Policy Brief

partnership for economic policy pep

No. 206 January 2020

Boosting youth entrepreneurship through informal credit in Benin

By Gbetoton Nadege Djossou, Jacob Novignon, Touwéde Bénédicte Atchade and Abdelkrim Araar

Key messages

- **Policies to promote youth entrepreneurship should include measures to facilitate access to informal and formal credit.**
- **Credit from informal and family sources complements finance to improve the performance of small-scale youth enterprises and start-ups.**
- **Among youth-owned businesses, women benefit more from access to credit than men.**

Benin's youth rely on informal credit sources to support entrepreneurship

A lack of public sector employment opportunities in Benin is pushing youth into self-employment. About 35% of youth are self-employed in Small and Medium Enterprises (SMEs) and 26% are in non-paid family work, whereas only around 19% are in wage employment[1]. However, youth entrepreneurs face important limitations to the growth and sustainability of their businesses. Lack of credit to start or grow a business is one of the main obstacles for Benin's young entrepreneurs, over 60% of whom rely on personal funds or money from friends and family[1,2].

The Government of Benin implemented various measures to promote entrepreneurship. These measures include the Microcredit Program for the Poorest (MCPP) and the National Fund for the Promotion of Youth Entrepreneurship and Employment (FNPEEJ), both established in 2007. However, financial inclusion remains low across the country and formal finance options are not accessible to everyone. Indeed, in many developing countries like Benin, **the complexity of formal credit sources limits access by start-ups and small firms**. In particular, the need to present collateral may prevent many from seeking and accessing formal credit. Meanwhile, credit from informal and family sources tends to be more flexible in terms of access and repayments. However, little is known about the impact of informal credit sources on youth enterprise performance in Benin.

A local team of PEP researchers sought to investigate how the impact of credit on the performance on Benin's youth enterprises varies according to the type of credit. They also explored whether gender and age influence the impact.

What is informal credit?

Informal finance refers to financial transactions that occur outside official financial institutions and that are not regulated by governmental authorities[3]. This includes informal credit from family or friends, moneylenders, informal credit unions, etc.

Those excluded from the formal credit market—such as SMEs unable to meet collateral requirements or located in rural areas far from formal credit institutions—rely on informal credit the most.

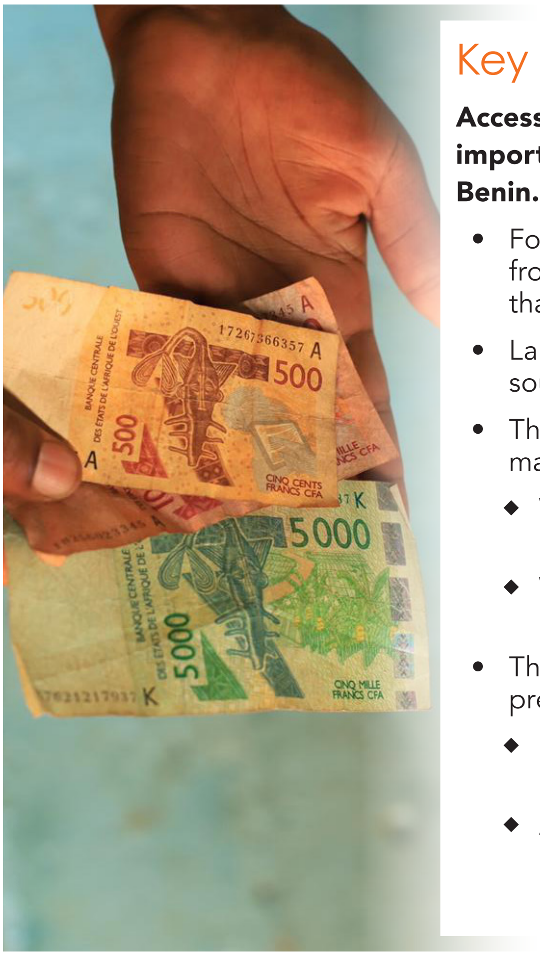
[1] INSAE. (2014) "Transition des jeunes femmes et des jeunes hommes de l'École vers la vie active au Bénin". Final Report, Intitut National de la Statistique et de l'Analyse Economique (INSAE), Cotonou, Bénin.

[2] ILO. (2018) "World Employment and Social Outlook: Trends 2018". International Labour Office (ILO)- Geneva.

[3] Hanedar, E. Y., et al. (2014) "Why do SMEs use informal credit? A comparison between countries". Journal of Financial Management, Markets and Institutions, 2(1), 65-86.

The analysis

The team analyzed survey data from 4,374 small and medium enterprises owned by youth (aged 18-35) in Cotonou. The data came from a World Bank study on firm formalization in Benin that includes information on firm performance and credit access. The data was collected over three rounds conducted in March-April 2014, April-June 2015 and May-June 2016.

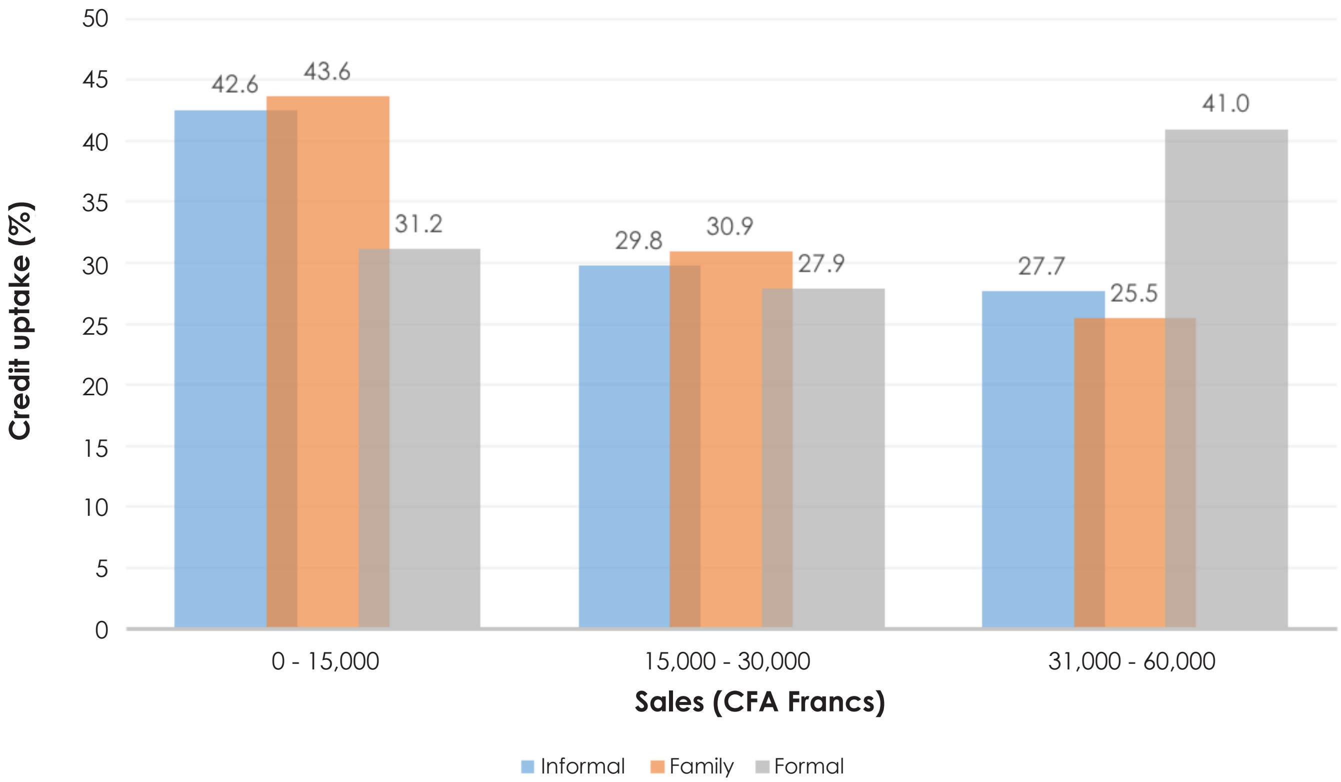


Key findings

Access to credit, whether from formal or informal sources, plays an important role in the performance of small-scale youth enterprises in Benin.

- For relatively small (in terms of sales) youth enterprises and start-ups, credit from informal and family sources is more important to their performance than credit from formal sources;
- Larger firms (in terms of sales) are more likely to rely on credit from formal sources;
- The impact of credit on firm performance is generally higher for female-owned youth enterprises compared to male-owned enterprises:
    - Women with access to informal credit are more likely to experience an increase in sales, relative to their male counterparts.
    - Women who access family credit are likely to experience higher sales relative to male owners.
- The impact of credit on firm performance is higher for older youth entrepreneurs.
    - For formal credit, the estimates were only statistically significant for owners in the 31-35 age range.
    - Access to informal credit by enterprise owners aged 17-25 increases sales by about 7%, while sales increase by about 5% for owners aged 31-35.

Sales level and credit uptake



Conclusions and **policy implications**

The low cost of family credit helps youth start businesses. **Policies that aim to encourage youth entrepreneurship should include measures to support credit access from informal as well as formal sources.** The team's findings show that informal credit sources have an important impact on business performance, especially for small-scale enterprises that may not have sufficient collateral to seek formal credit. Youth entrepreneurs and start-ups might also lack the skills to write a consistent business plan that can convince formal microcredit institutions to award them credit.

The role of local moneylenders, as sources on informal credit, should be rethought and introducing regulations for informal credit sources could be pertinent. To do so, **more flexible regulatory policies could be designed for local moneylenders**. For example, moneylenders should register before starting their activities and interest rates in the sector should be regulated. This strategy could also be more cost effective than previous government strategies, such as the Microcredit Program for the Poorest, which used only formal financial institutions to increase access to credit for female entrepreneurs in Benin. Similarly, designing **fiscal alleviation policies aimed at those financing the informal credit** may promote the offer and use of this kind of credit in a regulated sector.

Especially, in the context of Benin, mutual credit schemes in the informal sector – known locally as "tontine" – are widespread and allow SMEs to take credit at a zero (or almost zero) percent interest rate. These activities should not be ignored. **Policies should encourage formal credit institutions to develop products that have similar characteristics to those in the informal credit sector**.

Women entrepreneurs generally have a greater need for credit than men, most likely due to being excluded from accessing formal sources. Women's access to (informal) credit, therefore, tends to have a more significant impact on their business performance. Policymakers who seek to improve access to credit in Benin should **pay special attention to female-owned enterprises when designing credit programs**. It is particularly important to look at the constraints to accessing credit faced by women. For example, the government could develop its recent interventions to improve women's credit access by reducing collateral demands or providing guarantees for young female entrepreneurs.

Policies that address all businesses may not be effective, whereas **policies tailored to younger enterprise owners are likely to improve their performance**. Informal credit sources may be used while mentoring young business owners to help them graduate to formal credit. Supporting young business owners to develop their business models will improve their credit worthiness and help them gain access to formal credit. For example, regional entrepreneurial incubators where business models are nurtured and mentored by experienced entrepreneurs could be developed.

IDRC | CRDI
International Development Research Centre
Centre de recherches pour le développement international
Canada

UKaid
from the British people

This brief summarizes outcomes from PMMA-20272 supported under the PAGE II initiative (2016-2020). To find out more about the research methods and findings, read the full paper, published as part of the **PEP working paper series**.

PAGE II is a global research and capacity-building initiative for Policy Analysis on Growth and Employment in developing countries. PAGE II is supported by the Department for International Development (DfID) of the United Kingdom (or UK Aid) and the International Development Research Centre (IDRC) of Canada.