Microfinance Services for Youth in the Sub-Saharan African Region

This research report has been produced by the Warwick Social Enterprise and Microfinance Society (SEAMS) at University Of Warwick in cooperation with and under supervision of the Student Microfinance & Development Initiative (SMDI), the development think tank at the world's leading universities.

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www.smdi.org.uk

Case Study

Research commenced by the Youth Employment Network indicates 60% of MFIs do not lend to young people. The remaining 40% state that they do not differentiate on the basis of age but, as demand far outstrips supply and young people are regarded as riskier investments, in practice young people are not served by these microfinance institutions (MFIs) either.

Comment on to what extent this hypothesis reflects the sub-Saharan microfinance industry.

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1. Executive Summary

The report tests the validity of the claim made by the Youth Employment Network. The objective of the research is to understand the demand – supply mismatch of the microfinance services for the youth and the challenged and the opportunities in catering to the youth in the Sub- Saharan region.

The Methodology of the study mandated the investigation of both the demand and the supply side factors and this required a thorough evaluation of lending criteria of MFIs serving sub-Saharan Africa. Furthermore, this investigation was used to test whether these criteria exclude youth, explicitly or implicitly. The demand side factors were analyzed by an assessment on the needs of young people compared to those of adults regarding microfinance services.

The lending criteria for granting borrowers micro loans are more or less similar minor changes in the group size and interest rates as per their different programs. However, it is important to note that the rate of interest charged for the youth and adults is the same leaving behind low incentives for the MFIs to cater to the youth. The youth are considered risky investments and the returns gained from them remain the same. Thus the discrimination is in terms of the loan availability and not the cost of the lending.

Some of the important factors preventing the MFIs from lending to the youth are as follows;

- High risk takers
- Low knowledge and lack experience
- Low credibility
- Need to design different loan products for the youth
- Relatively smaller age range increasing costs
- Political and legal criticism - distracting the youths from schooling, cheap young labour could pose a threat to the adult employee market

- MFIs still have not covered a good amount of the adult market.

Nonetheless, there are microfinance initiatives across the continent making attempts to develop training and mentorship programs that could provide the youth with effective knowledge to start their business. Research on the sources of capital used by the youth for starting their businesses shows that they are hardly dependent on the Microfinance loans but rather fund their businesses with their own savings and family money. They generally use Microfinance funding for diversification. As a result it is important to understand that the needs of the youth are changing with time and it’s a perfect mix of both depository and microfinance services that they require for their future development. As a result it could be said that the old perception of the MFIs that investing in the youth could prove to be highly risky is changing but this transformation with definitely is changing but this transformation will definitely take time.

In conclusion, there is a change in MFI’s perception over the industry but the discrimination between the youth and adults is still prevalent.

2. Introduction

The Functionality of MFIs in Sub-Saharan Africa

In Sub-Saharan Africa, access to deposit and credit facilities is very limited; in Ghana and Tanzania only 5-6% of the population has access to the banking sector's services.

To tackle this problem, a variety of MFIs have been established which offer various services include providing credit, providing both credit and deposit facilities whilst others specialize in deposit collection.

An approach which has been commonly used in Africa is that of relying on community-based microfinance as is the case in Bangladesh. Traditional community-based cooperative groups such as local clubs and village associations have played a key role in the expansion of the microfinance in Africa. The three principal types of MFIs include:

1. **Saving and Loan Cooperatives and Mutuals (SLCs)** – particularly prominent in Benin.
2. **Rural and Community Banks (RCBs)** – account for the largest share of microfinance services. They are unit banks owned by members of the community (through the purchase of shares).
3. **Savings and Loans Companies (S&Ls)** – second largest type of MFIs.

Community based microfinance has the potential of yielding a wide range of benefits:

- Group saving schemes allow the savings of individuals to be mobilized jointly enabling them to use this as a form of security against loans. Lower risk of defaulting facilitates greater access to credit services.
- For the institutions, the community-based method provides scope for achieving economies of scale.
- Deposit collecting MFIs are able to tap into the resources of the poor who are otherwise isolated from the formal financial system.
- An approach where half the people (generally women) in a group are afforded a loan whilst the other half have to wait until the loan is paid back before they themselves get credit can be an effective means of operation and has been used in Ghana.

- The individual approach to microfinance (both savings and credit) is used when a person has a good credit repayment history or in case the group method is not appropriate.

Group based savings MFIs that are prominent in Africa rely more on peer pressure and joint liability as opposed to collateral when it comes to loan repayments. MFIs working with individuals ensure: short maturity for repayment, high frequency of payments and in some cases, a compulsory security deposit to encourage timely loan repayments.

Access to Finance

Working together with the commercial banking industry in Africa has proved mutually beneficial. Whilst MFIs rely on banks for liquidity facilities, deposit services and in some cases emergency credit (amongst other things), banks gain as they are able to expand their client base and operations to places such as rural areas.

Donors as well as NGOs in Sub-Saharan Africa have played a key role in helping in the expansion and development of MFIs bringing international experience. The governments too have helped promote the microfinance sector by putting in place relevant laws, regulations and institutions to provide a climate suitable for MFIs.

Nevertheless, MFIs in Sub-Saharan Africa have fallen short in some areas and these needs to be addressed in order to maximize their impact. First of all, reporting standards and bookkeeping need to be increased. Secondly there still exists a shortage of trained and skilled staff members and there has been a lack of documentation with regards to MFI activity. Information and databases on clients/borrowers, their credit histories and repayment records have not been kept up to date. Lastly and most importantly, as rightly stated by the Youth employment network, the MFIs give preference to the adult population while lending loans. This is not explicitly mentioned in the eligibility criteria but the work experience of the borrower, his knowledge about the market and industry is certainly taken into consideration.

3. Evaluation of the Lending Criteria for Microfinance Loans

Though every microfinance Institution has a unique way of formulating the eligibility criteria, there are a couple of general requirements to be fulfilled. These include:

- Permanent residence in the city in which they have applied for loan.
- Should engage in micro and small enterprise activities.
- Unemployed youth and women with strong commitment and potential for self-employment.
- Willingness to be organized into credit group and take loan through group collateral, usually in sizes of 5-10 people.
- Potential clients need to be between 18 to 59 years of age and economically active.
- Potential clients must be in the category of the poorest of the poor.
- He/she need to be credit worthy, with good reputation among the community that can be confirmed by the local credit and savings committee.
- He/she should present a business plan that also confirms the availability of market for the product/service loan is requested for.
- He/she must be willing to save some part of his/her business income at the microfinance institution through which they have access to loan.
- Make a deposit of 10% of the loan requested towards the loan insurance fund over a period of five weeks before loan is disbursed.
- Agree to pay interest and other fees within the grace period.

MFI's like Africa Village Financial Services give special interest grants to women, whereas institutions like ACSI wants some part of the client's business income be contributed towards them. Collateral group sizes and their annual lending rates and loan amounts vary from MFIs to MFIs. Most institutions provide the same rate of interest for both the adult and the youth population.

In Addis Credit and Savings S.C.[1] Annual lending rate is 12% with an additional annual

[1] Refer Page 21-22 for information on Organisations.

service charge of 3% for term loans whereas annual lending rate is 10% with a additional service charge of 3% for term loans, and it lends up to a maximum if 2000 birr in the first cycle, 3000 in the second, 4000 in the third, 5000 in the fourth and the fifth cycle. Maximum Loan term is 36 months and the minimum loan term is 7 months. There is a 30 day grace period for any one loan (adsi@telecom.net.et).

In Amhara Credit and Savings Institutions (ACSI), there are four different annual lending rates depending on the type of loan. For installment ad input loan, lending rate is 15%, and for end term and package loan it is 18%. It has set up the loan ceiling at a maximum amount of 5000 Birr. Maximum amounts for the various cycles ranging from 1^{st} to 5^{th} are birr 750, 1500, 2625, 3937 and 4921 respectively. Lastly, grace periods for all types of loans is again thirty days. (acsi@telecom.net.et).

However, for Five Talents Microfinance programmes, there is special emphasis laid down on the borrower having some savings between the range of 10-30% of the amount he actually borrows. The lending rate ranges from 1% to 3% depending on the programme. As far as experience in the field is concerned Five Talent claims to specifically target the active poor, excluded from financial services, and as an NGO they welcome clients who are first-timers, nevertheless providing training first, in order to avoid indebtedness. (tom.sanderson@fivetalents.org.uk)

Annual lending rate in Meklit Microfinance institution is of two types depending on the poverty level of clients and not on the age or experience of the client. Borrowers with the lowest standard of living and who are engages in petty trading activities are charged an annual lending rate of 14% and 2% service charge. This provision is given to urban and rural micro entrepreneurs irrespective of experience. Meklit applies 22% lending rate and 2 % service charge to the clients who are considered economically active.(www.microfinancegateway.com)

Most Micro Finance institutions in Africa charge an annual lending rate of 10% to 18% varying from MFI to MFI. Research papers imply that there is barely any discrimination in terms of interest rates between youth and experienced, **but there still exists discrimination in provision of micro finance loans.**

4. Demand - Supply Mismatch

The demand for microfinance loans in the Sub-Saharan Africa far exceeds the funding available. As mentioned above, the same rate of interest charged leaving no incentives for the MFIs to grant loans to the youth.

Lending to young population is considered much more risky compared to the adults due to a variety of issues. Geeta Nagrajan, the research director on the Micro-Finance in Conflict- Affected Areas topic at Chemonics International says that only 10% of youth population that apply for loans are granted the loan whereas the proportion is much high among the experienced users of microfinance loans. Though not explicitly mentioned in the lending criteria, the MFIs pay a lot of attention to a couple of factors reducing the funding available for them.

The research rates lack of credit worthiness among youth as one of the major reasons for high percentage of rejection of microfinance loans among youth. Credit default among youth is another factor worsening the loan among the youth population. Youth generate low profit margins for MFI's, as return from their portfolios may not compensate the cost to mobilize very small deposits and to lend small and short term loans for businesses with low profits.

Youth are generally high risk takers at the same time lack experience increasing the risk of investments in these start ups. The market size below the age group of 20 is relatively spanning just a couple of years. Also the microfinance institutions still haven't tapped many countries in the region. Rationally, a general trend in any business institution would be to look at more risky clients only after market saturates forcing them to take a higher risk for the same (or lower) amount of return leaving no incentive to cater to this section of the population.

The political and legal criticism adds to the misery. Human rights authorities and child advocates oppose the idea of microfinance to the children mainly on the grounds that they are vulnerable to exploitation and entrepreneurial activities at such an early stage in life could divert their attention from schooling and other physical developments restricting their physical and psychological development. Also with the allowance of labour at this age would mean cheap labour posing a threat to the adult employees.

In many countries, the borrower has to fulfill the minimum age requirement of 18 years to enter a legal binding contract prohibiting MFIs from lending loans to youngsters.

Political stability is another important factor which stops Microfinance Institutions from providing financial services.

Promoting savings in conflict areas of Uganda. With USAID funding, CARE paid cash to several young former child soldiers along with adults for labor-intensive community road rehabilitation. This program, Reintegration, Employment and Income (REIN), also trained the clients in cash management and small business development. Part of the cash payments were withheld as savings (the beneficiaries voted to increase the savings percentage) until rotational savings and credit groups (ROSCAs) were formed and trained. The savings, loan and business development aspect of the project was considered a success, with numerous small trading and animal husbandry activities created. There were 10,000 clients, half of whom were women, with many of the men being former child soldiers. When conflicts escalated in mid-2002, most of the program areas became highly insecure, forcing people to abandon their businesses and flee to refugee camps. The financial skills and business attitudes that were imparted during the program were reported to be used in the camps. [2]

[2] http://www.microlinks.org/ev_en.php?ID=3784_201&ID2=DO_TOPIC

Also serving the youth is challenging. Additional training, preparation and counseling is required alongside financial services. Also there needs to be special programs specifically catered for them with longer time durations, lower frequency of installment payments and additional supervision to reducing the defaulting risks. The loan products thus required by youth are much more different compared to that of adults thus increasing their costs of administering both these markets.

Not all microfinance institutions in the past have been successful in serving the youth.

Mixed results from linking microfinance with youth training in Mali.

In Mali, linkages were formed between Kafo Jiginew, an MFI, and a training institute, Mali Enjineu, to serve adolescent youth. The linkage was cost effective for Kafo Jiginew to offer a credit and savings with education product to the adolescent clients who were primarily selected from households with adult Kafo members. During the training period, clients could avail deposit services form Kafo. Loans were only made to trained clients. While the deposit services and no pressure to borrow were highly appreciated, the very short term loans with frequent meetings and repayment schedules were unsuitable, since these clients required longer time to start and manage a successful business that could generate incomes to service the loans on time. Therefore, the family had to meet their repayment obligations most of the time (Nteziyaremye and MkNelly, 2001). [3]

[3] http://www.microlinks.org/ev_en.php?ID=3784_201&ID2=DO_TOPIC

The research findings by the USAID organization shows a significant difference in the proportion of funding raised for starting business by the youth and Adults. The microfinance loan availability is much lower for the youth forcing them to look out for other options such as selling wages, taking money from parents and family and in extreme scenarios even using criminal means such as stealing. Another significant argument raised through this finding is that a significant proportion of youth start their business by their own savings as against less than 5% in the case of adults.

Figure 3: How Young People Get Started in Business

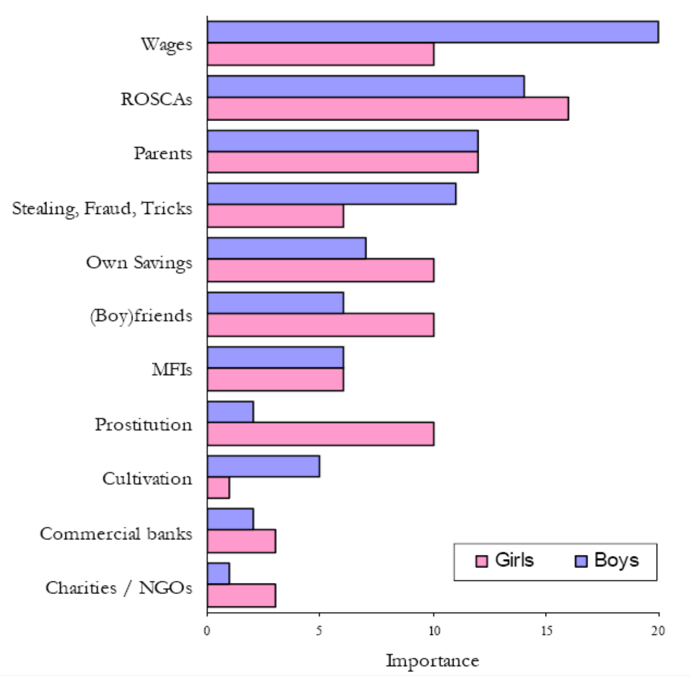
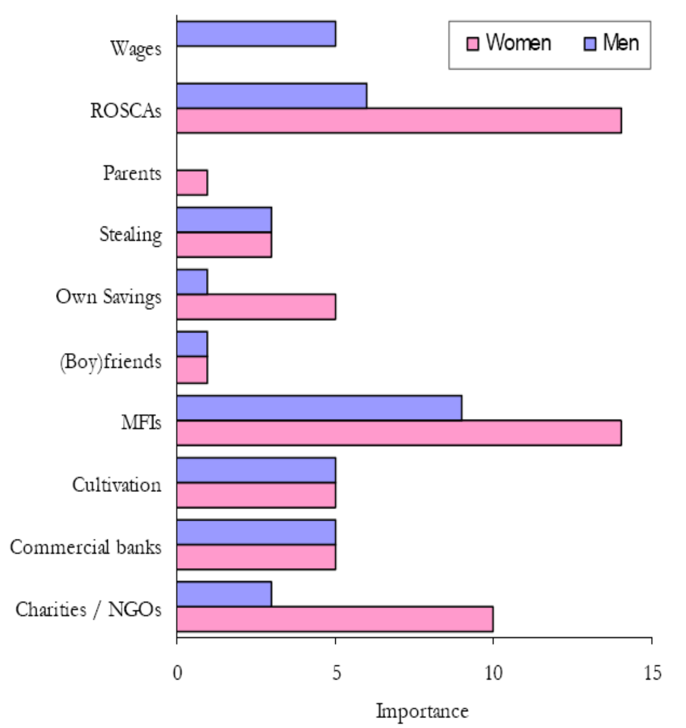


Figure 4: Sources of Capital (Adults)



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[4] http://www.microlinks.org/ev_en.php?ID=3784_201&ID2=DO_TOPIC

5. Changing Perception of MFIs

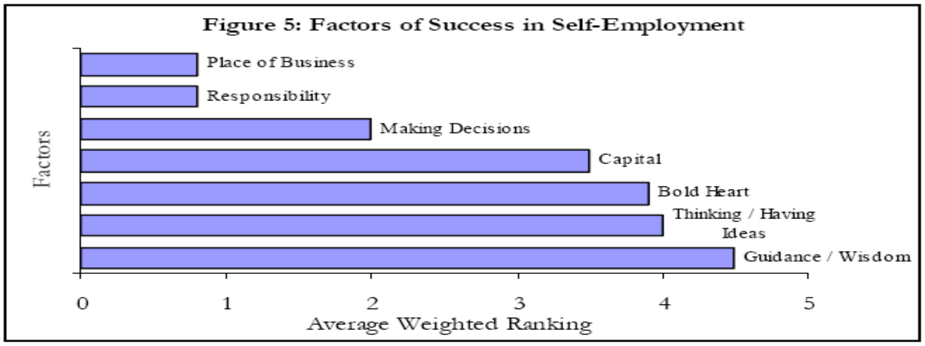

Figure 5: Factors of Success in Self-Employment

Many Microfinance initiative Organizations are taking up this issue and assisting the youth in terms of granting loans and providing technical assistance. Guidance and wisdom forms a priority and is one of the biggest challenges faced by MFIs in developing these markets.

Technical training, in fact, is a key aspect for micro finance institutions while granting micro finance loans. It is also purely dependent on the Micro – finance institution, how customer friendly they are? Although most of the MFIs do provide basic business training, provided by local loan officers, credit analysts or trainees. Micro Finance institutions provide trainings through local loans officers, credit analysts, and specialized trainers for efficient management of funds, smooth business operations and most importantly, to avoid indebtedness. For effective use of microfinance by youth, especially below 20 years of age, programs should consider combining entrepreneurial skills training with basic life and financial education. Pushing youth to become independent entrepreneurs without proper training is a recipe for failure. Linkage with various external trainings, such as school, training institutions, or youth outreach programs offer a good potential. Some MFIs are now mentoring and providing apprenticeships to youth and also to certain extent acting as their guarantors for the loans. However, it is important to understand that the trainers should also have adequate knowledge about the local market and the industry in which the youth would be interested. Needs of the youth differ from person to person and customizing the training processes for each borrower is practically not possible.

Linking apprenticeships with microfinance to ex-combatants in Guinea. ARC's program in Guinea was designed to promote employment generation and entrepreneurship among youth and ex-combatants. With only one year of funding (2002), apprenticeships were created to rebuild a local artisan base and provide youth with a sustainable source of training. Grants were provided to local artisans to buy materials/machinery; in return they took on a small group of apprentices. Since the apprentices gained skills during the program time period, it was to the artisans' advantage to hire them once the program ended. ARC also worked with local MFIs to include the trainees and other youth in the area to obtain loans.

6. Needs of the Youth

Savings vs Credit

The youth demand more of savings than credit from MFIs compared to the adults. They value savings and other financial services more than credit. While some youth have access to credit, their demand for savings and other financial services remains unmet because of lack of credit worthiness.

Demand for capital

One of the major demands of youth from microfinance institutions is to provide them with enough start up capital i.e. enough for smooth operations and running of the business. They strongly favor earning in small amounts and accumulating them to a lump sum amount whereas for the experienced players in the market capital for smooth operation is not much of a problem. Reemphasizing the data presented earlier, the youth put in much of their own money while starting a business compared to the adults.

Demand for loan

Research by Geeta Nagrajan has shown that they usually don’t proceed to MFI’s for start up capital, instead, demand for microfinance loan exists when there is a need to diversify. Also it is important to note that not all youth require microfinance loans. However, saving and deposit services are significant in developing assets of youth and be self-employed in their later stages of life.

7. Conclusion and Future Prospects

The research findings support the claim by the Employment Network that microfinance institutions fail to serve the youth. Though not explicitly mentioned by any institution, the research shows that there are no monetary incentives for MFIs to cater to the youth. However, the MFIs across the continent have taken initiatives and the conventional wisdom that young people come to microfinance institutions (MFIs) "empty-handed" is changing.

The youth currently needs a mix of both microfinance loans as well as the depository services for them to undertake savings to build their future assets. However, this could potentially be a major challenge for MFIs to cope up with since the amounts are low and administering them would lead to higher costs.

With regards to future success in the microfinance industry, several areas need to be addressed to maximise the impact MFIs in Sub-Saharan Africa have. First of all, reporting standards and bookkeeping need to be increased. Secondly there still exists a shortage of trained and skilled staff members and finally, there has been a lack of documentation with regards to MFI activity. Information and databases on clients/borrowers, their credit histories and repayment records have not been kept up to date.

Even though microfinance has experienced substantial growth in the last decade, 1.2 billion people worldwide still live in absolute poverty and so there is plenty of room for improvement. More effort needs to be concentrated on diversifying sources of funding – this will help improve some of the problems outlined in the previous paragraph. This is viewed as the main obstacle, though the awareness of its effects that is being generated would suggest that enough of a support base will be created to overcome it. Governments are playing a bigger role whilst banks are coming forward with different support packages. Furthermore, NGO-MFI partnerships are increasing.

Nevertheless, the extent to which microfinance outreach will extend is largely dependent on the economic conditions of developing countries. It is therefore up to the governments of these countries to ensure “macroeconomics stability, liberalised interest rates, viable alternatives to subsidised credit schemes, savings mobilisation, opportunities for institutionalisation, and participation of domestic and foreign investment.”[5]

[5] http://www.shatil.org.il/files/MF_the%20future%20of%20MF.pdf

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9. Glossary

1. Addis Credit and Savings S.C.

Year of Establishment - 2000

Legal Status - Addis Credit and Saving S.C. was legally registered by the National Bank of Ethiopia, according to Proclamation No.40/1996.

Current Operational Area(s) - Addis Ababa City Administration

Future Expansion Plan - Addis Credit and Saving S.C. is a region-based micro finance institution established to serve people residing in the City of Addis Ababa.

Total Number of Woredas Covered so far - All sub-cities

Total Number of Branches Opened so far - 10 branches

Total Number of Clients served so far - 30,000 (All urban)

Gender Sensitivity - Male clients = 18%; Female clients = 82

2. Amhara Credit and Saving Institution

Year of Establishment - 1996

Legal Status - Amhara Credit and Saving Institution (ACSI) S.Co. was legally registered by the National Bank of Ethiopia, according to Proclamation No.40/1996.

Current Operational Area(s) - Amhara Regional State

Future Expansion Plan - Operation will remain in Amhara region, but increasing outreach by 50% by expanding to more villages/Peasant Associations.

Total Number of Woredas Covered so far - 104 woredas (total no. woredas in the region is 105)

Total Number of Branches Opened so far - 10 branches and 163 sub branches

Total Number of Clients served so far - Total: 262, 880 credit clients and over 50,000 voluntary saving clients

Gender Sensitivity - 70% Male and 30% Female

3. **<u>Meklit Microfinance Institution</u>**

Meklit Micro Finance Institution (MMFI) has been providing credit & saving services to the poor people of Addis Ababa, Nazareth and Butajira who never had access to capital through fair loans. Meklit Micro Finance Institution has more than 4000 active loan borrowers

4. **<u>Five Talents</u>**

Five Talents gives people the opportunities to lift themselves out of poverty by providing access to basic savings ad micro credit services built on their trusted community tradition. They provide business training to help the poor start small businesses ad begin to build their future. Five Talents supports indigenous institution working in microenterprise development and work primarily through the following services and programs.

- Consulting services, training and education for micro credit programs.
- Loan capital to the poor.
- Materials that promote biblical business principles.