Synergies through Linkages: Who Benefits from Linking Finance and Business Development Services?

by

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International Labour Office · Geneva
Foreword

Entrepreneurs compete in rapidly changing markets and must respond to the challenges of globalization, technological advance and other factors. To be able to work themselves out of poverty, to survive and to grow, entrepreneurs need access to a range of services. Broadly, these are categorized as (1) financial services and (2) non-financial, or business development services (BDS), such as market information, management and vocational skills training and business advice.

Over the last 20 years, there have been impressive advances in development finance with the emergence of microfinance. A parallel development has taken place in the field of BDS in which a ‘new paradigm’ has emerged and changed the way practitioners think about delivering services to MSEs. In general, these two developments happened in parallel. While in the 1970s and early 1980s support to MSEs was combined in integrated packages, in the 1990s finance and BDS were delivered separately due to the prevailing view that this would be more effective.

This working paper takes a fresh look at how finance and BDS can be linked without jeopardizing the effectiveness of each service. It demonstrates how genuine synergies can be created for the three main groups of actors: MSEs, financial institutions, and BDS providers. MSEs, in particular, can derive substantial benefits because of greater access to both types of services. The paper also finds that there is no single blueprint for effective linkage. A careful examination of the local demand for, and the supply of, services is needed when choosing the type of linkage to be used in designing MSE support programmes.

The paper hopes to re-initiate a discussion on how to provide and integrate support for MSEs so that their growth can lead to decent employment. The target audiences of this paper are practitioners, development agencies and governments which are considering setting up or strengthening enterprise support programmes or otherwise linking BDS and finance.

The study is a joint effort of the InFocus Programme on Boosting Employment through Small Enterprise Development (SEED) and the Social Finance Programme (SFP).

The paper’s main author and core researcher is Merten Sievers, who has been involved in various MSE development programmes for SEED in the Balkans and Latin America. Paul Vandenberg made a substantial contribution to the final version of the paper. The research work for the paper was closely coordinated with Craig Churchill, Coumba Diop and Jim Roth of SFP.

Acknowledgement is due to Klaas Molenaar, Leo Soldaat and Nic van der Jagt of FACET BV, a consulting company in the Netherlands that specializes in MSE development. They read an earlier draft and provided valuable input. Recognition is also due to Lillian Villeda of USAID’s Microenterprise Development Division, who contributed important comments.

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Social Finance Programme   InFocus Programme on Boosting Employment
                          through Small Enterprise Development
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<tr>
<td>ADA</td>
<td>Appui au Développement Autonome (Luxembourg)</td>
</tr>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>ADEMCOl</td>
<td>Asociación para el Desarrollo Microempresarial Colombiano</td>
</tr>
<tr>
<td>BASIX</td>
<td>group of Indian companies engaged in investment and consulting</td>
</tr>
<tr>
<td>BDS</td>
<td>Business development services</td>
</tr>
<tr>
<td>BRAC</td>
<td>Bangladesh Rural Advancement Committee</td>
</tr>
<tr>
<td>CDASED</td>
<td>Committee of Donor Agencies for Small Enterprise Development</td>
</tr>
<tr>
<td>CEREM</td>
<td>Centre for Research and Documentation on Microfinance (ADA)</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poorest</td>
</tr>
<tr>
<td>CIPAME</td>
<td>Corporación de Instituciones Privadas de Apoyo Empresarial</td>
</tr>
<tr>
<td>EDA</td>
<td>Enterprise Development Agency</td>
</tr>
<tr>
<td>FFH</td>
<td>Freedom From Hunger</td>
</tr>
<tr>
<td>FFP</td>
<td>Fondo Financiero Privado (regulated non-bank financial institution)</td>
</tr>
<tr>
<td>FIE</td>
<td>Fomento a Iniciativas Económicas</td>
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<tr>
<td>IADB</td>
<td>Inter-American Development Bank</td>
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<tr>
<td>IDEPRO</td>
<td>Instituto de Promoción de la Pequeña Unidad Productiva</td>
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<tr>
<td>IGS</td>
<td>Indian Grameen Services</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
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<tr>
<td>LEDA</td>
<td>Local Economic Development Agency</td>
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<tr>
<td>MEDF</td>
<td>Macedonian Enterprise Development Facility</td>
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<tr>
<td>MFI</td>
<td>Microfinance institution</td>
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<tr>
<td>MSE</td>
<td>Micro and small enterprises</td>
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<tr>
<td>NGO</td>
<td>Non-governmental organization</td>
</tr>
<tr>
<td>PADME</td>
<td>Projet d’Appui au Développement des Micro Enterprises (Benin)</td>
</tr>
<tr>
<td>PRIDE</td>
<td>Promotion of Rural Initiatives and Development Enterprises (US-Kenya)</td>
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<tr>
<td>SDC</td>
<td>Swiss Agency for Development and Cooperation</td>
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<tr>
<td>SED</td>
<td>Small Enterprise Development</td>
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<td>Start and Improve Your Business (ILO)</td>
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<td>SME</td>
<td>Small and medium enterprises</td>
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<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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Executive Summary

Access to financial and business development services (BDS) are essential for the growth and development of micro and small enterprises (MSEs). Over the past decade, these two types of services have most often been provided separately. This paper explores the synergies derived from linking them.

The central hypothesis is that MSEs in developing countries can benefit from linking finance and BDS. It is recognized, however, that this will only happen if the providers of finance and BDS also benefit from the linkage. The paper considers, therefore, the costs and benefits of linking for three main groups of actors:

- micro and small enterprises;
- financial service providers; and
- business development service providers.

The paper reviews over 25 examples of linked provision and distils the main costs and benefits for the actors involved. It finds that there can be major benefits, especially for those MSEs that gain access to additional services that are essential for their growth.

In addition, a six-part typology of linked service provision is proposed, based on whether the linkage is voluntary or compulsory for the client and whether delivery is provided through one unified department of an organization, through parallel departments, or through separate partner organizations. The six resulting linkage types are (i) Unified-Compulsory, (ii) Unified-Voluntary, (iii) Parallel-Compulsory, (iv) Parallel-Voluntary, (v) Partner-Compulsory, and (vi) Partner-Voluntary. Each of these types has implications for the groups of actors involved.

The paper suggests that there is no one best type of linked service delivery, but that the circumstances of local providers and their markets will determine which approach is appropriate. It suggests, however, that voluntary provision is preferable to compulsory approaches, that the ‘unified’ or single department approach should be used sparingly, and that smaller microfinance institutions should attempt to partner instead of adding a parallel department.

This paper should be of value to practitioners and policymakers. It seeks to stimulate a new discussion on MSE growth and employment creation through linked service delivery.
Introduction

In developing countries, micro and small enterprises (MSEs) employ a significant portion of the total labour force. Many of these jobs exist in the informal economy, in poor, “survivalist” businesses that do not provide decent work. These businesses need to be developed so that the income and wages they generate can support a transition out of poverty for their owners and workers. One way of strengthening MSEs is to improve their access to vital enterprise support services. These services can be divided into two basic categories: (1) financial services, notably credit, and (2) a variety of non-financial, business development services (BDS).¹

In the 1970s and early 1980s, these services were typically delivered through integrated support programmes. In the late 1980s and in the 1990s, however, finance and BDS were increasingly separated as microfinance institutions (MFIs) developed and sought to achieve greater sustainability through specialization. The combination of BDS and finance provision increased the costs and lowered the productivity of many programmes. The problems of linkage were, however, mainly due to poor administration (i.e. insufficient or untrained staff, inadequate linkage design, poor efforts at cost recovery), rather than an inherent incompatibility of the two types of services. Nonetheless, many programmes embraced a “minimalist” approach of focusing exclusively on credit.

At the same time, a small number of institutions developed successful linked² services. These efforts have supported a growing concern that financial services alone are not sufficient for promoting long-term, sustainable enterprise development that helps reduce poverty. Entrepreneurs also need access to a wider range of BDS to enhance competitiveness and profitability.

Unfortunately, there has not been any systematic analysis of institutions linking finance to BDS. There has been even less effort to develop good practices. This study seeks to fill these voids. It does so by focusing not only on the benefits and costs for MSEs, but also by asking what benefits and costs exist for the service providers. If providers see direct benefits (or profits), aside from the gains they might wish for their MSE clients, they will be more willing to establish linkages.

The hypothesis of the paper is that the linked delivery of finance and BDS is not only beneficial for many MSEs – because it brings together two types of services that are essential for their growth – but that it can also generate benefits for the providers. An MFI may benefit if BDS helps its clients to better service their loans or grow faster. This, in turn, could improve the quality of the institution’s loan portfolio and its overall sustainability. The BDS provider could benefit by gaining access to a much wider pool of clients who are attracted to an MFI because of the loans on offer.

¹ Business development services include the following: management and vocational skills training, consultancy and advisory services, marketing assistance, access to information, technology development and transfer, and business linkage promotion. These services increase competitiveness through higher productivity, better product design or service delivery, and enhanced access to traditional or new markets (see: CDASED 2001). MFIs have tended to link credit with management services and there is less evidence of linkage with other forms of BDS. Credit can also be linked with non-business services such as literacy and numeracy training, nutrition classes, support for people with HIV/AIDS, and so on.

² The terms ‘linked’ and ‘linkages’ are being used in this paper as a general term to describe all types of linkages between financial and business development services.
Thus, the impact of linked delivery can affect three types of actors:

- micro and small enterprises (MSEs);
- financial services providers; and
- business development service (BDS) providers.

This paper offers a fresh look at the universe of existing MSE development interventions that establish some type of linkage. MSEs are defined here generally as those enterprises at the small end of the size distribution. Many institutions are, however, attempting to expand their client range by growing with their existing customers and attracting customers with larger financing needs. Examples of this movement upmarket are provided in this paper, although the majority of cases surveyed relate to smaller and poorer MFI clients. In addition, most of the BDS currently provided in linked programmes consists of management training, as reflected in the survey.3

The document is based on an extensive literature survey, including academic journals and “grey” literature, such as unpublished project documents and progress reports. To complement this information, e-mail messages were sent to specialized list-servers in microfinance and BDS. A wide range of responses, mainly concerning field experiences, was received. Furthermore, interviews with key informants in Latin America4 and at the International Labour Office in Geneva were conducted in mid-2003. Contacts were also established with other organizations working on the issue, including USAID and FACET, a Dutch MSE consulting company. A first version of the paper was presented at the BDS Seminar at the International Training Center of the ILO in Turin.5

The paper is divided into four sections. The first section reviews the changing trends among practitioners and donors regarding support to MSEs. The second section addresses conceptual issues and presents a six-part typology of linkages that have been used “on the ground”. Examples of successful and less successful approaches are provided to illustrate the various types. The third section reviews the empirical literature regarding the costs and benefits of linkage for each of the three groups of actors (MFIs, BDS providers, MSEs). The concluding fourth section draws lessons and provides a number of recommendations. It also highlights additional issues for analysis and research.

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3 Even though credit provision and management training are the most common services that have been documented, the author does not imply that these are always the most important services for MSEs. There are probably a high number of informal or indigenous providers with other services on offer that have not been captured by the research for this paper.
4 Mission by the author to Bolivia and Peru, May 2003.
5 A PowerPoint presentation can be downloaded at:
http://training.itcilo.it/bdseminar/Turin_Seminar/presentations3.htm
1. **Background and research hypothesis**

1.1 **Evolving context of enterprise development**

Micro and small enterprises make an important contribution to economic output and employment in developing economies. While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 per cent of employment in low-income countries is generated by the informal economy, while an additional 18 per cent is provided by (formal) small and medium enterprises. Together these two groups contribute 63 per cent of the GDP (Ayyagari et al. 2003, p. 10). Policy-makers and practitioners have designed a variety of interventions to stimulate the MSE segments of the private economy.

The focus of donor support has changed considerably since the late 1960s, with direct impact on modes of service delivery and target groups. The early emphasis was placed on formal small and medium enterprises, notably in manufacturing, as part of a general view that developing countries needed to industrialize. Given the relative lack of large indigenous firms and the scepticism towards the benefits of foreign direct investment, efforts were made to grow domestic enterprises for import substitution. These efforts did involve linked service provision, often based on industrial estates with support from a range of government BDS providers and state-owned development banks.

This approach proved unsuccessful in many countries for various reasons, including a misunderstanding of local business needs. Interventions were commonly based on a priori assumptions made at the head offices of donor agencies. Little effort was devoted to understanding local contexts, while financial and non-financial services were often delivered through agencies that were poorly prepared for the job – though heavily funded by donors. Enterprises were sometimes obliged to enroll in training courses when they only wanted credit, and vice versa. The institutions involved were not under pressure to become sustainable and therefore did not respond to market demand.

During the 1980s, the emphasis changed. Microcredit, based on group lending methodologies, caught the imagination of the donor community. It provided the answer to a number of key concerns. Firstly, it coincided with a renewed emphasis on direct support for the poor, following the ineffectiveness of macro-level reforms under structural adjustment programmes. Secondly, it was private-sector oriented, with borrowers investing in their own income-generating activities. Thirdly, the use of credit, instead of grants, with its emphasis on entrepreneurship and self-help, appealed to the neo-conservative governments of some major donors. Fourthly, the achievement of high repayment rates, with interest, meant that MFIs could become self-sustaining. Donors and practitioners adopted a financial systems approach, which focused on the sustainability of financial institutions:

The financial system perspective, in contrast, shifts the terms of the discussion away from individual firms, onto institutions and their ability to provide services on a sustainable and widespread basis (...) In shifting focus, the financial system approach necessarily relaxes its attention to “impact” in terms of measurable enterprise growth, and focuses instead on measures of increased access to financial services. (Rhyne and Otero, 1992, pp. 1561-62)

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6 The analysis in the remainder of this section is based on a variety of sources, including: Dunn, 2002; Helms, 1998, 2003; Schreiner and Woller, 2003; and Stack, 2003.
The separation of finance and business development services made sense for several reasons:

- Institutions with inadequate accounting systems were not able to separate the income and expenses derived from the two types of services. This weakness prevented informed decision-making regarding the pricing and profitability of services.
- MFIs began as NGOs but evolved into proper financial institutions that had to comply with finance sector regulations. The latter tended to require a clear accounting separation between finance and BDS.
- MFIs concentrated on one product line in order to monitor their cost efficiency more thoroughly.
- Some institutions delivered both services without gaining a real competency in either. As well, some experienced credit officers were not trained in providing BDS and were often burdened by the added responsibility of delivering BDS.

These problems reduced the productivity of staff and institutions. In response, many organizations made a clearer separation between the two services while others discontinued BDS delivery. The consensus was that credit activities should not be obliged to cross-subsidize BDS, as self-sustaining BDS was thought to be more difficult of achieve.

As a result, many MFIs adopted a ‘minimalist’ approach in which they concentrated on their core business with the goal of achieving financial sustainability. Emphasis was placed on the methodologies for delivering credit (and later other financial products) with less direct attention to client needs. The ultimate goal of providing credit – economic development and poverty alleviation – was overlooked. Dichter has argued that:

"By the late 1990s, especially within the microfinance sector, we heard hardly any debate on large questions about development. Instead what debate there was in microfinance focused almost exclusively on technique and scale, with purpose and impact having been taken largely for granted. (quoted in Fisher and Sriram, 2002: p. 79)"

At about the same time, policy-makers and practitioners developed a more client-led and market-centered approach to non-financial enterprise support services, now called BDS. This culminated in agreement on a set of guiding principles by the Committee of Donor Agencies for Small Enterprise Development (CDASED), which were designed to promote commercial BDS provision by local providers. This “new paradigm”, which emerged at the end of the 1990s, argues that “BDS can be delivered on a commercial basis even for the lowest-income segment” of the small enterprise sector (CDASED, 2001). This approach has fostered service delivery that is more self-sustaining and adapted to client needs. Most BDS programmes are still not reaching large numbers of MSEs, however.

Lately, the microfinance industry has been experimenting with ways to link services and make service provision more client-led. This stems, in part, from a recognition that the micro, small and medium enterprise sector is diverse. Some micro-enterprises can be supported effectively with group lending, whereas the needs of larger firms are more enterprise-specific. They can be better addressed through individual loans and ones that are large, have longer maturities and involve tailored repayment schedules (Churchill 1999). Lenders are keen on providing larger loans because it allows them to tap a new market niche.

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7 See for example Bajic and Pearce, 2003 or CGAP, 2003.
8 See also Dunn, 2002.
and to retain their best clients who are growing out of microfinance. The larger loan size and expanded client base can enhance the profitability of lenders. Furthermore, from a developmental perspective, these larger enterprises are more likely to create employment and return higher incomes to owners and workers. They can fill the “missing middle” that exists in the firm size structure of many developing countries.

Other factors – such as the increased competitiveness of financial sectors – have also contributed to the re-thinking of possible linkages between finance and BDS. Competition between MFIs has been increasing in countries like Bangladesh, Indonesia, Bolivia, Peru and Uganda. Institutions are seeking ways to stimulate customer loyalty or to otherwise gain an advantage over competition by offering additional services. Lenders can control credit risk better through linkage because the added services can lead to the increased viability and profitability of enterprises. Moreover, lenders can better assess the credit risk of a potential client by gaining access to information about that client from the BDS provider. More generally, the confidence that the microfinance approach is now mature, but that it is having only limited impact on reducing poverty, has prompted institutions to be more open to the idea of linking.

Thus, the pendulum is swinging back in the direction of linked services and broader development goals, but with a difference. There is a much greater emphasis on local demand, cost recovery and financial sustainability.

1.2 The actors and their interests: a research hypothesis

In determining the benefits of linking services, it is important to focus not just on the enterprises receiving the services, but also on the interests of the providers. For them to link services, either in-house or through partnerships, it is necessary that the new approach improves – or at least does not hamper – their performance. Many providers are keen to support overall development objectives but wish to do so while ensuring their own viability and expansion.

MFIs wish to keep repayment rates high, while expanding their client base. By improving their clients’ access to BDS, they can support the growth and success of their borrowers. Clients may be able to secure larger loans at a lower cost to the institution. In addition, MFIs could also offer a wider range of services to their clients by linking with existing BDS providers, without taking on the risk and cost of providing these services themselves.

Often, after giving advice on how to prepare a business plan or make a new investment, BDS providers realize that their clients are not able to access the necessary finance to realize their plans. Most BDS providers have a relatively small client base, often concentrated in urban areas, while many MFIs have branch networks that reach out to rural and remote areas. This high outreach could be used to expand the client base for BDS providers and thereby increase their sustainability.

For the enterprises, both financial services and BDS are important. By linking the two, entrepreneurs can access services they have not previously used. This may help to increase productivity, income and, possibly, employment levels. This perspective coincides with a

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9 See Nissanke (2001) on sources of enterprise finance in sub-Saharan Africa.
growing concern within the development community that credit is often not enough to support successful enterprises. In essence,

... poor borrowers from [microfinance institutions] often do not graduate to higher and higher loans, and consequently to productive small enterprises. While credit may initially be the ruling constraint for micro-enterprises, for them to grow beyond a certain size, other constraints come into play, for example of markets and managerial capacity. Micro-enterprises are therefore unlikely to grow significantly without inputs that can address these additional constraints. (Fisher and Sriram, 2002, p. 75).

One of the first findings of this study was that the number of practical experiences in linking services is large, but until now little has been done to conceptualize these linkages. Most of the evidence comes from the “field” and is having an impact on the thinking of development organizations. The Asian Development Bank (1997) has highlighted the importance of BDS for growth enterprises, while USAID has also noted the importance of linkage (ADEMCOL, 2001: Annex 6). The CGAP III strategy indicates that research will be undertaken to study the possibilities of linking (CGAP 2003). In addition, several training courses and conferences have taken up the theme. 10 Papers presented at the recent Microcredit+5 Summit suggest that MFIs are interested in new products and that the combination of credit and educational services, including BDS, can be an effective tool for fighting poverty. 11 In addition, the BDS debate on how to reach a larger number of the micro and small firms is continuing.

10 Micro Finance Centre (Warsaw) hosted a conference in Moscow (May 2003) which dealt, in part, with the issue.
11 CRECER, a Bolivian MFI, delivers microcredit plus educational training. Some 41 per cent of its clients have incomes of less than 1US$ a day. (http://www.microcreditsummit.org/papers/+5simanowitz.pdf)
2. Types of linkages

This study examined a range of institutions that were delivering BDS and financial services in a linked way. The most common linked delivery types have one of the following histories:

- A donor or a local institution starts as a MSE development or anti-poverty NGO and delivers different types of services (financial and non-financial). Its own field experiences and external influences (i.e. donors) result in eliminating one of the services or separating the two. If the two are separated, the institution concentrates on a core business (usually finance, because donors view it as an effective way to reach the poor).

- A financial service provider realizes that it can gain an advantage by taking on BDS. These are usually financial institutions that already feel comfortable in the financial market and have achieved a reasonable level of sustainability. They do not seek to improve their loan portfolio but offer BDS as an additional service to their clients either to build client loyalty, to gain a marketing advantage over their competition, to expand into new markets (i.e. react to larger businesses, poorer clients), or to better fulfill their developmental mission.

- A specialized BDS provider links with financial institutions. This approach is rare, however, as banks are usually reluctant to adapt their lending technologies to new types of clients (notably start-ups or clients without collateral).

Little has been done to grasp conceptually the different types of linkages that exist between BDS and financial services. One of the institutions at the forefront of advocating a specific methodology for linking is Freedom from Hunger (FFH). In this case, credit repayment is linked to education services, delivered in short training sessions. Dunford (2001: 1) of FFH defines three categories of linked delivery.12

- **Unified**: the same people of one institution deliver both types of services
- **Parallel**: an institution has two different organizational units, with separate accounting and different people, delivering the two types of services
- **Linked (or Partner)\(^ {13}\)**: two distinct institutions operating in the same area link to each other by referring clients to each other, undertaking joint marketing, etc.

This categorization does not, however, take into account the conditions under which services are linked. Another important dividing line is whether the linkage is compulsorily or voluntary, that is, whether an enterprise can opt to take only one type of service or whether it must take both together. To capture this difference, two categories are added to Dunford’s original classification. The two new categories distinguish between:

- Compulsory: clients must take both finance and BDS; and
- Voluntary linkage: clients can choose to receive both services or only one.

\(^{12}\) However, Dunford advocates linking credit to educational and health services, not necessarily BDS. The categories are also used by Stack (also with Freedom from Hunger) in referring to BDS.

\(^{13}\) For clarity, we use ‘partner’ instead of Dunford’s ‘linking’ for this third category. Thus, ‘linking’ and ‘linkage’, as used in this paper, are more general terms denoting all types of combinations.
The issue of choice is a controversial one. Some practitioners argue that BDS, notably management training, should be compulsory because it teaches borrowers how best to use the finance. By contrast, Helms (1998) argues that multipurpose MFIs should not oblige the client to buy other non-financial services:

... compulsory services: 1) increase the financial and non-financial costs to the client and the MFI, 2) imply a certain level of interference with the client’s own judgment as to which services are most useful, and 3) deprive MFI management of valuable information about client satisfaction with the compulsory services. (Helms, 1998, p. 2)

Another important question not addressed by the classification relates to sustainability. While good practice in financial services, as well as BDS, make sustainability (through client fees) a key goal, in linked delivery often one (and sometimes both) of the services is not sustainable.

By combining Dunford’s classification with the issue of choice, six types of linkage emerge (see Table 2.1). Each has distinct characteristics that affect MSE clients, the delivery of services by MFIs and BDS providers and, ultimately, the funding decisions of donors. These six types are explained below.
### Table 2.1: Linkages matrix

<table>
<thead>
<tr>
<th>Compulsory/Voluntary</th>
<th>Voluntary (client decides)</th>
<th>Compulsory (institution decides)/Service package</th>
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<tbody>
<tr>
<td><strong>Type of linkage:</strong></td>
<td></td>
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</tr>
<tr>
<td><strong>Unified</strong></td>
<td>ADEMCOL (Growth clients) (Colombia)</td>
<td>ADEMCOL (micro clients) (Colombia)</td>
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<td></td>
<td>Al Amna Tkwin Jdid (Morocco)</td>
<td>Bank of Khyder (Pakistan)</td>
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<td></td>
<td>Financiera Solucion (Peru)</td>
<td>Crecer (Bolivia)</td>
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<td></td>
<td>MiBanco (Peru)</td>
<td>Freedom from Hunger (FFH) supported institutions(^{14}) (includes non-business education)</td>
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<td></td>
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<td>GDREP/PRIDE (Guinea)</td>
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<td><strong>Parallel</strong></td>
<td>BRAC (Bangladesh)</td>
<td>ISSIA (Uganda) (training compulsory)</td>
</tr>
<tr>
<td></td>
<td>FIE-FFP FIE (Bolivia)</td>
<td>SEEDS (Sri Lanka)</td>
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<td>IDEPRO (Bolivia)</td>
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<td>PRIDE (Guinea)</td>
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<td>SEEDS (Sri Lanka)</td>
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<tr>
<td><strong>Partner</strong></td>
<td>ADA-CEREM/LUX Youth project-MFIs (Mali)</td>
<td>Primero Emprego youth employment programme (Brazil)</td>
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<td>BASIX (India)</td>
<td>VanCity Credit Union (Canada)</td>
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<td></td>
<td>Care Bosnia Credit and Market Access components (Bosnia-Herzegovina)</td>
<td>LEDA (Croatia)</td>
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<td>EDA Banja Luka - Microfins (Bosnia-Herzegovina)</td>
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<td>MEDF Banks- Business Centers (Macedonia)</td>
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<td>SIYB- Barclays bank/MFIs(Zimbabwe)</td>
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<td>SIYB-MFI (South Africa)</td>
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**Sources:** See bibliography.

**Unified-Compulsory:** Under this approach, the same institution, and the same department and staff within that institution, provides both services and clients are required to take both. This is one of the most common approaches. A typical way to unify the services is to train the borrowers during repayment meetings. Crecer and ProMujer apply this methodology, as do several institutions supported by FFH and Women World Banking. The training sessions are usually short and paid for fully or partly by the clients. Payment is made through a higher interest rate on the loan or by applying an explicit fee, usually paid with the credit installment.

\(^{14}\) Other FFH supported institutions include: ACLAM (Action Contre la Misère) in Haiti, COD/EMH (Coordination des Programmes de Développement de l'Eglise Méthodiste d'Haiti) in Haiti, CRECER (Crédito con Educación Rural) in Bolivia, FAMA (Familia y Medio Ambiente) in Honduras, FITSE in Malawi, FOCCAS (Foundation for Credit and Community Assistance) in Uganda, FUNDAP (Fundación Para el Desarrollo Integral de Programas Socioeconómicos) in Guatemala, Haingonala in Madagascar, Vola Mahasoa in Madagascar, see: [http://www.ffhtechnical.org/cwep/partners.html](http://www.ffhtechnical.org/cwep/partners.html)
Other projects (PAPIR, PRIDE, PADME, SACC0) use a more traditional approach in which classroom management training is delivered en bloc to micro-entrepreneurs before they receive credit. Services are also provided after the loan is received. The credit component is paid for, but might also have a small subsidy component.

Dunford (2001, p. 2) and Stack (2003) argue that the unified-compulsory approach is efficient because it reduces the costs to the institution and the client by using economies of scale and scope. Their perspective contrasts with that of Helms (1998) and others who argue that a “firewall” is needed to separate finance and BDS when delivered by the same institution.

**Box 1**

*Combining credit and education:*

*The case of Freedom from Hunger, Worldwide*

Freedom from Hunger (FFH) has developed a unique “credit with education” methodology. It is a unified-compulsory approach in which borrowers receive education in several areas. Most clients are poor rural women. Training is provided during the weekly meetings of the credit groups. The education includes hygiene, HIV/AIDS, literacy and also some basic BDS, notably on income-generation activities. Clients pay for the training through the interest on their loans.

FFH argues that clients are very satisfied with the training as it is adapted to their needs. It also claims that the training is delivered in a cost-effective manner for the institution and the client. The institution uses the same staff to provide training and disburse the loans, thereby achieving economies of scale and scope. The clients receive training when they gather to make loan repayments. The client, therefore, does not incur additional transaction costs (such as travel). FFH has reached a large number of women with this approach.

*Source: Dunn, 2001, p. 2. See also: www.ffhtechnical.org*

**Unified-Voluntary:** Under this approach, one department provides both types of services but clients can opt to receive only one. Four institutions were identified that started as MFIs and later added a BDS component. Different practices exist as to whether the client must pay for BDS, which is usually management training. Al Amana (Morocco) charges a small fee for training, while MiBanco and Financiera Solución (both Peru) do not charge (but clients covers the cost of travel and bear the cost of time taken to attend). Specialized officials of such financial institutions deliver the training. A possible problem is that MFI staff could have lower productivity levels. Credit is usually paid for by clients, with no subsidy.
Financiera Solución decided to offer the ILO’s *Improve Your Business* (IYB) management training to existing clients as a marketing instrument and a reward for client loyalty. Clients were not required to undergo the training and so it represents a unified-voluntary approach. Financiera Solución entered the Peruvian financial market in 1997 by providing consumer credit. After a crisis in its consumer loan portfolio in the late 1990s, it decided to enter the MSE market to expand and diversify its client base. The microentrepreneur segment currently has the highest growth rate among loan clients while also showing very low defaults rates (1.8 per cent in 2002).

Due to increasing competition for MSE clients, Financiera Solución decided to design a variety of incentive schemes to retain clients. These schemes included offering management training to its most successful clients. Of the clients contacted by the financial institution, 10-15 per cent have taken and completed the training. During the sessions, each client develops an investment plan that is passed on to a credit committee for evaluation. The credit committee also gets feedback from the trainers.

The institution currently has 200,000 clients. Training began in 2001 and 4,200 clients were trained in IYB by mid-2003. An additional 2,400 were expected to receive training in the second half of 2003. Financiera Solución only received support from the ILO in the initial phase for the printing of materials and technical assistance for the training of trainers.

In 2003 Financiera Solución was bought by Banco de Crédito del Perú, one of the biggest banks in Peru, and can now provide financial services also to medium and larger enterprises.

Financiera has now decided to continue the implementation of the IYB programme on a commercial basis. It initially believed that the effect of the training on the clients would be to create loyalty to the institution. It has been surprised with the very positive effect of the training on both enterprise growth, as well as client loyalty.

*Source: Interview with Aldo Mongilardi, Human Resource Manager, Financiera Solución, 29 April 2003.*

**Parallel-Voluntary:** One institution delivers both services through different departments with separate accounting and staff. Clients can opt to take one or both services. This approach has been used by institutions that began as BDS providers and later added financial services (i.e. FIE, IDEPRO in Bolivia). It also includes institutions more known for their financial services (i.e. BRAC in Bangladesh and SEEDS in Sri Lanka). BDS are usually partially paid for by the client and the payment is not linked to the credit (i.e. higher interest rate). While IDEPRO and FIE supply both services independently, BRAC offers BDS only to its borrowers. The credit has no or very low subsidy.
Box 3

Linking finance and BDS:
The case of IDEPRO, Bolivia

IDEPRO started off as a BDS provider in 1991 and today is the largest provider in Bolivia. In the beginning, all services were heavily subsidized but the organization is now working to achieve a higher sustainability of its service delivery. During the microfinance boom in Bolivia in the early 1990s, the institution built up a large microcredit programme due to high demand from the Bolivian market and high donor interest. At the same time the institution experimented with several linked products for entrepreneurs.

Best practice for financial services at the time called for separating BDS and financial services. IDEPRO created two departments and strongly dissociated credit and BDS activities. After 2001, IDEPRO segmented its credit clients into two groups. The first one (high performing clients) were transferred to a newly created non-bank financial institution, the Fondo Financiero Privado Ecofuturo, created by IDEPRO and other partner institutions. IDEPRO was required to retain the second group of clients who, during the economic crisis of the late 1990s, had failed to pay back their credits and were blacklisted. Today, Ecofuturo and IDEPRO refer clients to each other. IDEPRO is also studying the possibility of using BDS to improve the enterprises of the retained blacklisted clients and thereby enabling them to pay back their debts. After evaluating the business potential of such enterprises, those that show potential could be offered BDS to enable them to overcome their economic difficulties.

Source: Interview, Roberto Casanovas, Director of IDEPRO, 9 May 2003.

Parallel-Compulsory: In this category, clients are required to take both types of services but from separate departments of one organization. The approach is not common, as might be expected given that the BDS and credit departments are separate so that each retains decision-making authority. In the two examples found (ISSIA in Uganda and SEEDS in Sri Lanka) this category applies only for a few products the institutions are offering, while the departments do have other products that are offered with no linkage. The advantage is that the institution can establish the effectiveness and sustainability of the two services separately.

Partner-Voluntary: In this category, two separate institutions link-up by referring clients to each other. For example, at some Business Centers in Eastern Europe, clients are given assistance to write business plans that are tailored to the requirements of certain banks (i.e. MEDF in Macedonia). Some BDS providers advise clients on which MFIs and banks to approach and how best to make a successful loan application (i.e. SIYB in Zimbabwe). In turn, the financial institution markets and promotes the training programme for the BDS provider. In some cases, this approach also includes guarantee funds set up in the financial institutions to cover a portion of the credit risk of the clients (SIYB in southern Africa, see Box 6). The BASIX programme in India created a holding company with three independent entities (two financial institutions and one non-financial) that cooperated closely and targeted similar client groups (see Box 4).

15 However, here the problem remained that bank credit was not accessible to most SIYB clients (due to a lack of collateral).
BASIX has placed a livelihood approach at the center of a strategy that combines microcredit with a variety of activities, including infrastructure rehabilitation, entrepreneurship mentoring and market access. In contrast with most of the other examples in this paper, the BASIX programme was planned from the start as a linked programme. Unlike earlier projects, it has a clear focus on financial sustainability and efficiency.

Founded in 1996, BASIX is a holding company for a non-bank financial company, a not-for-profit company and a Local Area Bank. It provides both direct loans (to producers) and indirect loans. The latter are provided to intermediaries who on-lend, mostly to their clients. Intermediaries are private firms including suppliers, wholesale merchants, agro-processing firms and others. The not-for-profit company mostly acts as a BDS facilitator by supplying new products to existing BDS providers. This makes the approach a mix between a parallel and a partner approach.

Under its Dryland Agriculture Productivity Enhancement Programme, BASIX has worked with private companies, universities, research institutes and NGOs to increase the crop yields through better use of seeds and cultivation practices for sunflower, cotton, chili and groundnuts. New crops have been introduced, such as watermelon and paprika. In addition, a drip-irrigation technology has been piloted together with an NGO. The seeds and the equipment are now being sold on a commercial basis.

BASIX has also worked with the Andhra Pradesh Dairy Development Cooperative Federation to revive or improve three milk-chilling plants through enhanced procurement from local dairy farmers. The farmers themselves are able to supply more milk due to loans from BASIX.

A unique Inter-Borrower Expertise Exchange Programme has identified 90 microcredit users who are highly successful entrepreneurs. These have provided training to 200 other credit recipients in subsectors such as dairy, bakery, woodworking, repairs, and shop management.

About one third of BASIX credit clients are deemed not to need non-financial services, either because they are too advanced or they are not interested in growing their income-generating activities. About half of the remainder has received some technical support. The organization estimates that it has supported the livelihoods of 40,000 people since 1996.

Source: Fisher and Sriram (2001, ch. 4)

**Partner-Compulsory:** In this model, clients must take two services that are offered by partner organizations. For instance, clients must often show that they have completed the BDS (usually management training) to access the credit (VanCity in Canada). This will be the case for Primero Emprego, currently being launched by the Brazilian government, in which some institutions deliver credit and others provide training and other BDS. In both cases, the training is totally subsidized.
3. **Who benefits and who pays the cost?**

3.1 **Benefits and costs for financial service providers**

On the financial side, the hypothesis is that financial service providers would be interested to link with BDS to improve repayment rates. However, the experiences reviewed for this paper suggest that linkage can stimulate client loyalty and reduce the risk of moving upmarket to service larger borrowers.

Most MFIs that have added BDS have done so not for commercial reasons but rather in response to requests from donors or because of the requirements of specific government programmes. Financial institutions that have taken on BDS for commercial reasons, like Financiera Solución and VanCity, have used it to retain clients or as a screening mechanism to lower credit risk for individual lending approaches.

The hypothesis that BDS, notably management training, would lower the default rate of MFIs by improving enterprise performance could neither be verified nor rejected. This is mainly due to the lack of studies investigating the issue. The evidence that does exist indicates either that default rates have not changed, or that they probably improved. There is no reported evidence that default rates have increased. One study that considered the impact of BDS on repayment concludes that there is no significant link between credit repayment and BDS\(^{16}\) (Nisttahusz et al, 2002). The study did indicate, however, that clients who receive BDS usually have access to slightly larger loans and longer maturities. This may indicate an implicit recognition by the credit institution that these borrowers are more creditworthy.

A similar study was carried out on ADEMCOL (2001), a Colombian microfinance provider that added business training to weekly meetings with clients. Unfortunately, the results of the study are inconclusive due to other factors affecting delinquency\(^{17}\) and dropout rates. After training was introduced, staff reported higher client satisfaction and lower rates of delinquency. Data was not collected and recorded at the time, however. Recording began in 1999 but coincided with a more than three-fold increase in the client base, a series of senior management and other staffing changes and a “marked deepening of the national economic decline” which affected the viability of client enterprises. The dropout rate declined from 10.4 per cent of clients to 7.4 per cent in early 1999, then rose to 17 per cent before declining again in 2001. Delinquency rose from 3 per cent to 10 per cent before settling back to about 4 per cent over two and a half years.

The study concluded that it was difficult to determine the impact of the training on the performance of the organization. Financial sustainability increased in 2001, which might be partly be attributed to a 50 per cent increase in the client base in one year and a rise in training fees to a level more closely in line with actual costs (see: ADEMCOL, 2001, pp. 18-22).

In addition to these focused studies, there is additional evidence that BDS provision may improve the financial viability and protect or increase the client base of credit providers. The linking of *Start and Improve Your Business* (SIYB) training with banks and microcredit institutions in Zimbabwe has had a positive impact on the latter’s profitability and arrears rate, according to credit providers (ILO 2002). This linkage is further explained in Box 6.

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\(^{16}\) The study of Nisttahusz looked at a wide range of business development services, including management training, consulting, information and market access services, marketing and financial management.

\(^{17}\) In arrears for more than 30 days.
Peru, the provision of Improve Your Business (IYB) training by Financiera Solución has had the intended affect of rewarding client loyalty and thereby discouraging borrowers from switching to other credit providers. Financiera has also been pleasantly surprised with the impact of the training on the growth of its clients’ enterprises (see Box 2). In another case, Halder (2003) concluded that clients with BRAC (the Bangladeshi NGO) who received BDS and credit generated twice as much income, on average, as those who received only credit (see Box 7). Although Halder did not investigate differences in the default rate, it is reasonable to suggest that those who received combined services were more able to repay – and to repay faster – than those receiving only credit. The study also showed that clients made considerable income gains because of BDS and could have afforded to pay the full cost of the service.

Box 5

Al Amana, Tkwin Jdid programme, Morocco

VITA, an American NGO, initiated a linked activity inside Association Al Amana, an MFI in Morocco. After conducting a market study with Al Amana’s borrowers and detecting a high degree of willingness to pay for BDS services, Al Amana and VITA decided to start a training activity alongside the microfinance operations called “Tkwin Jdid” – Arabic for “New Training”. This was done to give Al Amana a marketing advantage in the competitive Moroccan microcredit market and to test a new technology (digital-video) for BDS delivery. Furthermore the institution wanted to test piggy-backing on the existing credit network and the use of “low-cost non-trainers”, the Al Amana credit agents.

This training was delivered through short training videos that were designed for Al Amanas clients, who were mostly illiterate. The participation in the training was not a precondition to access credit. The cost was calculated at US$1 per training session with three training sessions for a group of 7-10 people. The training consisted of showing a video for 7-10 minutes and initiating group discussions about the situations shown in the video. One of the first training videos was a marketing module showing clients (mostly retailers) how to improve the presentation of their products and how to interact and learn from customers in marketing their products. The training was promoted and executed by credit agents of Al Amana. Over a two-year period, 1,535 participants were trained, representing 7.3 per cent of active credit clients. The training team believed that the impact of BDS was more immediate and effective than the credit.

However, after producing several modules, it proved difficult to produce new video materials due to the methodological difficulties for some teaching areas. Furthermore some credit agents did not have the necessary skills or commitment to promote training even though an incentive scheme was set up. The piggy-backing on the credit activities was also problematic, as it drained non-staff resources from Al Amana (computers, facilities etc.). Al Amana realized that it had to invest more in the training of credit agents that were successfully marketing the training and to hire a senior staff member specialized in marketing training activities.

Focus group discussions with clients after training showed that different client groups expected to be treated differently and that women microentrepreneurs were feeling uncomfortable being in the same training sessions with men. All these factors led to low cost-recovery for the programme in the pilot phase.
However, after gaining a better understanding of customer needs and by restructuring the marketing and delivery structures inside Al Amana, the programme was re-tested in three branch offices and has now successfully trained another 600 participants. Al Amana management is now expanding the programme to additional sites and investing in new client needs assessment tools with the view of reaching self-sustainability of the training component in 2007.

*Source: E-mail correspondence with Maarouf Mohammed, Director of Studies and Development, Association Al Amana; Final Report submitted by VITA to USAID, also received by e-mail.*

If default rates do not improve, then the expressed concern of financial services practitioners may hold true that institutions can lose the focus and productivity of their operations if they deliver both services. This is a concern especially if the same person is responsible for delivering the two services. Moreover, productivity will be lost if one of the services is offered for free (Nisttahusz, 2002).

Many of the problems associated with linkage are related to poor administration or programme design. The linked provision of training and credit by PRIDE in Guinea provides an interesting example (Kimball 2001). The programme provided credit linked to a compulsory training session each month, lasting two hours. One problem was that the training offered was not demand-oriented and became repetitive for repeat borrowers. To test demand, PRIDE made training non-compulsory in two field offices and saw attendance drop by 10 to 20 per cent. The training sessions might have reduced monitoring costs because loan officers could meet with borrowers at the monthly meeting. However, those borrowers most in need of monitoring tended to skip the training sessions and thus required personal visits by the loan officers. PRIDE conducted time-use studies on its field staff and found that over 40 per cent of their time was allocated to training activities. Furthermore, training added to administrative costs because building space was rented to accommodate the trainees.

One of the main pitfalls of compulsory linkages for financial institutions is that a client might not want both services, which could contribute to desertion in a competitive microfinance market. It can also leave the client with a bad image of the credit provider if he or she is obliged to take an unwanted service. This could damage the reputation and client base of the institution, ultimately affecting its cost structure. One of the main issues will continue to be the financial sustainability of these institutions. Many microfinance institutions are still struggling with sustainability and are reluctant to link to BDS because of the possible cost implications.

### 3.2 Benefits and costs for BDS providers

The second hypothesis is that BDS providers can expand their client base by linking with credit institutions, as the latter often have much broader outreach. An additional benefit may arise if BDS providers refer their existing clients to finance providers and these clients, having been strengthened by credit, return to acquire additional BDS. The available evidence indicates, however, that BDS providers have seldom tried to link with financial institutions. The reasons for this are unclear but may include the fact that the BDS field is still relatively young and most providers are preoccupied with their own sustainability. BDS providers may
also be serving a different segment of enterprises (for example, slightly larger ones, but this depends on the type of BDS) than that of microcredit providers. At the same time, many BDS providers may be unwilling to develop their own unified or parallel programmes because the nature of credit (which may entail pursuing defaulters or delinquent borrowers, for example) is very different from providing BDS. In the case of informal or “indigenous” BDS providers, cultural and social barriers to link to existing financial institutions may also play a role.

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**Box 6**  
**BDS facilitator linking to financial institutions:**  
**The SIYB experience, Zimbabwe**

Start and Improve Your Business (SIYB) is an ILO programme that provides existing BDS providers with a comprehensive training package for start-ups, micro and small enterprises. In Zimbabwe, the clients of several institutions supported by SIYB complained that after learning how to write a business or investment plan, it was difficult to gain access to credit. The SIYB programme developed a linked programme in which commercial banks and MFIs were requested to help in the marketing of the SIYB programme. The banks referred clients or potential clients to SIYB providers and encouraged them to attend training.

The Zimbabwean Credit Guarantee Company then bore a portion of the risk of the credit provided by the commercial banks. It agreed to bear 50 per cent of the risk for male, and 75 per cent of the risk for female entrepreneurs. Hivos, a Dutch development NGO, subsidized part of the management training on a decreasing basis with the hope that the private BDS providers would continue providing training once the link to finance had been established and entrepreneurs would be willing to pay the necessary fees to ensure programme sustainability.

An evaluation conducted after 18 months showed that out of 1,049 trainees, 290 submitted a business plan to a bank and 200 of these were offered loans. The evaluation noted that banks and microfinance institutions felt that “the value of the trained entrepreneur is impacting positively on the profitability of their institution and that their involvement with the SIYB programme is based on their belief that trained entrepreneurs reduce the arrears rate”.

Some entrepreneurs experienced growth in repeat loans, which are cheaper to deliver and hence increase the profit of the financial institution. In some regional programmes, the loan portfolio doubled. Financial institutions also gained popularity with clients for linking them to SIYB. One MFI was proposing to incorporate the cost of training as part of the loans, and another one started to offer loans to pay for training. However, the evaluation did not show how the sustainability of BDS providers was affected.

*Source: ILO, 2002.*

On the other hand, there are several interesting cases in which BDS providers have taken the initiative. IDEPRO in Bolivia started as a BDS provider and then added microfinance in response to the high demand in the country and the availability of donor funding. Its activities involved some unified provision of credit and BDS but increasingly a parallel approach was established. IDEPRO’s client base expanded, mainly as a result of
increased microcredit provision, and it decided to transfer its well-performing borrowers to a regulated financial institution which provided better access to credit. It is often the case that finance is regulated differently and more strictly than other services, which makes it difficult for BDS providers to develop unified structures. One alternative to a normal partner structure between two separate providers is a partner structure that includes separate institutions, which are commonly owned. BASIX in India, for example, is a holding company that consists of a non-bank financial institution, a not-for profit company, and a Local Area Bank. Clients can receive both finance and BDS.

Most BDS that are linked to credit still take the form of management training. This trend might indicate that linked programmes are still not adequately meeting client demand, which presumably is heterogeneous. However, some institutions are working on innovations in BDS such as: market access through enterprise databanks; specialized vocational skills training (i.e. poultry raising, dairy farming); and business and investment plan writing and counseling. These services are more adapted to demand and therefore might be more sustainable on a commercial basis for the provider.

Many BDS providers still face the problem that their clients lack access to finance and that more could be done to link them to credit sources. One case of a BDS programme trying to link with finance providers is the SIYB programme in Zimbabwe (Box 6). An effort was made to focus on high-potential entrepreneurs and assist them in accessing finance from commercial banks and a microcredit provider. To develop the linkage, a public credit guarantee company introduced the SIYB programme at bank head offices through letters and had one-to-one meetings with the heads of retail lending institutions. Thereafter, the banks wrote to their branches encouraging them refer loan applicants for SIYB training and asking them to be receptive to applications from trained entrepreneurs. This programme has lead to over 200 loans being approved for graduate trainees.

3.3 Benefits and costs for micro and small enterprises

The hypothesis for MSEs is that linked provision ensure their access to services they had not received before, thereby increasing their productivity and job creating potential. While finance can stabilize the income of an enterprise, BDS can help it grow. Only two known studies have specifically measured the impact of linked delivery on clients; they both indicate that there are strong positive benefits. These are reviewed in this section with particular attention on the type of linkage.

A study by Nistthausz (2002),18 examined the results for a sample of 140 micro-entrepreneurs in Bolivia. Half of these received both services, while the other half received only credit. Those who received both services achieved better business results and were able to get loans with a longer maturity:

The completed research shows that, from the entrepreneurs’ side the enterprises that had exposure to BDS showed a better performance than the enterprises that were not exposed to BDS. (Nistthausz, 2002, p. 86)19

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18 Nistthausz is director of CIPAME a Bolivian association of enterprise service providers. The study looked at a wide range of BDS.

19 “La investigación realizada muestra que, desde el punto de vista de los empresarios, las empresas expuestas a SDE presentan un mayor desempeño que las empresas que no estuvieron expuestas a SDE, en cuanto a los resultados económicos alcanzados por las mismas.” Translated by the author.
Nisttahusz also found that micro-enterprise owners have very little understanding of how to use combined services for maximum benefit. Little had been done on the institutional side to better match services to the needs and demands of the clients.

A second study, by Halder (2003), focused on clients of BRAC, the Bangladeshi credit and services NGO.\textsuperscript{20} BRAC takes a subsectoral approach by providing training in specific activities (poultry raising, tailoring, etc.), supported by access to inputs (such as week-old chicks) where there are missing or weak markets and access to on-going technical support and advice. Interested women are provided with three to seven days of initial training, are given access to credit and then are supported with on-going inputs and market access. Women pay for these inputs and services but in general such fees cover only 47 per cent of the costs (see Box 7). Specialised staff deliver the training and other services, and costs are tracked separately. These features indicate that BRAC has a parallel-voluntary approach. The voluntary aspect has increased over time as it caters to enterprise demands more directly.

Halder’s analysis is based on 543 borrowers, of which one-quarter received skills training while the remainder did not. The trained and non-trained groups were broadly similar, consisting of women from the poorer sections of society. However, the trained group had a lower initial endowment of household assets, owned less land and had larger households. It did exhibit a higher rate of literacy but the rate was low for both groups: 20 and 30 per cent, respectively.

Given these characteristics, Halder found that that the trained group generated gross annual income that was double that of the other group (US$217 compared to US$107). She concluded:

An attempt was made to find out whether credit in combination with skills training is more effective or whether credit alone is what is needed to increase income levels. Among all members receiving credit, the income of those who received skills training was almost double, indicating the positive contribution of skills training along with credit in increasing income. (Halder, 2003, p. 31)

The study also analysed the cost effectiveness of the training for the clients. As noted in Box 7, the increased income considerably exceeded the service charges paid by the clients. This “implies that the service package offered by BRAC is highly cost-effective” for clients, Halder concluded (2003, p. 34). Because BRAC only covers 47 per cent of its costs in providing these services, it could increase service charges toward full cost recovery for its organization and still benefit its clients.

The conclusions of the study are important but must be viewed in the context of the type of linkage used. Success derives in part from the holistic, subsectoral approach but it is also based, no doubt, on the voluntary nature of the linkage. The policy lesson is not that all micro-entrepreneurs should receive training, but more modestly, that those interested and willing to undergo training will be more successful than if they choose credit alone.

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\textsuperscript{20} Halder is BRAC’s senior research economist, Research and Evaluation Division.
Various other programmes note the benefits to MSEs of linked services, although statistical evidence using a reliable methodology with treatment and control groups may not be available. Financiera Solución has noted improved enterprise growth among clients who have completed management training (Box 2), while Al Amana also found that linking was beneficial and even that microcredit clients tended to benefit more from the training than the credit (Box 3). The SIYB programme in Zimbabwe demonstrates that promoting a link between training providers and local financial institutions has aided new or existing entrepreneurs to get their loan applications approved. A number of other programmes require training before credit is approved, as they recognize that the rate of business success is assisted by the training (i.e. VanCity). An example of this is the innovative Internationalization of Entrepreneurship programme (IntEnt), which helps immigrant entrepreneurs in the Netherlands start up businesses in their country of origin or form joint ventures with other firms in those countries.\footnote{IntEnt is joint project of FACET-BV, a Dutch small enterprise consulting firm, Tridos Bank and the SEON Foundation. It works in four pilot countries: Ghana, Morocco, Surinam and Turkey.}

Compulsory linkage may not be beneficial for clients who want only one service but are required to take both. Clients might have to waste time and fees. If institutions are to be financed out of paid-for services, client satisfaction needs to be a priority. In addition, several reports point out that clients often find it confusing to get services from the same institution
and the same person, especially if these are charged separately (Halder 2003; Twik Jdid). This might suggest the need for (unified) service packages where the client pays one price for both services or that services should be separated clearly for the client to distinguish and choose between services and providers.

Overall, the results discussed here in this section do not point to a clear model. They do, however, provide indications of how to structure the joint delivery of services. The last section outlines some of the lessons that can be derived from these cases and offers suggestions on conducting further research on this issue.
4. Conclusions and suggestions

This review – which included 28 linkages in and between providers – examined only a fraction of existing activities. The research shows that little has been done to conceptualize the linkages and develop good practice models. While the number of impact studies available is small, there is strong evidence that combined delivery does not only result in significantly higher income for the clients but that it may be possible to cover the cost of the training and credit from client fees (Halder, 2003). This suggests that the financial sustainability of linked approaches may not be as difficult to achieve as has often been assumed. Indeed, there are important synergies that can arise from linking services.

Central to the issue of effectiveness and sustainability is the question of how the linkage is executed. This involves two levels of analysis. The first involves the six-part typology developed in Section 2, that is, whether it should be voluntary or compulsory for the client, and how close the linkage should be (unified, parallel or partner). The second issue is how the linkage is actually executed. Here the productivity and sustainability of providers is a central concern.

4.1 What type of linkage?

Development practitioners have moved away from discussing “best practice” to embracing “good practice”, on the understanding that there is no single best approach and that effectiveness will depend on context and conditions. Therefore, it is not useful to choose the best option out of the six possible options for linking BDS and financial services. While some are generally more advisable than others, it is better to describe which option is advisable under what conditions.

As a general rule, clients should have choice in their services. They can assess their needs, in line with their capacity to pay, their present and planned activities and their abilities. Even for a client who needs both services, a voluntary approach allows for the choice of services at a time appropriate to the needs of the business. The voluntary approach offers choice and flexibility to match the heterogeneity of enterprise needs. Not only is it important that clients choose services they need, but in doing so they signal to providers which services are relevant and useful. Thus, the three voluntary linkages in Table 1 are preferred over the three compulsory ones.

Compulsory linkages result in unnecessary costs for clients who desire only one of the services. In addition, such linkages result in the loss by the service provider of important information concerning the quality of, and the demand for, the service. Clients cannot express their dissatisfaction with a single service by refusing a repeat purchase. An argument for an exception to this rule may be made for first time or inexperienced borrowers. For these clients, there can be some intrinsic value in combining finance with initial training, advice, or other services. Such a package would ensure that clients have a basic understanding of business management, the use of credit and their plans as entrepreneurs. However, it is less likely that providers will adapt their supply to the existing demand if they do not receive demand signals through their clients. The most successful cases of this compulsory service packages have incorporated BDS in credit repayment sessions.

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22 This problem can, however, be avoided by conducting client satisfaction surveys (i.e. FFH).
Many of the problems with joint provision have arisen in regard to the unified options. These options are not inherently flawed but will tend to generate problems if credit officers are given the added task of BDS provision for which they have neither the time nor the expertise. In addition, it is difficult for MFIs to properly cost the BDS services that they decide to add. Thus, existing MFIs seeking to add BDS are best advised to avoid a unified approach. In particular, small MFIs should avoid adding BDS themselves and opt for some type of partner arrangement. Larger organizations that are adding BDS are also better placed to add specialized staff.

Whether to adopt a parallel or partner format will be determined, in large part, by the existing environment of providers. There may be no need for an MFI to add BDS; it can simply make clients aware of the availability of BDS, or require them under a compulsory arrangement to seek BDS with a provider with which the MFI has a partner arrangement. In the absence of BDS providers in the market, the MFI may have no option but to set up its own (parallel) department.

However, if a credit provider wishes to expand its activities (and generate more profit) it may decide to add BDS using a parallel approach. In this case, it is doing so for commercial reasons and should undertake a sober assessment of its capacities and future competition.

Linking to BDS, in either a parallel or partner format may be desirable if an MFI is seeking to secure larger enterprises as clients or to retain better clients who have outgrown micro loans. The linkage also allows the MFI to gain access to information about a client’s business that can be used to better assess credit risk.

In summary, service providers should:

- opt for voluntary over compulsory;
- opt for unified solutions only if the staff can handle it efficiently; and
- opt for partner over parallel, if existing providers already exist.

There is no simple answer to the question: what type of linkage? There are only suitable options for given circumstances.

4.2 Suggestions of effective linkages

While this study suggests that the how to of linking BDS and finance is still not fully resolved, some lessons can be identified. The most common linking approach still seems to be a combination of training and credit. This not only applies to the developing world but also to developed countries such as the United States (Schreiner and Woller, 2003, p. 1577). Additional research is needed on the type of BDS services to be linked with finance to ensure that clients get what they want and need. In this regard, we can highlight a number of key issues for consideration:

- **Assess your market.** Look at the existing supply and demand of services, including indigenous and informal forms of delivery of both finance and BDS. Micro and small enterprises often have access to a range of informal providers but still are in need of services that are not available on the market. Finding out what clients can already obtain and what they need is a key element of keeping providers relevant.
• **Link up after developing a core competency.** Experience shows that enterprise development institutions set up with tasks that are very broad find it difficult to develop a core competency and become sustainable. Providers should only link to other service providers or build up parallel structures after they have developed a core competency in one of the areas and there is a good chance of becoming sustainable. The idea can be summed up in the phrase: “have a broad vision but a narrow specialization”.

• **Assess (and re-assess) the benefits of linkage.** Providers should not merely accept or reject the option of offering BDS and finance, or of linking with other service providers. Instead they should carefully assess the benefits (and risks) to their organizations, keeping in mind the goals of greater outreach and the developmental objective.

• **Be client driven.** Make sure that the provider or linked providers receive the market signals they need from their clients to not only adapt their services to client needs but also to ensure their own sustainability.

• **Use credit as a first service.** Some of the most successful organizations included in the survey (Financiera Solución, BRAC) show that in a number of cases credit is a good entry point for clients. Once the client has experienced the usefulness of credit and business has stabilized he or she might want to try a new, service, different in nature. BDS are usually much less “tangible” than money and therefore the demand may need to be cultivated. The financial institution could link up to a BDS provider to help its clients grow.

• **Adapt to local subsectors.** The experience of BRAC and other organizations show that it might be a good option for providers to concentrate on certain subsectors. Producers usually have different needs than traders; retailers operate differently than wholesalers. Some subsectors, such as agro-processing, are seasonal, while in others production and market demand fluctuate very little during the year. Only by maintaining contact with clients and conducting occasional market surveys can providers understand the needs of clients.

### 4.3 Future possibilities

There is much that still needs to be understood about linking services. This paper has touched on some of the methods but more assessment of the impact of linkage needs to be conducted and made available to the community of practitioners, policy-makers and researchers working with micro and small enterprises. In addition, there are a number of avenues for further study that look beyond linking traditional services. Linkages that exist between informal BDS and finance providers need to be researched in more depth. Also looking at embedded services that could be coupled with credit might be an interesting option; for example, leasing schemes and the embedded service provided by machinery suppliers can be coupled.23

The examples in this study are mostly related to micro-enterprises. However, providers need to be conscious of the changing nature of their clients. As part-time income-earning opportunities develop into bona fide micro-enterprises and as micro firms become

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23 Deelen et al. (2003, pp. 28-29) note that leasing schemes often include after-sales services by machine producers, including maintenance.
small firms, they are likely to require a new mix and range of both financial and non-financial services. Larger loan sizes and new modalities may need to be offered to encourage the expansion of enterprises to fill the “missing middle” in the enterprise size structure of developing countries. Training may need to shift from advice on business start-up to expansion. The range of BDS may broaden with the addition of components such as advice on technologies and productivity, standards, telecommunications, marketing and others. The growth of a relevant small and medium enterprise sector that can rapidly adapt and bring technological innovations into markets is a key for long-term economic development. The synergies that result from linking effective services for enterprise development can thus contribute – not only to micro and small enterprise development – but also to broader structural change in the economies of developing countries.
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