

**International Conference on Self-employment  
(OECD/CERF/CILN)**

**Burlington, 24-26 September 1998**

**Enterprise Creation by the Unemployed:  
The Role of Micro-finance**

**An ILO Action Program**

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## **Background**

### **What is at stake?**

Over the past few years, there has been an impressive increase in the number and volume of Government programs that seek to encourage the unemployed, the young, welfare recipients and disadvantaged groups of the population to set up their own, very small business. In fact, in 1998 alone, new legislative initiatives for self-employment programs are being proposed in the US, France, Germany, the Netherlands and other countries. These micro-enterprise promotion/self-employment programs are generally considered successful: tens of thousands of the unemployed make use of this opportunity every year and actually succeed in their undertaking.

At a juncture when parliaments and administrations decide on the details of program implementation, it is an opportune time to take a closer look at the performance of self-employment programs: what needs to be improved to maximize social benefits and minimize social costs? An important question that emerges after the first generation of self-employment programs is: what model works best to ensure adequate access of the business starter to capital, during business creation and thereafter? Some programs provide micro-finance, others delegate it to banks, yet others operate in partnership with specialized, private micro-finance agents. The question is: is there a social good in micro-finance schemes for self-employment that would justify longer-term budgetary support, considering the transaction costs and risks involved for the intermediaries?

If this case can be made, it is still open to debate how to articulate such public support: what are the performance criteria on which it should be based? Which types of institutions should be eligible? Which Government agency can monitor them best and at the lowest cost? In other words: to what extent can and should performance standards for micro-finance intermediaries in developing countries be applied to intermediaries providing micro-finance to business starters out of unemployment in developed market economy countries?

The matter is not made easier by the fact that many micro-finance intermediaries are anything but transparently managed, anywhere in the world. They use different ranges of instruments, they operate on a small scale, and their ownership and legal status is diverse. How can one measure performance of such a heterogeneous group? And what are the implications

for policy?

This ILO Action Program wishes to address the information needs of Government on how to finetune incentives, sanctions and other monitoring instruments for micro-finance operators in self-employment/micro-enterprise promotion programs, and on the other hand to upgrade performance and transparency in the micro-finance industry, whether non-banks, banks and a variety of other agents.

### **Welfare reform, entrepreneurship and self-employment**

Self employment for the unemployed is not uncontroversial. Some argue that it leads to self exploitation and creates unsustainable businesses, others see it as an instrument of welfare reform, to help reduce public sector expenditure and the burden on social security systems. For some it is the bridge to more and better entrepreneurship, to expand the frontiers of the private sector while to others it only increases the pool of working poor, whose wages are too low to make a decent living and who end up taking on other income-generating activities.

The ambivalence surrounding the notion of self-employment reflects the multiplicity of policy objectives which this type of measure is supposed to help achieve. Originally, a measure of active labour market policy, it has taken on a load of other policy objectives, such as regional or local economic development, private sector promotion, competition policy, etc.

Critics of self-employment programs for the unemployed also attack the performance of intermediaries which finance, train and advise the unemployed; they are considered to carry excessive overheads, reach too few beneficiaries and lack professionalism. Even the overall social justification of self employment program has been criticized because of alleged market distortions, high costs, and unclear objectives.

### **Micro-finance**

Micro-finance is, to begin with, finance on a very small scale. That does not mean that micro-finance is necessarily non-bank finance. Some banks, especially in developing countries (BancoSol, BRI, GB, etc.) operate on a very small scale. But on the whole, and especially in developed market economy countries, with highly competitive and cost-conscious banking industries, one observes the gradual withdrawal of banks from individual loan transactions

(household and companies) as well as from areas with a high concentration of demand for small scale transactions (inner cities, rural areas). Research in industrialized countries shows that the average capital required for setting up a micro-enterprise is approximately US\$ 10,000 to US\$ 15,000 <sup>1</sup>. This is below the break-even point of most banking groups, including municipal savings banks and cooperative banks.

Micro-finance also has a qualitative dimension: the relationship between lender and borrower is different, closer (the French refer to "*financement de proximité*"). The lender is in fact not just a lender, but also a provider of advice and technical assistance, mentor, and tutor. The financial transaction is, in fact, embedded in various non-financial transactions. It is a highly personalized transaction (with all the advantages and disadvantages that this implies). The micro-finance lender is often prepared to forego interest revenue, adjust the lending technology and use collateral substitutes, like group liability or personal, unmarketable belongings. The micro-finance lender wants to help (in French "*financement solidaire*"). It is this multi-faceted nature of micro-finance, somewhere between the hard-nosed financial market and softer social concerns that makes it challenging to review its applicability to self-employment programs.

Not every micro-finance instrument is for micro-enterprise creation. Micro-finance in industrialized countries often also addresses the problem of household indebtedness. It provides payment, deposit and insurance services where no equivalent banking outlet is available. Even micro-credit is not always used to purchase assets or to ensure the funding of working capital requirements. Quite often it takes the form of consumer loans, and sometimes one cannot even distinguish between consumer and business loans.

Self-employment/micro-enterprise creation requires capital and advice. The activities most frequently launched by the unemployed are in the service sector, such as retail, repair and catering activities, personal and business services <sup>2</sup>, all of which do not require much capital hence the gap to bank finance, but more initial investment than what the unemployed individual or welfare recipient can mobilize out of personal savings or liquidation of other assets (hence, the need to find an external funding source). This credit/equity gap exists at the creation of the

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<sup>1</sup> The average capital requirement for setting up a micro-enterprise varied from DM 15,000 to DM 20,000 in Germany; £ 6,500 in Ireland; Ff 50,000 in France; and Hfl 24,000 in the Netherlands.

<sup>2</sup> See "*Cinq ans après leur installation, le devenir des bénéficiaires de l'ACCRE et de leur entreprise*", DARES, 1996; "*Klein krediet en zelfstandig ondernemerschap*", B&A Groep, 1998; "*Stock-taking exercise Ireland*", Carmen Duggan, 1998

micro-enterprise and as long as the new entrepreneur fails to establish a stable relationship with a bank. The question: “does micro-finance make sense within self-employment programs?” is therefore related to the entire process of gradual integration into the financial market and it is not a simple question of looking at the availability of micro-finance at the time of enterprise creation.

### **Micro-finance intermediaries in self-employment programs: a typology**

There is a variety of agents distributing micro-finance services, i.e. primarily micro-credit to business start-ups coming out of unemployment. The inventory exercises carried out in the first phase of this Action Program showed that the different agents can be distinguished by the following criteria:

- services provided: only micro-finance or also non-financial services?
- legal form and ownership
- fiscal status: non-for-profit vs. for profit vs. public
- mission statement: position on the continuum between outreach and sustainability
- scale of operations
- link to banks
- link to other enterprise creation agents (Chambers)
- link to social partners
- link to Government agency supervising self employment program .

The results of a first round of surveys are presented in the Birmingham conference report.

## Performance evaluation of micro-finance agents: criteria

Outreach to the targeted population and the financial sustainability of the intermediary are the two main criteria for a successful intermediary. The micro-finance agent is an “intermediary”<sup>3</sup> in the sense that it receives capital for on-lending:

- from public budgets (as grants, interest-free credit lines or subsidized interest rate loans)
- from the general public (donations): and
- from the capital market or other financial intermediaries.

One can distinguish four arrangements and distribution of roles:

- there is, first, the set-up with an overall self-employment program (Bridging Allowance or ACCRE) which provides income support for a limited period of time, which in itself is to facilitate access to bank credit. Here the program itself does not provide for micro-finance services.
- In the second arrangement (NL), self-employment programs come with a micro-credit window, which itself is operated by the *Sociale Dienst* (the local social services agents) in collaboration with Chambers of commerce.
- A third arrangement is a pure training/information-providing self-employment program, which plays a purely facilitating role with regard to bank credit.
- A fourth, less organized scenario, exists when private micro-finance providers operate without the involvement of a self-employment program and distribute micro-loans themselves or facilitate access to bank services.

Obviously one cannot compare the performance of agents operating under different scenarios; nevertheless, the **need** to measure performance and to control and audit exists, especially in view of the large sums of money involved.<sup>4</sup>

## Outreach

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<sup>3</sup> The term “intermediary” is not meant, however, to imply that the agent has the legal capacity to mobilize deposits from the general public.

<sup>4</sup> The annual cost of the Bridging Allowance was DM 944 million in 1997; ACCRE’s expenditures amounted to Ffr 1.2 billion; the BBZ disbursed Hfl 141 million in loans in 1997 and Hfl 48 million in income support.

Most agents operating in an independent fashion have difficulty in upscaling their activities. The 1996 Directory of Micro-enterprise Promotion Agents in the USA<sup>5</sup> shows that, on average, these agents disbursed 29 loans per program with a loan size of US\$ 9,248. On average, each program served 245 individuals, i.e. most of the clients were non-borrowers who received training or technical assistance. The limited outreach (or fragmentation) is an issue for those agents that are obliged — either by-laws, statute, legal status or in view of eligibility criteria of public funding programs — to show that they cover their operating costs, or at least — if this should prove impossible for reasons explained in the following section — that know their costs and revenues and produce intelligible, audited financial statements, at least on the micro loan portfolio.

In most cases, the unemployed are not the exclusive and explicit target group. The 1996 AEO Inventory shows that most of the 500 micro-enterprise promoters target the “working poor”, “disadvantaged populations” in inner-city areas, “single mothers heads of households” or simply the “marginal population”.

### ***Sustainability***

Institutions that confer private benefits should adopt corresponding pricing policies so as to stay in the market in the long term. Eventually, they should be able to survive without Government grants, subsidies or donor money. While the provision of micro-finance services to the unemployed and welfare recipients can be seen as a public good, therefore, justifying budget support, there is a need for accountability, whether or not the micro-finance intermediaries are expected to be profit-making.

What kind of micro-finance agent are we talking about: a public administration (the typical local labour exchange), a government bank, a private NGO using public grants or credit lines for on lending? Each is under a different degree of pressure to be accountable for its use of public money. Sometimes, different types of institutions with different governance and ownership structures provide the same services to the same clientele, but vary as to the degree of accountability.

The range of services also influences sustainability considerably. Financial services can

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<sup>5</sup> 1996 Directory of US Micro-enterprise Programs



be priced more easily at their full cost than can advisory or training services. Agents that offer only micro-finance services are potentially more sustainable than other agents offering a panoply of training activities. Yet, one could also turn the argument around and state that some agents hide behind their costly business advisory services, alleged to be vital, because it covers up their basically loss-making operations and helps to secure Government grants. How much transparency is necessary and feasible in this respect?

### **Micro, meso and macro dimensions of micro-enterprise programs**

The individual unemployed person's activity, its sustainability and viability is the centre of analysis at the **micro level**. Business survival depends on a host of factors, but the key hypothesis here focuses on the quality, scope and intensity of support provided by an intermediary matters. Put differently, it is assumed that the average unemployed person is not able to develop a business idea, plan, mobilize capital, obtain the required papers and struggle through the first three years without the guiding hand of a mentor.

Assuming that the sustainability and survival of such a micro-enterprise hinges on the micro-finance services, income support and advisory services provided, one must logically explore the stability of the intermediaries involved. Are they competent, stable, business-like? This issue lies at the **meso level** of the analysis.

How should such subsidies be financed? For what time horizon? Is this a temporary or a permanent area of policy concern? The underlying hypothesis at the **macro level** is: there may be a case for more and longer term subsidies to intermediaries, but this case needs to be build on more transparency so as to allow genuine performance-based public support.

### **Relevance**

At present, there is a multitude of legislative and administrative initiatives to launch new self-employment programs or to adjust and modify existing ones. In many cases the detailed design is still under discussion. As such, this would be an opportune place for the Action Program to come in. The following is a brief overview of current initiatives:

- UK (New Deal - Enterprise Creation by the Young)
- France (Enterprise Creation Program for the 18 to 30 year old; a similar program for

beneficiaries of welfare RMI states)

- US (5 legislative items currently under review by Congress, to be singled out here the Self- Employment Assistance Act which would make the SEA a permanent feature; other legislative items also touch on self-employment/micro-enterprise creation, however less explicitly focused on the unemployed, although they are not excluded)
- Germany (decision to leave 10% of their annual budgetary allocation to their free discretion with implicit encouragement of self-employment to all local labour exchanges (“Arbeitsämter”);
- EU: in late 1999, the Regional and Social Funds will arrive at the end of their funding cycles and are up for renewal.

## Micro-enterprise Programs in North America

### The United States

Micro-enterprise plays a key role in addressing unemployment, poverty and community deterioration in the United States. *The 1996 Directory of U.S. Micro-enterprise Programs*<sup>6</sup> describes 266 practioners organizations that collectively assisted over 36,000 businesses with loans outstanding of more than US\$ 36 million in 1995. The recognition of the growing importance of micro-enterprise programs is illustrated by the array of pending legislation for US federal programs:

- *Entrepreneurial Development Act* (US\$ 100 million);
- *SBA Micro-loan Program* (US\$ 60 million);
- *SBA's Women Business Center Program* (US\$ 9 million);
- additional appropriations to the *Community Development Financial Institutions Fund* (CDFI) of US\$ 125 million;
- consolidation of the *Jobs for Low Income Individuals Program* (JOLI) (US\$25 million);
- the permanent authorization of the *Unemployment Insurance/Self-Employment Assistance Program* (SEA);
- the enactment of the *Assets for Independence Act* which would authorize a US\$ 100 million Individual Development Account demonstration program (high leveraged savings accounts for home ownership, education or business capitalization).

A key player in the US micro-enterprise sector is the Association for Economic Opportunities, the apex professional association of micro-enterprise promotion and financing NGOs. Research on U.S. micro-enterprise programs has been conducted under the auspices of the Aspen Institute's Self Employment Learning Project, as well as by academic research institutions, such as Rutgers University, the Institute for Social and Economic Development, the New School for Social Research, Harvard University, University of Chicago, Dartmouth College, Syracuse University, and the Urban Institute.

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<sup>6</sup> Published by the Self-Employment Learning Project (SELP) of the Aspen Institute in collaboration with the Association for Enterprise Opportunity (AEO), 1997. The 1998 Directory is currently under preparation.

The bulk of financial support to micro-enterprise programs currently comes from federally-sponsored programs, supported by six federal agencies, i.e.

- *Community Development Block Grant* by the U.S. Department of Housing and Urban Development;
- *Community Development Financial Institutions* by the U.S. Department of the Treasury;
- *Job Opportunities for Low Income Individuals* by the U.S. Department of Health and Human Services;
- *JTPA Micro-enterprise Grants* by the U.S. Department of Labor;
- *Micro-enterprise Development Program* by the U.S. Department of Health and Human Services;
- *Micro-loan Demonstration Program* by the U.S. Small Business Administration;
- *Rural Business Enterprise Grants* by the U.S. Department of Agriculture, and
- *Self Employment Assistance Program* by the U.S. Department of Labor.

## Canada

In Canada a variety of new financial instruments, ranging from regional development funds to private risk or venture capital, have emerged over the past decade. These funds are based in many cases on new partnerships between Government, the private sector and social partners. Of particular interest to the ILO is the trade union involvement in notably Quebec.

A study on "*Fonds de Développement Local et Régional au Québec*" conducted by the Inter-university Research Group (PROFONDS) commissioned by the Federal Office of Regional Development (1996) showed 284 funds in Quebec with a capital of over Can\$ 3.1 billion. Main investors are the Federal and Local Government (53%), followed by the trade unions through "*Fonds de Solidarité des Travailleurs*" (17%) cooperatives (Desjardins and Caisses Populaires) (10%) , traditional banks and private enterprises (10%) and others (citizen groups, religious organizations etc) (10%).

Priority of the funds is to target start-up business (96%). Loans for business development and expansion is equally favoured (respectively 82% and 73%). 10% of the funds explicitly focus on the very small, micro-business and independent workers, while another 30% focus on entrepreneurs who are part of a target clientele, such as single mothers, refugees, welfare recipients, young people etc. Most funds offers very small investments per project; seven out of ten funds invest less than Can\$ 10,000 and nearly two out of three funds invest for a minimum period of two years.

The important role of the trade unions has emerged from the fact that over the past decade, the federal and a number of provincial governments have authorised the creation of labour-sponsored venture capital corporations (LSVCC); investment funds administered by trade unions with the right to raise capital from their own members as well as the public at large.

## France

Micro-finance is an important instrument to combat social exclusion in France. The ACCRE program (*"l'Aide aux Chômeurs Créant ou Reprenant une Entreprise*) allows the unemployed to receive unemployment benefits as a lump-sum payment upon starting their own business. First introduced in 1977 and allocated to 70,000 people in 1987, the lump-sum payment was abolished in 1997, which immediately reduced the number of micro-enterprises created (approx. 35,000 in 1997). Expenditures in 1996 amounted still to Ffr. 1.2 billion.

At present, there is a legislative initiative to launch a similar enterprise creation program for the 18 to 30 year old.

Local authorities (i.e the *Conseils Régionaux*) and the *Agence pour la Création d'Emplois* also support enterprise creation.

Civil society has become increasingly interested in fighting social exclusion through micro-finance instruments. Responding to the limited access to the traditional banking sector for SMEs, various (non-bank) financial organizations have sprung up and a few banks have become interested in the mobilization of solidarity savings. The general concern of these organizations is enterprise creation, community development and the fight against social exclusion.

FINANSOL (*"Financement Solidaire"*) represents a network of these operators. The organizations represented in FINANSOL can be distinguished by the type of financial service they provide. Some private organizations distribute public funds in the form of loans , like ADIE (*"Association pour le Droit à l'Initiative Economique"*). ADIE's maximum loan amount is Ffr 30,000 (approx. US\$ 5,000) and they focus exclusively on the long-term unemployed. Other organizations provide loans to small or micro enterprise starters, such as NEF (*"Nouvelle économie fraternelle"*) and Caisse Solidaire Nord Pas de Calais.

Financial and non-financial support go hand in hand. Some of the other organizations represented provide guarantees, facilitating access to the traditional banking sector, such as *Fondation France Active* while others provide equity investment, either through small groups of individual investors (i.e. clubs of CIGALES) or small capital-development societies (*Autonomie et Solidarité*).

It is in this context that the Steering Group in France met for the first time in February 1997. The Steering Group consists of representatives of the Government (Ministère de l'Emploi et de la Solidarité, CNRS, APCE), trade unions (CFDT), employers organizations (Chambers of Commerce, CNPF), micro-finance operators (ADIE, Cigales,,), research institutes (Centre Walras, Epargne sans Frontières) and others ( Comité de Bassin d'Emploi de Dunkerque). The OECD has joined as an observer.

## **Germany**

Germany has a very elaborated promotion system for start-ups and SMEs. Due to the political structure the federal and state governments as well as local administrations are involved in designing and/or administering support measures. A recent overview of more than 400 federal and state programs for SMEs shows that programs for start-ups normally do not have an explicit micro-finance component - they usually state maximum ceilings for credits but no minimum amount.

New efforts to support the unemployed via micro-finance with a view to help them take up self employment have to take into account the complex structure of the German promotion system, characterized by:

- a multitude of similar, sometimes even identical programs. With respect to Western market economies Germany may have the highest number of promotion measures for SMEs world-wide. The number of programs ranges between 400 or 1.200 (depending on the definition for "program") with more measures coming up continuously.
- a dense support network of e.g., centers for start ups, Chamber of Commerce and especially the German banking system with the "house bank" arrangement which acts as intermediary in several programs.

Despite a multitude of programs, individuals planning to start an enterprise still feel excluded even from most of targeted federal programs, such as the ERP program for business creation and the ERP equity assistance program (both administered by the Deutsche Ausgleichsbank) not to speak of financial services offered by private banks. This has led to the creation of public or public-private schemes at the federal, state and local levels, which aim to

overcome micro entrepreneurs restricted access to finance.

The best known federal program to support self-employment of unemployed involving a micro-finance component is the “bridging allowance“: unemployed persons who wish to start their own enterprise can receive unemployment assistance as income support for maximum 6 months. This program with a funding volume of one billion DM in 1997 assisted some 80,000 unemployed in that year alone.

The ILO Action Program is supported by representatives of different federal ministries (Labour as well as Economics), employers organization (BDA), research institutes (the Institute for Employment Research, the Institute for Finanzdienstleistungen, the RWI and the ZEW) and the micro-enterprise programs, such as Landesagentur für Struktur und Arbeit (Potsdam), the Starhilfefonds beim Senator für Arbeit (Bremen) and the Lawaetz-Stiftung (Hamburg).

## **Ireland**

Between 1991 and 1997, the number of unemployed people entering self-employment increased in absolute numbers, from 1,300 in 1991/2 to 1,750 in 1995/6 and to 2,800 in 1996/7 (Eurostat data). The proportion of self-employed who had been unemployed before also increased, from 11.6 % in 1991/2, to 15.3% in 1995/6 and to 20% in 1996/7. These trends coincided with the establishment of major programs of public support for unemployed business starters.

In response to these trends, there are a very substantial numbers of players operating in micro-finance, both at the national and local level. National agencies / programs are, for the most part, direct providers of funding and micro-finance to unemployed business starters while local agencies, in contrast, are much more likely to mediate between the funding provider and the beneficiary.

Two major **public programs** to support the entry of the *long-term* unemployed into self-employment have been in place in Ireland since 1993. These (*the Back to Work Allowance Scheme –BTWAS- and the Area Allowance Enterprise Scheme – AAES*), operate back to back and effectively constitute a continuous four year program of support for the unemployed. In April 1998, these programs had a combined participation of 15,600 people, accounting for



approximately 12 percent of the registered long-term unemployed.

There are by now a very wide range of agencies providing assistance including micro-finance available to unemployed business starters. These have emerged over the past decade and are promoted by organisations and agencies in various sectors, including the private sector, community sector, religious organisations, and the trade unions. Almost all rely on the provision of finance from other sources:

- First Step
- Enterprise Trust
- CREDO
- Society of St. Vincent de Paul
- Irish Trade Union Trust

The Irish Steering Committee will lead the research work in Ireland and will include the membership of representatives from the various sectors, such as Government representatives (i.e. ADM), banks (i.e. the Bank of Ireland), micro-finance institutions (i.e. Fingal Centre for the Unemployed, Northside Partnership, SME Partnership), and trade unions (i.e. Irish National Organization of the Unemployed).

## **United Kingdom**

In the UK, the Government has provided funds to support unemployed people to develop businesses under a variety of schemes for nearly two decades. Current sources of finance include:

- The Department for Education and Employment (DfEE) — Work Based Training for Adult unemployed (ages 25-64) which includes self-employment as part of a training option
- The Department of the Environment, Transport and the Regions (DETR) — the Single Regeneration Budget (SRB) is a competitive policy program aimed at certain geographical areas which sometimes includes measures of support for self-employment, available only to winning areas in England and Wales through local authority partnerships

- the European Regional Development Fund (ERDF) is a regional program focussing on the most deprived geographic areas and principally delivered through local authorities.

However, as the landscape of micro-finance activities expands, new projects and vendors of micro-finance have begun to spring up. Some of the newer programs which provide support to self-employment are:

- **New Deal**
- **Prince's Youth Business Trust (PYBT)**
- **Employment Zones (Business Enterprise)**
- **Training and Enterprise Councils**
- **Small Firms Loan Guarantee Scheme**
- **Birmingham based Aston Reinvestment Trust**

These programs are involved in local self-employment schemes and function as “gatekeepers” of Government funds.

Local authorities have been supportive of micro credit and small business funds for many years. Some manage their own small business and micro credit funds, whilst others have engaged in partnerships with the private and voluntary sectors. Alongside the local authority loan funds and public private sector loan funds, a handful of major company or industry loan funds exists. Some of these were initially established to assist redundant employees of the industry, for example, the British Coal Enterprise Fund, whilst others have been set up as part of their community program initiatives for certain geographical areas, such as the BP Enterprise Fund.

The UK Steering Committee for the Action Program brings together representatives from the range of actors involved in micro-finance. They include: members of the Government (i.e. Department of Education and Employment), micro-finance practitioners (i.e. Aston Reinvestment Trust and Prince's Youth Business Trust), Research Institutes (New Economics Foundation and Malcolm Lynch Solicitors), and trade unions (Trade Union Congress)

## **The Netherlands**

Micro-enterprise is increasingly attracting the attention in addressing unemployment and social exclusion in the Netherlands, specifically in difficult urban areas. The Government is still the major player in this field with the “*Besluit Bijstandsverlening Zelfstandigen*” (BBZ) program. This provides the self-employed as well as unemployed individuals that are planning to start their own business, financial support through (i) the provision of income support during a maximum period of 18 months and (ii) loans for capital investment of maximum Hfl 42,000 (approx. US\$ 22,000). A recent evaluation of this program showed that most of the new entrepreneurs needed income support, while only 25% needed a loan as well. 29% of the BBZ participants are female. The survival rate of the start-ups is 68% after three years. The outreach of the program in 1996 was approximately 3,000 loans. The total amount involved in the BBZ was approx. Hfl. 240 million in 1996 (US\$ 130 million).

In addition, there are some initiatives at the local level that offer micro-finance services, such as “*Werk en Ondernemen*” in Leiden and “*DIMO*” in Assen. These private organizations target the most disadvantaged groups. Other local micro-finance initiatives in Amsterdam (Mama Cash) and Rotterdam (STASON) exclusively focus on women entrepreneurs and provide guarantees (ABN AMRO Bank is involved), while STASON provides ethnic minorities with venture capital. The outreach of these initiatives is limited.

To increase financial support for start-ups by private investors, the Government introduced the “*Aunt Agatha Scheme*” in 1996. Private investors can increase their interest tax deductible threshold by Hfl 5,000 per year if they lend to start ups. In the case of the borrower’s bankruptcy, the private investor can deduct the loan amount from the taxable income for a maximum amount of Hfl 50,000. Two major commercial banks have opened Aunt Agatha Funds, but no information is available on the volume and the impact of these activities.

Little research has been conducted in the Netherlands on micro-finance in connection with self-employment. The Economic Institute of SME (“*Economisch Instituut voor het Midden en Klein Bedrijf*”) in cooperation with the Business Research Centre of the University of Maastricht carried out a research on the lower segments of the capital market (defined as up to Hfl 100,000).

In this context, the ILO Action Program has attracted the attention of public and private partners in the Netherlands. The Steering Group with representatives of the Ministry of Social Affairs, banks (Triodos Bank, Rabobank), practitioners (Dimo, Mama Cash, Stason, Werk en

Ondernemen), research institutes (B&A, Research voor Beleid), trade unions (CNV) and private enterprises (SHELL) has met on several occasions since December 1996.

## ILO's Experience in Micro-enterprise Development

Employment issues and job creation have long been at the center of the ILO's action. Since its ground breaking research on the informal sector in the 1970s, ILO technical cooperation has primarily focused on developing countries, and always included the provision of both financial and non-financial services.

Micro-finance in the ILO means to look primarily into distributional issues, like

- access to financial markets;
- the scope for self-help organizations;
- informal financial arrangements;
- links between labour and financial markets;
- financial markets as a vehicle for social objectives; and
- the social impact of policies addressed at the financial sector.

Besides the Action Program on *Enterprise creation by the unemployed: the role of micro-finance in industrialized countries*, ILO work includes research on the impact of financial sector liberalization on the access of micro and small enterprises to financial services, gender and the control over financial resources, the use of collateral substitutes in loan securization, and strategies to reduce transaction costs in bank lending to micro and small enterprises.

Research often provides the technical basis for international and regional meetings. In discussing the *Recommendation on Job Creation in Small and Medium-sized Enterprises*, the International Labour Conference, in June 1998, touched repeatedly on enterprise finance issues. In addition to organizing internal meetings on micro-finance, such as the April 1997 workshop on *The Social Dimension of Finance*<sup>7</sup>, the ILO has been asked to prepare technical papers on micro-finance issues for partner organizations, such as the Inter-Parliamentary Union.<sup>8</sup>

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<sup>7</sup> Social Finance Unit: *The Social Dimension of Finance: A Practitioners Workshop* (24-25 April 1997, Geneva - Workshop Report, ILO 1997)

<sup>8</sup> For the last Annual Conference of the Inter-Parliamentary Union (IPU) in Windhoek (2-11 April 1998, a paper was prepared on *Women in the informal sector and their access to micro-finance*, which was sent to all member parliaments of the IPU subsequent to its discussion at the meeting.

The ILO is on the Executive Committee of the *Consultative Group to Assist the Poorest* - a World Bank-led multi donor consortium on micro-finance -, supports the *Micro-credit Summit* and is an active contributor to the *Donors' Working Group for Financial Sector Development*. The ILO is also increasingly involved in technical and policy discussions on financial sector issues taking place among the agencies of the UN system.

Internally, a number of initiatives are being undertaken to secure coherence on the ILO's approach to micro-finance. Recently, technical experts from various units in the ILO formed the *Interdepartmental Working Group on Finance*, an informal network which meets to discuss micro-finance issues. The preparation of an *Institutional Action Plan*<sup>9</sup> for the Meeting of UN Agencies' Council of the Micro-credit Summit in New York (June 25-27, 1998) has helped to forge a consensus at the top management as to the ILO's role in this area. In addition, information on the latest developments in micro-finance are disseminated through an e-mail-based *Social Finance Newsbrief*.

A recent review of ILO technical cooperation, covering the period 1996 -1998, identified 52 projects with a micro-finance component.<sup>10</sup> Nineteen are exclusively focused on micro-finance, while the rest contain other intervention components. The total budget of these 52 projects is US\$ 67.8 million, with US\$ 6.1 million going into micro-credit funds, and an estimated US\$ 30.1 for research, advisory and capacity building services in the field of micro-finance. These resources are provided by 10 bilateral donors<sup>11</sup>, UNDP and the ILO itself. The regional focus of the projects lies in Africa, followed by Asia and Latin America.

The Action Program on *Enterprise creation by the unemployed: The role of micro-finance in industrialized countries* builds on this expertise, especially in designing and implementing international action-research programs with multiple stakeholders that aim to satisfy urgent information needs by policy makers and program managers.

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<sup>9</sup> The ILO Institutional Action Plan was presented at a meeting of the Council of UN Agencies by Mr. Göran Hultin, Assistant Director General.

<sup>10</sup> Social Finance Unit: Micro-finance in Technical Cooperation Projects - A Survey, ILO June 1998 (draft).

<sup>11</sup> The Netherlands is the biggest donor, followed by Norway, UNDP, Italy, and Denmark.

## **The ILO Action Program on *Micro-enterprise Creation in Industrialized Countries: The Role of Micro-finance***

### **The value added**

Surveys of micro-finance applications in the North, on the other hand, tend to adopt a micro perspective: they describe the development of individual schemes, without attempting to assess the socio-economic relevance of micro-finance for self-employment in the aggregate.

There have been several assessments of micro-enterprise program (see ANNEX 4); and there have been in at least three countries attempts to compile information on micro-finance operations.<sup>12</sup> The international comparisons have either dealt with self-employment programs for the unemployed generally or within the context of local economic as well as entrepreneurship development<sup>13</sup>. The ILO Action Program proposes to systematically explore the role, scope and limits of credit and other financial services as a strategic ingredient of self-employment programs.

The ILO initiative focuses on institutional performance and the policy and regulatory environment.

### **Issues**

The Birmingham Conference of the ILO Action Program selected several themes on the basis of the following criteria:

- demand driven: what is the demand for information and guidance from the point of

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<sup>12</sup> See 1996 Directory of US Micro-enterprise Programs for the USA; *Financements de proximité: 324 structures locales et nationales pour le financement de la création de petites entreprises en France*, EPICEA, 1996

<sup>13</sup> See "Self-employment for the Unemployed: Experience in OECD and Transitional Economies", S. Wilson and A. Arvil, World Bank, 1994; "Arbeitsmarkt politik für Existenzgründer", N. Meager, Social Science Research Center Berlin, 1995; RWI study 1997; "Self-Employment Programs for the Unemployed", OECD/US DOL, 1995; "Micro-finance et Developpement Local", OECD/LEED, 1998; "Local Development and Employment Strategies in Europe", EC, 1995

view of policy makers and managers of self-employment programs with micro-finance components?

- commonality: the need for action-research has to be felt and articulated in several, and at best in all seven countries participating in this ILO Action Program.
- feasibility: can the problem/issue realistically be resolved through the provision of information, or do other measures need to be developed, i.e. pilot projects, meetings with technical or political level staff, full-fledged longer term programs?

Based on these criteria, the following items were selected by the participants:

***Issues in connection with the survival of the self-employment activity***

- Access, accessibility (general, specific groups) to support services, especially micro-finance: entry requirements, eligibility criteria
- Need perception and articulation by clients
- Information excess
- Entrepreneurship among the unemployed
- Self-employment, self-exploitation and over-indebtedness
- Trial and error: the right to have a second chance
- Survival factors
- Coming out of the grey/black market

***Issues in connection with the sustainability and outreach of micro-finance agents in self-employment programs***

- Who and what precisely are the “intermediaries handling micro-finance”? (special focus on “social economy” institutions as well as on banks)
- Are the unemployed involved in the design of programs?
- Performance in terms of outreach
  - targeting
  - client selection
  - scope of and limits to up-scaling
  - lending technology and financial innovations



- Performance in terms of sustainability
  - how do different programs define “performance”, “success”?
  - mission, scale of operations and range of services
  - pricing of services
  - internal governance: self-monitoring, control, transparency, benchmarking (for example, tools for determining and reducing transaction costs)
  - external accountability
  - funding (diversification, stability, terms and conditions)
- Coordination, networking, elimination of overlaps, concentration, etc.
- External links
  - to social partners
  - banks and other regular financial market operators
  - other enterprise creation promoters (Chambers)

***Issues in connection with public support to micro-finance agents***

- Clarification of policy objectives (labour market policy, anti-poverty policy, competition policy, regional development policy, financial sector development policy, other?)
- Strategies
  - link objectives - instruments appropriate?
  - creation of new institutions to act as intermediaries or use of existing ones, for example through downgrading banks (credit scoring)?
  - alignment, harmonization: too many funds and programs? Observatory, data bank, register
  - selection of intermediaries (process, openness, competitiveness; what exactly are public-private partnerships?)
  - monitoring of intermediaries (how do different public authorities do it?)
  - incentives and sanctions: effective? fair?
  - transfers and subsidies (how much is actually involved? Comparison to unemployment costs, transparency, optimality issue etc.)
  - integration of self-employment programs into local/regional economic development plans
- Evaluation (social and private cost-benefit analysis)
  - overall labour market effects (induced job creation)

- substitution and displacement effects
  - deadweight effect
  - cost-effectiveness (compared to what other public policy measure?)
  - income distribution effects (micro-finance = a subsidy/implicit transfer or a (potentially) commercial proposition?)
  - market distortion effects
  - targeting, eligibility criteria and equal opportunity
- Feeding “good practice” information to intermediaries
  - Feeding results of self-employment program evaluations into welfare reform debate

## **Research Themes**

- 1. Is there a case for public support to micro-finance intermediaries?**
- 2. Micro-finance agents - performance measures with regard to sustainability and outreach.**
- 3. How do the public-private partnerships that support micro-enterprise programs structure and sustain their cooperation?**
- 4. What performance incentives do public authorities provide to encourage good program design, implementation and monitoring?**
- 5. Business survival factors: What ensures success of self-employment by the unemployed and low-income groups?**
- 6. Self-employment: the quality of work in micro-enterprise**

## **Organization and management**

There are three major agents involved: the Steering Groups in the participating 7

countries, the executing research agents and the ILO. The Steering Group directs and supervises research. It selects themes to be dealt with and chooses the research institute and researchers who carry out the task. The role of the ILO is to coordinate the work between and among the countries involved, to ensure consistency and comparability. The ILO is the facilitator and the manager.

## Strategy

This ILO initiative consists of two phases: an orientation and fact-finding phase (1998-1999) during which the knowledge base on micro-finance in self-employment programs will be created and an application phase (2000-2005) during which, in considering the recommendations of the 1999 Turin conference, will apply the findings through advice, guidance, hands-on assistance to policy-makers and micro-finance programs.

The strategy of the ILO Action Program is participatory, demand-driven and follows an action-oriented approach. It is *participatory* because the themes for action-research were elaborated through several rounds of consultations in the 7 countries concerned. While it has been a time-consuming process, it has proved to be a worthwhile investment, seeing that the Action Program as a whole has passed into the hands of the different Steering Groups and ensured their ownership.

The ILO Action Program is also *demand-driven* because Steering Groups are composed of representatives of Government, banks, social partners, micro-finance institutions and researchers. Researchers do not define research themes.

Finally, it is *action-oriented*, in that issue papers will be finished by November 1999 and presented at the Turin conference. The Action Plan adopted on that occasion will provide ILO hands-on assistance to policy-makers and program managers so as to strengthen their capacity to redesign, monitor and evaluate self-employment programs with micro-finance components.