help to build social capital in communities. The structure can be useful in operating informal social protection schemes as well, such as burial societies. Yet these associations also have drawbacks. Members cannot always access savings when they want them, and the timing of required contributions and payouts may not match their cash flow needs. The approach favors people with steady incomes who can contribute consistently.

Village savings and loan associations (VSLAs), also called *accumulating savings and credit associations (ASCAs),* were pioneered in the early 1990s by CARE International, which developed a standard model for VSLAs based on Niger's *tontines*. Generally 15–25 individuals agree to join forces for saving and borrowing during a fixed period (usually one year). The group elects a management committee and money counters. No one else handles the money, which is stored in a cash box with multiple locks. The key holders are not part of the management committee. The group determines the services offered (savings, lending) and corresponding terms and conditions. At regular meetings, members purchase one to five savings shares; the share price is determined by the group and remains unchanged throughout the year. These savings capitalize a loan fund for members, who can borrow amounts not exceeding three times their savings. Loans are given to individuals or groups, for a term not exceeding the groups' end point, at a monthly interest rate of 5–10 percent (though rates as low as 1 percent or as high as 20 percent are reported). Record keeping takes three forms: memorization, passbooks that record only the ending fund balance, or central ledgers that track financial activity. When a cycle ends, group members share the savings and corresponding interest. Returns can range from 35 to 50 percent; after only a few years, a group might manage US$2,000–US$10,000. Through small periodic contributions, groups may also maintain a social fund available to the entire community. Members may leave the group at any time, under terms decided by the group. As a result, unlike ROSCAs, VSLAs intermediate funds between savers and investors within a group over a short period of time.

Aside from CARE, numerous organizations have promoted VSLAs, including Aga Khan Foundation, Catholic Relief Services, Oxfam/Freedom from Hunger, Pact-WORTH, PLAN, the United States Peace Corps, World Relief, and World Vision. VSLAs have reached at least 61 countries in Africa, Asia, and Latin America and have more than

(continued)

savings and credit groups limit banking costs through their own outreach, governance, and accounting, and they can recruit staff locally at relatively low salaries. For this reason, they can charge lower interest rates than MFIs. Larger groups with access to a local bank may opt to protect funds there at an affordable cost (account charges are shared across members, along with any interest earned on the deposit).

These informal services have some disadvantages. Their local nature and structure limit intermediation. They depend on members for funds and can lend only the money that is available in the group. The lending terms are short, rarely exceeding one year and usually lasting only a few months. This brief time horizon has the benefit of allowing close supervision and limiting losses (little time passes before it is clear whether a member can honor an obligation). The loans are useful for covering lumpy household expenditures such as school fees or the expenses related to a festival, but they are not suited to an investment in a farm or in HE equipment, which may require a longer repayment period. Everyone in the group pays the same interest on loans—even risky loans—which appropriately biases risk downward. Even the larger and more sophisticated savings and credit cooperatives (SACCOs) may struggle with profitability, as their membership base may never be large enough for them to spread out the basic overhead costs of facilities, management, and security and achieve lower unit costs than other financial institutions, espe-

Box F3.5

(continued)

6 million active participants. The organizations promoting the savings groups train the members in group operation and governance, but because these groups are essentially self-managed, the risk that funds may be lost through fraud, theft, or borrower default remains. Larger groups in or near urban areas may safeguard their funds in a bank, and CARE is testing the use of mobile banking technology to store and withdraw group funds in VSLAs in East Africa.

Self-help groups (SHGs) are small village groups of 10–20 women who pool their savings over a few months until they have sufficient capital to lend to group members or to others in their village. SHGs link with banks and form federations with other villages, allowing them to accumulate more capital for lending. The interest is not distributed back to members; it is left to grow. Used widely in India, SHGs have potential in Africa, but efforts to establish them have had mixed success. In India they rely on strong social dynamics among women within villages and social connections between villages to catalyze federations. The social structures in African villages are not as conducive to developing strong women's groups, and women in Africa are less able than women in India to devote the time required to attend meetings, in part because the lower density of settlement requires them to travel longer distances.

Savings and credit cooperatives (SACCOs), or credit unions, are member owned, not-for-profit financial cooperatives providing savings, credit, remittances, and other services to members connected in some way (for example, they may belong to the same workplace, community, or religious group). A volunteer board of directors is elected from among the membership; each member has one vote. SACCOs finance their loan portfolios by pooling members' voluntary savings rather than seeking outside capital. Ideally, members earn higher returns on savings, pay lower interest on loans, and generally pay fewer fees. SACCOs' local nature can prevent them from expanding and reducing their unit costs, especially in rural areas. Their democratic nature requires members to balance borrowers' preference for low interest rates against the high returns sought by shareholders, who mainly save. Finally, because SACCOs operate far more like banks than cooperatives, their governance and regulation urgently demand attention. Although their assets form a very small share of the banking system's assets, SACCOs serve a very large (and relatively poor) population. A system to guarantee SACCOs' probity, stability, and accountability may not necessarily be costly. It may suffice to institute sound governance and internal controls to protect members' deposits and limit SACCOs' exposure to risk, but much more research is needed to determine what works best.

Sources: Allen and Panetta 2010; Bakiene et al. 2012; Collins et al. 2009; IFPRI and World Bank 2010, brief 3; VSL Associates, "About Us: VSL Model," http://www.vsla.net/aboutus/vslmodel; "Rotating Savings and Credit Association," http://en.wikipedia.org/wiki/Rotating_Savings_and_Credit_Association; "What Is a Credit Union?" http://www.woccu.org/about/creditunion.

cially in sparsely populated rural areas (5,000 clients is often considered a minimum efficient size for MFIs). The agreed rates on loans are typically 3.0–3.5 percent a month for SACCOs in Uganda, which may still exceed what many smallholders and HE owners can afford while still being able to profit from a loan for an enterprise (Bakiene et al. 2012; Collins et al. 2009).

The Role of Government: Increasing Access and Protecting Consumers

Normally, informal finance exists outside the scope of government regulation and support, but government, NGO, and donor programs have supported the spread of SACCOs and VSLAs through outreach, training, and the formation of national SACCO member associations. Program staff train group members on procedures to keep the funds safe and limit the loss of funds through theft, fraud, or bad loans, but according to all accounts, reliability remains a problem.[6]

To protect consumers, governments are looking for ways to supervise the larger groups, such as SACCOs, but supervising a large number of small groups is rarely feasible.[7] Government involvement in SACCOs and VSLAs can also backfire. Informal groups operate on trust, supported by a set of procedures to ensure transparency. They keep costs down for their members because they operate efficiently and do not have to spend time complying with regulators' requests for information. For larger SACCOs, in which members find it more challenging to exert proper supervision themselves and the sums involved are substantial enough to undermine the SACCO program, some sort of public supervision may be justified.

In general, however, governments should keep their involvement in informal savings groups to a minimum. The public tends to interpret government involvement in such programs as a signal that participants can exert less financial discipline, which undermines the approach. In Tanzania, a qualitative study documented numerous cases in poor districts where public funds intended to provide grants or bring cheap credit to owners of HEs never materialized. Instead, the funds stayed in the district capitals, presumably in the hands of the officials there. Only the NGO-organized VSLAs effectively provided capital to HE owners (Kweka and Fox 2011).

An especially damaging practice is for governments or NGOs to use an informal savings group to inject capital into the community. Studies show that this practice reduces the groups' incentives to build up their own savings pool and places the sustainability of the initiative at risk. For this reason, NGOs seem better suited than governments to the task of developing and supporting informal savings groups.

The Role of Informal Financial Institutions: Expanding Financial Inclusion

VSLAs and SHGs both hold potential for including young people and addressing their capital constraints, particularly if the group offers mentoring and access to information as well as finance. In Uganda, an innovative strategy is being developed to work through NGOs to establish VSLAs and promote the inclusion of young people. A donor (the International Fund for Agricultural Development) will provide funds for the Ministry of Finance and Economic Development to contract with NGOs to develop and nurture VSLAs. The proposed target is to establish 15,000 new VSLAs over five years. At least 15 percent of the new members are expected to be young people, either through the formation of youth savings groups or the incorporation of young people into VSLAs. Project funds will support the staff and materials to train local groups; no funds will be provided as paid-in capital to the groups.[8]

In addition to providing informal financial services, savings groups support their members in the same way as lending circles in MFIs—they provide encouragement and a forum for members to share experiences. Numerous descriptions of savings groups attest to the importance of this feature (see box F3.6 for an example from Mali), which could be a valuable means for young people to learn from others and build social capital (Banerjee and Duflo 2011; Nimusiima et al. 2012). As savings groups spread to young people, group members are approaching their NGO partners for additional

"Group management of loans is very bad. One lady in our group borrowed T Sh 500,000 and then ran away. I had borrowed only T Sh 100,000. How come the one who had borrowed T Sh 100,000 had to pay for someone who had borrowed T Sh 500,000?"
Tanzania (US$1 = T Sh 2,500)

Box F3.6

Village women in Mali: Achieving food and financial security through savings and credit groups

Saving for Change (SfC), a village savings and loan program initiated in rural Mali in 2005, places women firmly in charge of their own financial inclusion. The women served by the program are largely illiterate, poor (mostly living on less than US$1 a day), and living in very isolated areas. By regularly saving small amounts and lending group funds short term to members with interest, each group of about 15–25 women accumulates and mobilizes capital without relying on matching or external funds. By July 2008, SfC had 95,000 members; later that year, the program expanded into four of Mali's five nondesert regions. By April 2013, SfC served 18,804 groups (423,654 members). A rigorous evaluation of SfC's impact was conducted between 2009 and 2012 to document the program's contribution to household livelihood strategies and savings and credit provision.

A randomized controlled trial (RCT)—the gold standard for impact assessment—used detailed socioeconomic surveys of 6,000 households in 500 villages in 2009 and 2012 to gather information from SfC participants and nonparticipants in treatment and control villages. In the interim, researchers repeatedly surveyed a subset of 600 households from treatment and control villages on their financial transactions, assets, income-generating activities, consumption, and health. The resulting information provided insights into how households were evolving over the course of the study.

To interpret and contextualize the RCT data, qualitative research elicited detailed information from a small sample of 19 villages chosen to reflect some of the variation—in geographic location, ethnicity, livelihood strategies, and other variables—across SfC sites. Fifteen of the villages were located within the RCT zone in Ségou; four were outside the RCT zone and had participated in SfC since 2005. In each village in 2009 and 2012, researchers spent two to three days conducting focus group discussions, community interviews, and key informant interviews. In the villages familiar with SfC since 2005, these activities provided details on how community members had adapted the SfC model to meet local conditions, needs, and livelihood strategies over time.

The RCT found an overall increase in savings (by 31 percent), a greater flow of credit to women in SfC villages (12 percent more women reported borrowing from the savings groups), the accumulation of assets (livestock holdings grew in value by 13 percent in SfC villages), and a reduction in hunger during periods of food insecurity. Most women cited a less tangible impact—the social capital generated through participation in a savings group—as one of the program's most highly valued benefits. The groups included younger, less socially integrated women, although they joined slightly later than the initial participants. Finally, the savings groups had no measurable impact on business development or expansion, perhaps because many groups are located in such remote areas.

SfC seems to have improved food and financial security in these isolated, food-insecure, and impoverished areas. The fact that some women surveyed in the control villages formed savings and credit groups on their own, without external advice from SfC, indicates that these groups offer perceived advantages and are well adapted to local needs.

Source: BARA and IPA 2013.

services, including business education and life skills training. Plan International, an NGO active in supporting youth savings groups in West Africa, has been meeting these requests by contracting with local trainers to provide short courses on demand. Based on this experience, they are developing a holistic training syllabus for their youth savings groups. The content, which is adapted to the needs and learning preferences of young people, is designed to support disadvantaged youths in the transition to adulthood and a sustainable livelihood.[9]

Savings groups may be an effective venue to integrate the delivery of youth programs in communities. Through such groups, national strategies for youth could combine programs to foster savings behavior, build business and soft skills, support female empowerment, and expand financial inclusion, with the goal of enabling young people to pursue sustainable livelihoods.

Notes

1. In these countries, a bank account is considered a contract; the minimum age to sign a contract is 18, and no provision is made for an adult cosigner.

2. See the FINDEX website, http://go.worldbank.org/1F2V9ZK8C0.
3. Postal savings account systems were developed to get around this problem by making use of underused rural postal service staff, offices, and security systems to bring savings accounts to populations not served by traditional banking systems.
4. Gains are even higher when compared with account charges at up-market commercial banks.
5. CGAP blog, January 2012 (http://www.cgap.org/blog/looking-back-trends-branchless-banking-2012).
6. See Collins et al. (2009), Karlan and Appel (2011), and Banerjee and Duflo (2011) for discussions on how and why this occurs.
7. This section draws on Glisovic and El-Zoghbi (2011).
8. Based on draft project document, November 2012 (see IFAD 2012).
9. See http://plan-international.org/what-we-do/economic-security.

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