



POLICY BRIEF

Issue No. 53

MAY, 2015

Grants Vs Loans! What works best for young entrepreneurs?

Madina Guloba, Gemma Ahaiabwe, Ibrahim Kasirye and Elizabeth Birabwa Aliro

“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 accessed credit and borrowed from formal banking 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 aged 18-24 years had accessed credit and borrowed from formal banking institutions. Evidence shows that, while Uganda is the second most enterprising economy in the World, 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 from financial service providers. Specifically, 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

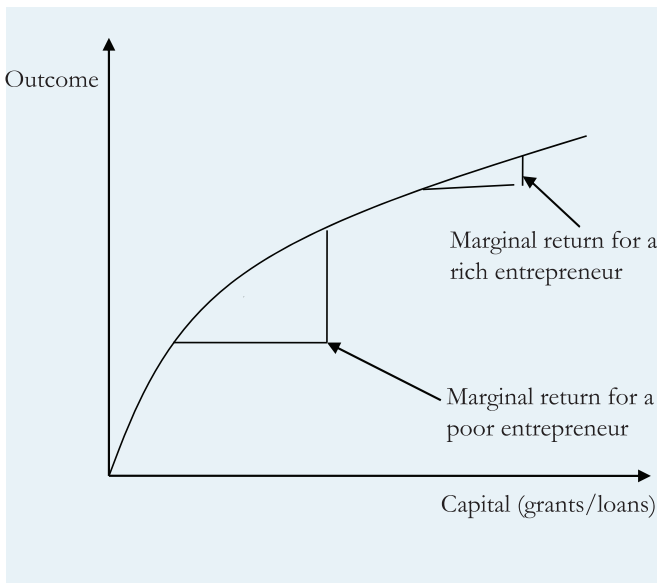
formal financial services. Yet micro financing, from these formal sources, is believed to have positive impacts on development outcomes like starting and expanding businesses and income diversification. As a result, micro-credit finance has emerged as an essentially promising avenue for financing the 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. This brief extracts evidence learned that can significantly inform future interventions towards youth entrepreneurship development in Uganda.

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: Marginal returns on micro finance provision



Source: Aghion and Morduch, 2005

3. Findings⁴

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

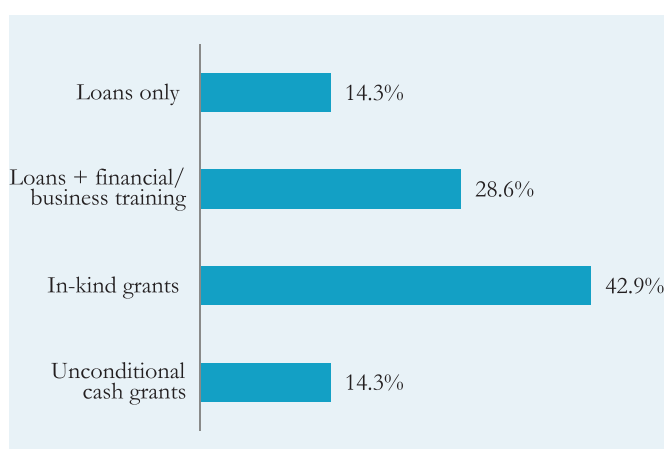
b) In-kind grants perform better than cash grants: Evidence that compares the impact of cash grants and in-kind grants on men and women owned micro enterprises in urban Ghana suggests that in-kind grants perform better than cash grants. The authors find that in-kind grants lead to large increases in 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 start 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 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 while for the WINGS it was due to the strict eligibility criteria for instance approval of business plan for business use. 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.

Figure 2: Summary of key findings from evaluations



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

Figure 2 synthesises findings from our review on micro finance provision in which our tally shows 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.

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.

Lessons learned

From our synthesis of evidence on ground, we note that:

- Implementation of government programmes with a microcredit provision component should consider offering 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 financial institutions to offer loans that have a

Recent Policy Briefs

“Performance of Public-Private Partnerships in delivering social services: The Case of Universal Secondary Education Policy Implementation in Uganda.”
No. 52 April 2015
Mildred Barungi and Ibrahim Kasirye

“Targeting Right: Which Crop for Which Region in the Commercialization Drive?”
No. 51 October 2014
Annet Adong

“Why have majority of farmers in Uganda remained subsistence?”
No. 50 October 2014
Annet Adong

About the Authors

Madina Guloba, PhD, is a Research Fellow at Economic Policy Research Centre

Gemma Ahaibwe is a Research Analyst at Economic Policy Research Centre

Ibrahim Kasirye, PHD, is a Principle Research Fellow at Economic Policy Research Centre

Elizabeth Birabwa Aliro is a Programmes Manager at Economic Policy Research Centre

The views expressed in this publication are those of the authors and do not necessarily represent the views of the Economic Policy Research Centre (EPRC) or its management.

Copyright © 2014

Economic Policy Research Centre

targeted training component for example in financial management attached to them.

- Policy makers and practitioners should actively demand for and use evidence prior to starting new projects to inform the design elements of national programmes. This will ease monitoring and evaluation of programme implementation to ascertain aspects of success and failure for future programmes.

Endnotes

- 1 Formal Banks include: Commercial Banks, Credit institutions and Micro Finance and Deposit-Taking Institutions (MDIs), EPRC (2013). Uganda 2013 FinScope III Survey Report Findings: Unlocking Barriers to Financial Inclusion, EPRC, Uganda
- 2 Global Entrepreneurship Monitor (2014). 2014 Global

Report. For more information visit www.babson.edu

- 3 Beatriz Armendáriz de Aghion and Jonathan Morduch (2005), *The Economics of Microfinance*. The MIT Press, Cambridge, Massachusetts, London, England.
- 4 EPRC-ILO (2015). *Youth entrepreneurship in Uganda: A Context Analysis of Policy, Stakeholders and Evidence* (forthcoming draft).

To access this policy brief and the relevant documents, go to the EPRC and ILO websites or contact the corresponding author on mguloba@eprc.or.ug

The Economic Policy Research Centre (EPRC) is an autonomous not-for-profit organization established in 1993 with a mission to foster sustainable growth and development in Uganda through advancement of research-based knowledge and policy analysis.

Learn more at:
www.eprc.or.ug
TWITTER: @EPRC_official
www.facebook.com/EPRCuganda
eprcuganda.blogspot.com

Address:
Economic Policy Research Centre
Plot 51, Pool Road, Makerere University Campus
P.O. Box 7841, Kampala, Uganda
Tel: +256-414-541023/4
Fax: +256-414-541022
Email: eprc@eprc.or.ug