

PAGE

policy analysis on growth and employment



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Priority policy research issue for the second PAGE II (2017) call for proposals

Entrepreneurship and financial inclusion for inclusive growth

In what follows, we introduce the priority thematic issue of **Entrepreneurship and financial inclusion for inclusive growth**, identified for the second round of PEP's call for research proposals for its PAGE II program.

To assist applicants in designing their research proposal, PEP resource persons have prepared a complete review of existing scientific literature on each of the priority themes. Follow this link to access the [recommended reading](#) lists online.

IMPORTANT: For all policy research issues identified for this round of funding, applicants are encouraged to explore impacts on inequality across gender, socio-demographic groups and age groups. Consideration of gender aspects should be included for all issues.

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Motivation and situation analysis

Labour market rigidities tend to exclude many low-skilled individuals especially women and youth, throwing them into self-employment income strategies and restricting growth options for the corresponding economies (Perry et al., 2007). Inclusive growth policies are therefore becoming necessary to explicitly aim at improving the capacities of the poorest and most vulnerable to benefit from economic growth in their countries. Two of the more important policies are the transfer of managerial skills for entrepreneurship and access to financial markets.

The promotion of entrepreneurship has gone beyond increased access to credit and expanded the focus on the transmission of business and managerial skills to micro and SMEs. Women and young workers tend to be overrepresented in the informal economy (Perry et al., 2007), increasing their vulnerability compared to other groups.

Higher financial inclusion has been found to be significantly correlated with lower poverty and income inequality. About 2.5 billion people and over 200 million businesses are still excluded from the formal financial system, limiting growth, job creation and employment opportunities. It would be important to explore further who are being reached by these innovative products and how they have contributed to improving the welfare of these groups.

Research issues

Despite the increased volume of applied and academic work promoting the effective transfer of managerial skills for entrepreneurship and financial inclusion, the lack of conclusive insights and the relatively weak positive evidence that business training and measures increase access to financial services has led policy-makers and practitioners to experiment with different types of pro-entrepreneurship training programmes and interventions. Although the number of programmes offering entrepreneurial support has increased over the past decade, as have resources dedicated to studying them, the lack of knowledge sharing and learning across practitioners, academics, and development agencies has been a limiting factor for better programmes and policies, particularly for those that have the potential to span across countries, regions as well as academic disciplines. With a large number of programmes being implemented to promote entrepreneurship and financial inclusion, it is of great interest from a development policy perspective to evaluate whether these programmes are achieving their intended outcomes. Below we outline six areas for further analysis.

a. Heterogeneous entrepreneurs and the optimal policy mix

Most firms in the developing world are micro-enterprises, and most micro-enterprises are unipersonal firms, or firms who only employ family members. The decision to run a micro-enterprise, in turn, is driven by different motivations. Some micro-enterprises are motivated by the desire to start and grow a firm (dynamic entrepreneurs), while others are motivated by the need to generate income to support the family (necessity entrepreneurs). Men and women, as circumscribed by gender roles, may differ in these motivations, with some evidence that women are more likely to fall into the latter category.

The different needs and motivations among entrepreneurs require properly targeted entrepreneurship programmes. The evidence available suggests that programmes that indiscriminately address the needs of very different types of entrepreneurs are ineffective. Programmes that reach low-growth micro-enterprises represent a good opportunity to reach poor beneficiaries and potentially pursue social inclusion objectives. Proper screening mechanisms are important to match programmes with the populations that can most benefit from them.

- How can we distinguish necessity entrepreneurs from dynamic entrepreneurs?

- Does gender play a role in forming necessity entrepreneurs vs. dynamic entrepreneurs? What factors might prevent or obstruct women from pursuing dynamic entrepreneurship?
- How relevant is that distinction, or other characterisations, to define the type of support required to promote firm's growth?
- What are the most promising policy options to promote dynamic and necessity entrepreneurship? Do these differ between men and women entrepreneurs?
- To what extent do dynamic and necessity entrepreneurship contribute to inclusive growth and poverty reduction?

b. Entrepreneurship programmes and managerial skills transfer: the training delivery challenge

Overall, the evidence on entrepreneurship programmes and managerial skills is non-specific and fragmented. The available body of high-quality evidence on entrepreneurship programmes is relatively sparse, and distributed across different academic disciplines. This has significantly limited our understanding and our ability to identify more effective entrepreneurship programmes and policy design.

Experimentation with innovative training delivery mechanisms is needed to adjust to behavioural and time constraints of heterogeneous entrepreneurs.

- How can we make these business training programmes more efficient in their use of time?
- Can the use of ICTs help smooth the length-flexibility trade off?
- What are the most effective managerial skills and entrepreneurship training delivery mechanisms that will promote microenterprise development and socio-economic empowerment of the poor?
- How can we ensure that women and youth receive non-discriminatory support from pro-entrepreneurship training programmes?

c. Complementary mechanisms for entrepreneurial training

These more sophisticated programmes have the potential to expand the entrepreneurial policy toolkit, although recent studies suggest we need to be patient to get the correct policy implications, as many of the changes associated to these interventions take time to materialise (Valdivia, 2015).

Only recently has evidence emerged on the complementarity of financial services and business skills interventions. Recent meta-evaluations have also highlighted the importance of this complementarity. This evidence is, however, stronger for male-run SMEs. One potential explanation for the higher effectiveness of SME financial services for male clients may reside in gender-specific bargaining that occurs within households.

Labour market imperfections (imperfect information and mobility) often exclude low-skilled, inexperienced, poor individuals from formal employment, leading them to become self-employed. Policies that relax labour market rigidities (e.g. access to information and mobility of labour) can also be a way of improving the efficient self-selection of entrepreneurs into programmes that can benefit them.

- How relevant are more integrated support programmes, combining business training, credit or cash transfers, technical assistance, etc., to sustainably promote the growth of micro and small entrepreneurs in developing countries?

- Which is the component that makes the most difference for the different types of current or potential entrepreneurs?
- Which combinations of supporting packages are favourable for entrepreneurs from different gender and age groups?

d. Linking institutions to entrepreneurship and SME policy

A supporting institutional framework, for example the recognition of ownership and business entity for individuals, is necessary to enable the full potential of business enterprises especially at the small and micro-level. However, the specific channels through which these macro factors condition the effectiveness of entrepreneurship and SME policy remain poorly studied. In addition to education, the public sector plays a critical role in the provision of physical infrastructure to connect entrepreneurs and their business premises to the market of goods and services and clients, especially in rural regions. This is a fertile area for exploring variation in governance and institutional characteristics across countries and regions in order to design an effective institutional framework for entrepreneurship and SME policy.

- What is the nature and extent of legal and physical infrastructure required to promote the development of entrepreneurship and SMEs across sectors? And among women?
- How can we better coordinate the provision of resources at national, regional and local levels and the maintenance of essential physical infrastructure to support entrepreneurship and SME programmes?
- What is the importance of institutional support to the SME investment climate and SME development?

e. Product development for financial inclusion: micro-credit, micro-savings, micro-insurance?

Recent experimental evaluations show less optimism about the general impacts of microcredit to reduce poverty and promote economic growth. The international literature is now more optimistic about the role of savings to promote several development goals: empowerment of poor individuals in their decision-making, coping with health risks, promoting entrepreneurship and even promotion of investment in agricultural productivity (Karlan, Ratan and Zinman, 2013). Families under-save as a result of the lack of formal savings products that serve their needs, lack of information about benefits and opportunities, lack of trust in the formal financial system and high transaction costs or behavioural biases that complicate the fulfilment of saving goals. Wherever possible, ICTs are being used to reduce transaction costs, while financial literacy training is being implemented widely to address the informational deficit. Commitment savings products have shown promising results to prevent behavioural biases towards undersaving, but their effects seem to be rather small due to low take up. On the other hand, financial literacy trainings have shown mixed or no effects in developing countries.

- What is the differentiated role of savings, insurance and credit products for the poor in reducing their vulnerability to the different economic and climatic shocks they face over time?
- What business model innovations and product adjustments are required to improve access for the poor, women and youth? In particular, what are the roles of ICTs, cultural factors and behavioural nudges for take up and sustainability?
- Under what circumstances does improved access to formal financial products increase the welfare of poor households?

- How can commitment savings products ensure an adequate balance between rigidity, to avoid temptations for relatively superfluous consumption, and the flexibility individuals need to use savings to cope with individual or aggregate shocks?
- What is the impact of innovative IT financial schemes, such as mobile phone-based microfinancing schemes, in financial inclusion and entrepreneurship development?

f. Financial literacy: Information and knowledge for financial inclusion

Evidence shows that many of the financially-excluded lack knowledge about basic financial math and features of available financial products and that financial literacy is positively associated to the take-up of key financial products in developing countries (Cole et al., 2011). This has led to significant efforts to provide financial literacy programmes, both in developing and developed countries, but their positive impact on the use of financial products is inconclusive (Karlan, Ratan and Zinman, 2013). Why is it that many financial literacy interventions have not shown a definite positive impact on the use of financial products by the unbanked? Would the combination of financial literacy interventions with adjustments in product development have a better chance of enhancing the welfare of the poor through improved financial decisions?

Methodological Approaches

a. Microeconomic policy approaches (PMMA and field experiments)

Studies using firm-level data can help understand whether there are significant differences in productivity between male and female-headed firms or whether the latter are discriminated against in the credit market. For example, Seck et al. use such data with a combination of endogenous switching regression methods and a propensity score matching (PSM) approach to establish that there is no evidence of gender discrimination in the credit markets in Senegal. The study also finds that increasing credit access for credit-constrained firms, as well as to firms that already benefit from credit, improves both female- and male-owned firms' efficiency.

Other studies, such as the one by Chowdhury et al., use household level survey data to analyse the role of access to microcredit on entrepreneurship, by gender. Using an instrumental variable approach, the authors try to take the issue of reverse causality (i.e. those that are entrepreneurs are more likely to demand credit) into account. The conclusion is that credit is important, but more so for men. Thus, microfinance institutions (MFIs) often target women with the hypothesis that women give the money to their male partners for them to invest in their firms.

Ikenwilo et al. use a regression discontinuity design to analyse the impacts of credit on female beneficiaries' welfare in Nigeria. They take advantage of collaboration with Amoye Microfinance Bank, which uses a credit score to allocate credit to applicants based on the ranking provided by three high level officials. The collaboration also allows the authors to combine household level data with administrative data on the financial behaviour of eligible individuals. The study finds that microcredit reduces the incidence of child labour and food shortage in the household. They also find positive effects on women's empowerment, social capital and business income. This paper contributes to the growing literature of the impacts of microcredit on the welfare of recipients beyond its poverty reduction effects, which have been most recently questioned.

Relatedly, Nwosu et al. uses a Nigerian Entrepreneurship Survey and a PSM approach to evaluate the impacts of the access to formal credit on firm performance. They first define and identify credit-constrained firms and then observe that those that are not credit constrained

have a clearly better firm performance. They also use variants of the Blinder-Oaxaca decomposition method to analyse the presence of gender discrimination in formal credit markets, but they fail to find evidence that support such discrimination.

On entrepreneurship, Daoud et al. use the Global Entrepreneurship Monitor (GEM) survey to analyse factors that are associated with the decision to become an entrepreneur in Palestine. This addresses a key question in the entrepreneurship literature as we increasingly see the need to distinguish subsistence (or necessity) entrepreneurs from dynamic entrepreneurs. Using multinomial discrete choice models, this study finds that women are less likely to start a business, and they also have lower skill self-perception and greater fear of failure, so that business training and confidence boosting interventions for women may play a role in reducing the entrepreneurial gender gaps in Palestine.

The microeconomic evaluation tools presented above (and others), together with appropriate data, can help to evaluate and provide policy recommendations about:

- The most effective entrepreneurship programmes to transfer and improve managerial skills, their optimal duration/intensity and delivery mechanisms
- The effectiveness of mixed supporting packages for entrepreneurship (e.g. business training, easier access to credit and technical assistance)
- The role of savings, insurance and credit products in reducing vulnerability of the poor

Over the last years, many PEP-supported projects (both under the PAGE initiative and in previous phases) using different micro-modelling data and estimation techniques have covered entrepreneurship and financial inclusion issues. The table below provides some examples.

Research title	Authors
Risk tolerance, gender, and entrepreneurship: The case of the occupied Palestinian territory (oPt)	Daoud et al.
The impact of a rural microcredit and financial inclusion schemes targeting women on household vulnerability and economic empowerment: Evidence from South West Nigeria	Ikenwilo et al.
Access to credit and women entrepreneurship: Evidence from Bangladesh	Chowdhury et al.
Female entrepreneurship, access to credit, and firms' productivity in Senegal	Seck et al.
Is there discrimination against women entrepreneurs in formal credit markets in Nigeria?	Nwosu et al.

b. MPIA approaches

This thematic area is generally uncommon for CGE modelling application as the main instrument of analysis. Nonetheless, CGE can be a powerful tool to simulate SMEs where financial capital is considered as a factor of production to be included in the production function along with labour, physical capital and natural resources. This approach has been used in the past by some authors (e.g. Decaluwé and Nsengiyumva, 1994) using a financial CGE model that considers the allocation of credit between different sectors as a key policy instrument. Alternatively, CGE modelling can differentiate production activities between large firms and SMEs to compare enterprises of different sizes. In terms of financial inclusion, CGE modelling can simulate variations in capital investment financed through different sources such as government subsidies, private savings, and foreign investments. As an example, Morley et al. (2011) took a very simple approach to treat working capital as a production factor. A similar approach could be followed to treat financial investment as an increase in the physical capital stock.

Although entrepreneurship and financial inclusion is a relatively new area for CGE modelling and other macroeconomic modelling tools, this represents an opportunity to advance the modelling techniques to help analyse and provide policy recommendations on following issues:

- How do different sizes of enterprises affect economy-wide employment and labour productivity across sectors?
- How do different sources of financial credit affect the activities and performances of SMEs?

The table below shows recent PEP-supported projects using MPIA approaches focusing on some of the research issues proposed related to entrepreneurship and financial inclusion.

Research title	Authors
Macroeconomics implications of female entrepreneurs facing financial frictions to access to credit: a CGE approach.	Babilla
Endogenous savings rate with forward-looking households in a recursive dynamic CGE model: application to South Africa	Lemelin

c. Field experiments

Please consult [Field experiments summary paper](#).

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