POLICY BRIEF

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Grants Vs Loans! What works best for young entrepreneurs?

"This is the basis for the most important critique of microfinance. The poor are not entrepreneurs. The idea that more than a few will turn tiny loans into a viable business is simply unrealistic."—Ian Smillie, *Freedom from Want: The Remarkable Success Story of BRAC, the Global Grassroots Organization That's Winning the Fight against Poverty*

Executive statement

Access to formal financial services remains limited in Uganda. Only 4 percent of the youth have access to formal credit institutions. As a result, youth are increasingly accessing microcredit to finance their business enterprises. However, several studies reviewed reveal that in-kind grants perform better than cash grants. In addition, impacts differ across gender with male youths registering more notable successes on business turnover than their female counterparts. Strict eligibility criteria, approval of business plans, family pressure, motivation, initial credit constraints and few initial assets were some of the contributing factors in driving gender differences of financial impacts.

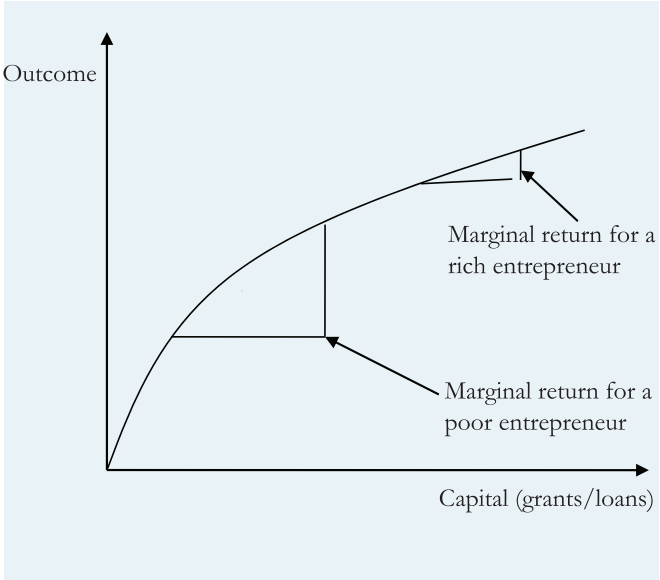
1. Introduction

Access to formal financial services remains limited in Uganda. The FINSCOPE III survey findings revealed that only 4 percent of the youth had accessed credit from formal banking institutions (EPRC, 2013). Evidence from GEM (2014) report shows that, while Uganda is the second most enterprising economy, for every business started another closes. Often cited in this failure are the numerous number of procedures in starting a business, limited access to credit, and inadequate information on access to credit/finance. Formal banking institutions consider the youth a risky cohort on the premise that their business ventures are at incubation phases and start-up, and lack the necessary collateral, verifiable credit history and steady employment, a prerequisite for accessing formal financial services. Yet microfinance is believed to have positive impacts on development outcomes like starting and expanding businesses and income diversification. As a result, micro-credit finance has emerged as an essentially promising avenue for financing the vulnerable category, of which, the youth belong. However, micro financing models 'do matter' for successful outcomes on business development. The financial needs of youth may require different product features and delivery channels to yield positive impacts. It is thus pertinent that we address the information needs of young entrepreneurs in particular, by providing evidence on the efficacy of various microfinance design features and components that have proven to work for young entrepreneurs. The evidence arises from scientific impact evaluation studies conducted in Uganda and Sub Saharan Africa from 2000 to-date.

2. Rationale

Micro finance economists argue that providing an additional unit of capital to entrepreneurs will lead to large marginal returns on investments for poor entrepreneurs than the richer entrepreneurs based on the law of diminishing returns (Figure 1). Many studies, thus far, reviewed were primarily on poor groups of individuals ranging from vulnerable teenage girls, youths and poor women and men with low or in most instances, no initial access to capital.

Figure 1: Why we need to provide micro finance to poor unemployed and under employed youth?



Source: Aghion and Morduch, 2005

3. Findings

Evidence on the impact of micro credit financing on young entrepreneurs reveals the following:

Loans versus Grants

a) *Generally, compared to grants, loans yield greater outcomes and the impact is greater when combined with training*
An evaluation of a youth training and microfinance intervention program in Uganda geared toward micro enterprise growth through provision of loans (US$180 to US$220), unconditional cash grants (US$200), Start Your Business (SYB) training or a combination of these interventions was carried out. Evaluation findings revealed that the loan-only intervention had some initial impact, but this did not persist nine months to the follow- up; men with access to loans and training reported significantly higher profits (54 percent greater profits); and the grant intervention had no impact. There were however, no effects on women from any of the interventions.

Cash Grants versus in-kind Grants

b) *In-kind grants perform better than cash grants:* Evidence that compares the impact of cash grants and in-kind grants on male and female owned micro enterprises in urban Ghana suggests that in-kind grants perform better than cash grants. The authors find that in-kind grants lead to large increases in business profits for men with less robust effects from the cash grants component. For women, the in-kind grants lead to large business profits but only for the firms that were initially profitable and not of subsistence nature.

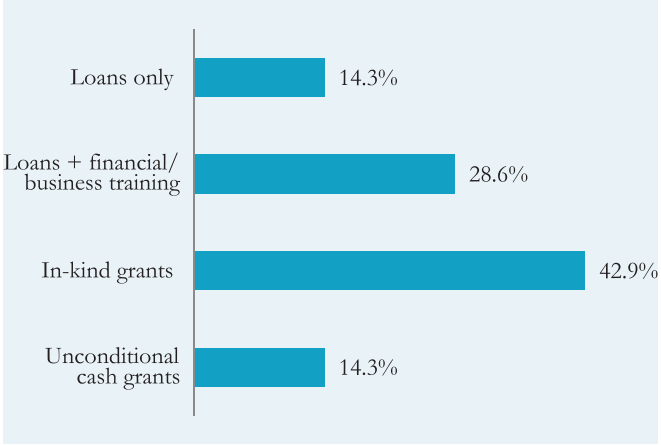
c) *Cash grants have greater impacts for business starts ups but not on business expansion:* Both the Youth Opportunities Programme (YOP), and the Women's Income Generating Support (WINGS) programs offered cash transfers for business start-ups for the youth and women in Northern Uganda. Evaluation of the YOP revealed that funding worth US $382, in form of cash grant transfers to self- organized groups to use on vocational training, or tools and materials to practise a craft, yield positive impacts on incomes (41 percent increase), increase self-employment (65 percent), hours worked (17 percent higher), and

Outcome

ability to keep records, register businesses and pay taxes (40 percent higher). Under the WINGS program, impoverished Ugandans, mostly women, were experimentally offered individual business training, business grants worth US$150, supervision, and business advising. Sixteen months after the intervention, microenterprise ownership and incomes doubled, cash savings tripled, and short-term spending on durable assets increased by 30-50 percent. The success of these interventions was attributed to the group lending design under YOP, and the strict eligibility criteria for instance approval of business plan for business use under WINGS. However, the Start and Improve your Business (SIYB) programmes found that provision of grants for women positively affects creation of new businesses among potential entrepreneurs although it did not necessarily have strong effects on existing businesses.

d) *When an intervention targets both men and women, impact tends to be greater for men*
In Figure 2, we summarise findings from results and score interventions that had ripple effects; twice as much as those that just had positive marginal impacts. Thus, results show that in-kind grants yield higher returns (42.9 percent) followed by loans provided together with business training. Because loans only and unconditional grants perform the same way, when the groups' model is applied they have similar impacts on labour market outcomes and business profits.

Figure 2: Summary of key findings from evaluations



Source: Authors own compilation based on evaluated studies in Sub Saharan Africa

4. Conclusion

Generally, synthesis from the studies indicates that in-kind grants perform better than cash grants. Cash grants tend to perform better for business start-ups compared to business expansion. On average, studies indicate that loans generally perform better when combined with training and gains are highest for those with initial credit constraints and few initial assets. Intuitively, micro credit and grants for entrepreneurship development often work if the programs also try to understand who becomes an entrepreneur and why. As a result, provision of credit or grants (in-kind and (un)conditional) to youths who desire to make entrepreneurship an occupation and create employment for others, is justified and often achieves desired labour market outcomes. Evidence from impact evaluations capturing this aspect of mind-set to entrepreneurship in Uganda is not available and hence could be studied in the future.

Policy Recommendations

From our findings we recommend that:

- Implementation of government programmes with a microcredit provision component to offer in-kind grants to beneficiaries as they are easier to monitor and yield greater impacts.
- Where in-kind grants are not feasible/ sustainable, the second best alternative is for programmes or microcredit institutions to offer loans that have a training component attached to them.

- Policy makers and practitioners should actively demand for and use evidence prior to starting new projects. Evidence will help to assess the success and failure of previous on-going programmes and draw lessons for future programmes.

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