

# **The Impact of Microfinance on Employment: what do we know?**

**Bernd Balkenhol<sup>1</sup>**

## **Contents**

	<b>Page</b>
<b>1. Introduction</b>	<b>2</b>
<b>2. The impact of micro finance on jobs: what do MFIs know?</b>	<b>5</b>
<b>3. Findings of empirical studies</b>	<b>6</b>
<b>4. What are the key issues?</b>	<b>10</b>
<b>5. What can microfinance institutions do for more employment?</b>	<b>15</b>
<b>6. What sort of employment should MFIs promote?</b>	<b>17</b>
<b>7. Should MFIs care about the employment conditions in their clients' enterprises?</b>	<b>20</b>

---

<sup>1</sup> Social Finance Program, ILO, Balkenhol@ilo.org

## 1. Introduction

In Africa over 48% of the labour force is engaged in informal activities, in Central and South America 45% and in Asia 33%<sup>2</sup>. They are own account workers or micro-enterprises engaged in a variety of survival activities. It is this clientele operating in the informal economy that use micro finance institutions (MFIs). How has microfinance - after several decades of successful, and often growing operations – changed the living and working conditions of the poor? Have loans and other financial services helped to create jobs? Is microfinance a strategy for job creation? Has it changed the demand for labour in the informal economy?

Employment is key to the attainment of the Millennium Development Goals, without access to productive employment and decent work poverty will not be halved by 2015. Logically the question comes up: what can microfinance, the strategy for poverty reduction par excellence, can do to help job creation? After all, microfinance is attractive and in many cases superior to alternative anti-poverty strategies, for several reasons: it has rapid, massive and verifiable effects; it can be measured and evaluated; it can often be scaled up quickly; it can be targeted with precision at the poor and sometimes even the very poor; unlike grant or transfer-based programs in poverty reduction, microfinance recycles financial resources, they do not get lost but stay in the local economy. But above all: microfinance treats the poor as autonomous individuals who are expected and want to take charge of their lives.

The concern for job creation resonates increasingly in the microfinance industry itself: major microfinance networks justify their work also with the expected impact on job creation. Opportunity International, for example, claimed having created or maintained over 1,2 million jobs in 2004 worldwide<sup>3</sup>. This is an impressive figure. Of course, it can be argued that the word “employment” may not actually mean full time, stable and remunerated jobs, but also largely unpaid family jobs. Indeed, the notion “employment” is elusive in an environment like the informal economy where most clients are own account workers with unpaid family workers. Moreover, employment in the informal economy is often sub-standard: unproductive and un-remunerated, not recognized or protected by law, lacking social protection and

---

<sup>2</sup> Schneider, Friedrich (2002)

<sup>3</sup> OI UK Annual report 2004, p.7

economic security. If access to finance should indeed be leading to the proliferation of substandard employment, then this may give MFIs something to think about.

However, beyond anecdotal stories of child labour, debt traps and other shifts and substitutions between different kinds of labour we do not really know much. The reason for our ignorance is the way the client of MFIs is most set up, namely as a “household-enterprise”. Whatever happens to employment in a household-enterprise largely escapes the attention of the MFI, whether it is the transformation of a seasonal job into a permanent, or of a paid job held by a person from outside the family to an apprentice, or of children attending school to children working at home or even away from home. Creating, transforming, maintaining and terminating employment occurs largely out of sight and reach of the MFI.

The household-enterprise is a black box with highly fungible financial resources, generated and spent by the household and the enterprise for consumption, savings and investment. Logically the goals of such a complex set-up are also complex: household enterprises seek to generate income, manage risk and protect against income fluctuations by diversifying income generating activities, to build up human capital through education, access to health care. MFIs seek to respond to the various expressions of the demand from such complex units: employment is usually not an explicit or exclusive goal in micro finance, but in one way or another contained in the mission of most MFIs, cutting across income generation, risk management and empowerment.<sup>4</sup>

There are other methodological challenges to establish “impact” of microfinance on employment:

1. employment is an indirect effect, filtered by decisions made at the level of the MFI client; it is the entrepreneur, and not the MFI that makes investment or budget allocation decisions. The MFI chooses its client, but the client decides how to use the loan.

---

<sup>4</sup> **Income-generation:** The most common approach is to provide microfinance services (credit, equity, leasing, and payment and guarantee products) to start or expand an income-generating activity in a micro enterprise. This allows entrepreneurs to build assets and to create and sustain jobs. **Risk-management and reduction of vulnerability:** microfinance also plays a role for vulnerable persons to cope with and mitigate risk. Through appropriate risk-managing financial services, such as savings, emergency loans and possibly insurance products, microfinance helps vulnerable groups to stabilize income levels and smooth consumption and thereby to weather the storms of unpredictable expenses and income droughts. **Empowerment:** Microfinance approaches, e.g.: group lending, savings mobilisation etc, enable persons to take over financial responsibility for their life and thereby strengthening social capital and empowering people, especially women.

The titles in J.D. von Pischke’s credit impact bibliography in fact reveal that the preferred dependent variables are empowerment, risk management and community level issues. J.D. von Pischke, Poverty, Human development and Financial Services, UNDP Occasional Papers 25, New York, 1999

2. There are different forms of employment. Anecdotal evidence suggests that micro-finance has an effect primarily on self employment and unpaid family labor, in other words on incomes of the direct client of the MFI, less on wage employment outside of the client's family.
3. This is complicated by – largely hidden - shifts and substitution effects taking place within the “household-enterprise” between different forms of paid and unpaid employment: in the beginning of a MFI-client relationship when the first loan has just become available, unpaid family labor is likely added to the work force, then - with repeat loans and a secured and continuous flow of credit - non-family labor may be brought in, usually at very low wages, until eventually workers may be recruited from outside the family, paid at market rates<sup>5</sup>. These could be the idealized features of a growing MFI client, where improvements in the access to finance bring about an employment effect. However, this still is largely a matter for speculation, because the dynamics and directions of these shifts are difficult to trace for a MFI or any other outsider.
4. The shifts in demand for labor enhance work quality sometimes, but not automatically. If a loan allows parents to have sufficient additional income that they can afford to take a child out of work and back into school, then it has improved work quality for the entire household-enterprise. But one can easily imagine other scenarios where taking out a loan means that family members have to work much longer hours at no pay. In this scenario work quality would deteriorate. This is not an academic concern; it matters to the working poor. Some even attribute the preference of the poor for self-employment to the inferior quality of wage employment in the informal economy: exploitative informal jobs.<sup>6</sup>

---

<sup>5</sup> An assessment of MIBANCO clients in Peru observes that compared to a control group the clients with access to microfinance increased wage employment on average by 9 days per month, but it is not clear, though, whether this occurred progressively over time or as a result of a change in production techniques.

<sup>6</sup> Graham Wright, Examining the impact of microfinance services – increasing income or reducing poverty? SED, vol.10, No.1, p.38.; M.Yunus is quoted as saying: “Wage employment is not a happy road to the reduction of poverty. The removal or reduction of poverty must be a continuous process of creation of assets...” ibid p. 43

## 2. The impact of micro finance on jobs: what do MFIs know?

Without any doubt, employment is on the radar screen of many MFIs. ACCION, Opportunity International and other networks present their work as a contribution to employment and local economic development:

*“By helping a poor family to increase their income, micro-enterprise development has an immediate and lasting impact on quality of life - the ability to afford food, shelter, education and healthcare. As business income increases, the business is able to expand, and the effect spreads beyond the family into the local community, through employment and contribution to the local economy. Thus, the benefits of micro-enterprise development help grow not just businesses, but stronger communities as well.”*

While MFIs know the employment status of the direct client, they know much less, if anything, of the increases or reduction in family labour, contract labour, apprentices and non family labour. A ILO survey of 46 MFIs in 24 different countries showed that 74% of MFIs had “the self employed” as clients– leaving it open whether these had some wage labourers or not, 17% had primarily self employed in their clientele and just 4 (9%) had only a minority of self employed amongst their clients<sup>7</sup>. The relative ignorance of MFIs contrasts with the declared mission statements which often single out employment creation as a key objective and justification.<sup>8</sup>

Who really are the clients of the MFI, what do they do for a living? The profile of a MFI’s clients says a lot about its potential impact on the local economy. MFIs with a predominant micro-enterprise portfolio, i.e. those where the enterprise dimension dominates the household dimension and where there is at least some modest non-family wage labour - are more likely to make a difference to job creation than MFIs which cater to clients operating at the subsistence level, where the household dominates the enterprise dimension.

---

<sup>7</sup> However none of the interviewed MFI dispose of regular client information data bases which can lead to unusual estimates of the socio-economic status of clients.

<sup>8</sup> . A MFI in Brazil, for example, defines its mission as follows: “*To profitably serve employees and customers in an ethical and lawful manner supporting the local micro enterprise, boosting the regional socio-economic development.*” One should think that a MFI like this would be keen to find out what goes on within its clients’ micro enterprises and whether it actually contributes to “socio-economic development”, the local economy, and in particular job creation.

MFI staff and managers may have their own understanding of “employment”: in the case of KASHF managers consider as loans for self employment only transactions used and controlled by the women clients, whilst the use of loans by the client’s spouses, sons or other male family members does not count as self employment. Similarly, San Roque, a financial cooperative in Bolivia, extrapolates from the type of loan to employment status: agricultural loans are assimilated to loans for self employment, consumer loans are considered as transactions with wage employed.

### **3. Findings of empirical studies**

Industry-wide global data sources do not capture employment as a dimension of the impact of microfinance. The MIX, for example, uses 11 outreach indicators: average loan balance per borrower, average savings balance per saver, both also expressed as % of GNP; the percentage of women clients, the absolute number of borrowers respectively savers and the number of loans handled that did not exceed \$ 300. All of these can be calculated by the MFI without having to see the client, three other impact indicators require to go and see the client and generate household level data: “clients living on less than \$ 2 a day, idem on less than \$ 1 a day per household member. “ MFIs tend to prefer to measure outreach by indicators for which they do not need to generate special data at the client level. This may explain the scarcity of data on employment<sup>9</sup>, which also needs to be especially extracted from the client.

Within the context of the Social Performance Task Force launched in 2004 efforts are under way to harmonize social performance and impact indicators. A look across the methodologies developed and proposed by M-CRIL, M-Finanza, CERISE, AMAP, ACCION and GRI shows, however, that criteria related to employment are not (yet) part of impact management. M-CRIL is the only rating agency which suggests to measure also “hired employment in credit-supported enterprises”.

There is some body of empirical work on the link between changes in the access to finance and changes in the demand for labour. Overviews of the methodological issues in impact assessments of microfinance in general can be found

---

<sup>9</sup> And this may be just right; the point is not to bring every data base to go out and collect employment related information. The MBB and the MIX are excellent sources for information on the financial health and solidity of MFIs, and it may be more appropriate for another data source to go for employment and other social impact.

in Gaile/Foster<sup>10</sup>, von Pischke, Bolnick/Nelson<sup>11</sup> and Sebstad/Chen, Schrieder and Sharma<sup>12</sup>. Employment figures as one of the outcomes examined, but not prominently<sup>13</sup>. This may be due to the confusion surrounding the concept of employment.

Some authors count as employment only wage employees from outside the family (which largely overlaps with “formal” employment), others also include paid family labour and apprenticeships, but exclude child labour and unpaid family labour, whilst others again also include these forms of employment (all of the latter falling under “informal” employment). As a result the authors often argue at cross purposes, with those having a restrictive notion of employment coming out fairly negatively on the impact of microfinance, whilst others with a broader concept of employment do see positive changes in the demand for labour.

Hulme and Mosley claim that the “technical change induced by borrowing was not dramatic, nor ...the influences on employment outside the family”.<sup>14</sup> The difference between borrowing micro-enterprises and the respective control groups is less than 1 employee:

	(a) Over-time comparisons: average increase in paid non-family employment since first loan (persons per enterprise)		(b) Differences between borrowers and control group at time of survey (persons per enterprise)	Average borrower household income, 1992 (\$)
	Borrowers below national poverty line	All borrowers		
Bolivia BancoSol	-0.1	0.8	0.7	360
Indonesia BRI unit desas		5.8		296
Kenya KIE-ISP		1.1	1.1	445
Bangladesh TRDEP		0.1		
India RRBs				

<sup>10</sup> Gaile, Gary and Foster, Jennifer, Review of methodological approaches to the study of impact of micro-enterprise credit programs, AIMS, USAID, Washington, 1996.

<sup>11</sup> Bolnick, Bruce and Nelson, Eric, Evaluating the economic impact of a special credit programme : KIK/KMKP in Indonesia, JDS, 26, 1990 pp.299-312

<sup>12</sup> Schrieder, Gertrud and Sharma, Manohar, Impact of Finance on Poverty reduction and social capital formation, Savings and development No.1, 1999, pp.67-93

<sup>13</sup> Dunn, Elizabeth and Arbuckle, Gordon, Microcredit and microenterprise development performance: impact evidence from Peru, SED, vol.12, no.4, December 2001, pp.22

<sup>14</sup> Hulme, David and Mosley, Paul, Finance against Poverty, London 1996, p.102

Bangladesh				
BRAC	0.7	0.8		107
Kenya				
KREP Juhudi	0.1	0.3	0.5	217
Sri Lanka				
PTCCs		0.3		143
Malawi				
Mudzi fund		0.0	- 0.5	78
SACA		no data		197
Mean	0.2	1.0	0.5	196

Source: Hulme/Mosley, p.102

“Rising levels of outputs financed by loans” are “...accommodated by increased demands for family labour only.” Similarly, Montgomery et al. found that BRAC loans are not generating “additional incomes for the non-borrower poor to any significant degree, ...(but) are more important for ensuring productive employment for the borrower and her (his) household members.”<sup>15</sup>

The second group of researchers admit a broader range of employment forms, the outcome here is more up-beat. The size of the client’s operations at the first contact with the MFI appears to determine also the demand for increased wage labour. Clients of the KIK program in Indonesia had total (i.e. unpaid and paid) labour between 3 and 15 persons when they got their first loan; obviously at least some of them could no longer be considered as “household-enterprises”. There were also important differences between sectors (construction jobs shrank, but in agriculture, manufacturing and trade jobs were added). Overall, the \$ 791 million credits injected by the central bank into the commercial bank sector via refinancing facilities led “within two years to \$ 255 million in additional fixed investment and the creation of 67,000 jobs.”<sup>16</sup>

This line of argument was confirmed in the early and mid 1990s in the series of impact assessments of individual MFIs carried out on behalf of USAID in the framework of the AIMS programme<sup>17</sup>. The survey of Zambuko Trust in Zimbabwe, for example, found that “participation in the program had an influence on the number of person-hours worked and that on the whole paid employment was more prevalent

<sup>15</sup> Montgomery, Richard, Bhattacharya, Debapriya, Hulme, David, Credit for the Poor in Bangladesh, in Hulme/Moseley, op.cit. volume II,

<sup>16</sup> Bolnick/Nelson, op.cit., 308

<sup>17</sup> Assessing the Impact of Micro enterprise Services

amongst clients than in the control group, but that there was no impact on paid employment in the household enterprises”<sup>18</sup>.

The AIMS survey of SEWA in India found that participation “...led to some modest employment creation”.<sup>19</sup> Employment was measured by the number of person hours on average in the week or month preceding the survey. There has been a substantial increase in hours worked between the first round in 1997 and the second round in 1999. These increases were more important for SEWA clients than for the control group.

The AIMS survey of MIBANCO in Peru covered 518 households (305 treatment group and 175 control group) who operate mostly in petty trade (78%), services (15%) and production (7%). Over half are home-based, in other words typical household-enterprises with several income generating activities running at the same time. MIBANCO’s loans were for working capital purposes, which did not prevent clients to use (at least part of) the MIBANCO loan to acquire fixed assets. Measuring employment as the number of days worked per month, the study distinguishes between employment of the owner/operator, household/family members and non-household members (less than 15% of all employed in clients’ businesses), and it is generally only the latter category who receive wages. The impact on overall employment per month was 9 additional days per month overall, and 3,3 for paid non-household members. Extrapolated to the 40,000 MIBANCO clients in 1999 this would amount to 4,3 million more work days per year, the equivalent of 17300 full time jobs, of which 6300 paid jobs for non household members.

Other studies focused on the shifts between different forms of employment. In 1997 an assessment of 133 household clients of the Landless People’s Development Fund of CARD in the Philippines looked at the number of days worked by each family member per month as well as the hours employed in a day<sup>20</sup>. The results show a “large increase in employment for both wife and husband in the credit financed activity”. Again this has to be seen in the context of a bundle of income generating activities, as employment, defined as own labour use, declined in other economic

---

<sup>18</sup> Barnes, Carolyn Microfinance program Clients and impact: an assessment of Zambuko Trust, AIMS project report, USAID, Washington, p.98

<sup>19</sup> Chen, Martha and Snodgrass, Donald, Managing resources, activities and risk in urban India: the impact of microfinance, AIMS, USAID, Washington 2001, p. 98

<sup>20</sup> Hossain, Mahabub and Diaz, Catalina, reaching the poor with effective micro credit: evaluation of a Grameen bank replication in the Philippines, IRRI conference, Los Banos, June 1997the

activities. The injection of credit seems to have triggered a re-composition of the bundle of income-generating activities.

Substitutions from wage employment to self employment are reported in the survey of 29 districts (thanas) in Bangladesh undertaken by Khandker, Samad and Khan for the World Bank and the BIDS. The authors conclude that microfinance as delivered by Grameen Bank, BRAC and RD-12 accelerated the shift from wage employment in the informal rural sector to self employment, but that overall production and employment increases were held back by the absence of technological changes.

Without pretending to be exhaustive one can distinguish empirical studies that examine the impact on one or several form(s) of employment from analysis that is particularly interested in the magnitude and direction of substitution effects. The latter perspective is especially relevant from a development and growth point of view: the stylized pattern of growth sees the client of a MFI start off with a bundle of several income-generating activities (“household-enterprise”) to specializing and concentrating in one activity, i.e. a genuine micro enterprise, which over time and with increasing capital accumulation grows in assets, turnover, labour productivity and emerges as a small formal enterprise which creates jobs, decent jobs. The cursory look at the empirical evidence shows, however, that this idealized model of growth is too simplistic and may need to be differentiated.

#### **4. What are the key issues?**

##### **- The type of financial institution**

None of the studies looked into variations that can be attributed to the ownership and governance of the MFI or any other lending institution. However, it is plausible to expect a financial cooperative to be better informed about household-internal shifts in labour demand than other types, simply because of its greater mix of consumer and enterprise loans.

##### **- The financial service**

Access to finance is practically identified with access to credit. The assumption is that job creation hinges on investment, and that investment requires external finance. However, strictly speaking access to leased tools and equipment, or

to guarantees, payment and transfer services, including the case where a family joins a credit union to be able to receive remittances from a migrant family member, all of these should be considered, as well, in addition to credit. This is only occasionally touched upon, for example, in the SEWA study for AIMS which points out that savings are considered just as important by the SEWA clients<sup>21</sup> or in the annual report of FIG, an international guarantee mechanism based in Geneva, which claims having been at the origin of the creation of 20,000 jobs in 2005<sup>22</sup>.

**- The enterprise... what “enterprise”?**

Credit – and any other financial service – does not directly and immediately lead to employment. It all depends on the use made of financial resources: the client’s decision on use is often not readable for the MFI, it may diverge from the agreed purpose. Whether that happens and how effectively credit use translates into employment is determined by the client’s mix of income, consumption and savings/investment.

Household-enterprises use money fairly flexibly for the occasional income generating activity, for social investments, children schooling and consumption. It could also be that the person dealing with the MFI is not the person using the loan<sup>23</sup>, which can have all kinds of liability risks for the direct client. Household-enterprise are not incorporated, hence the blurred liability in case of repayment problems.

Being closer to the poverty line a household enterprise is more risk averse than a specialized enterprise with separate accounts and limited liability; risk aversion restrains the propensity to invest in new production technologies, which would boost employment. Hulme and Mosley find indeed limited technological innovation and increases in labor productivity as a result of micro loans.

Because of risk aversion household-enterprises also tend to hang on to their bundle of income generating activities. While understandable as a strategy of risk diversification and risk management it means that productive assets are spread too thin, not yielding any productivity improvements and thus wage increases.

The ease of substitution between, say unpaid family labor and wage labor, varies from one sector of activity to another. Facing constrained substitution and limited choices between different labor inputs, the household-enterprise will tend to

---

<sup>21</sup> Chen/Snodgrass, op. cit. : 95

<sup>22</sup> Communication by FIG, July 2006

<sup>23</sup> “According to studies carried out by Kashf about 30% - 40% of clients worked for their own account in 2003. For the remaining clients, their spouse or sons or blood relatives used credit for family businesses.”

keep to sources of labor from within the family: children, apprentices from the enlarged family, unpaid family labor. The owner of a micro enterprise and her family may also extend their working hours, regardless of the marginal returns to their labor input (a form of self exploitation), before they can bring themselves to pay for the services from outside the family. This is likely to be more pronounced in an environment with rigid hiring and firing rules in the formal labor market. As ease of substitution between different kinds of labor input matters a lot to operators in the informal economy, heavy labor regulations may act as a break on hiring workers from outside the family, reinforcing the use of own labor, child labor and unpaid family labor even in cases where the client could benefit from wage labor<sup>24</sup>.

#### **- The transformation of credit into employment**

Investment in fixed assets, i.e. a new tool or machine, is generally considered to be the precondition for a job created. However, this is not necessarily the case. We shall see below that the acquisition of new machinery has actually led households to withdraw children from school, because the productivity boosts exposed all of a sudden the opportunity costs of leaving the child at school. Micro loans can also be used to enlarge the working capital of a micro enterprise or to remove a temporary liquidity bottleneck. It is not clear what would be in these instances the repercussions on employment.

If there are already some paid non family workers – even if they are only on part time, then any additional loan is more likely to translate into paid employment for non family members. This argument could by extension signal that small enterprises might have the strongest “employment elasticity” compared to other size categories. Bolnick and Nelson, for example, arrive at a positive conclusion about employment impact in their assessment of the KIK programme which served small enterprises.

In addition, the employment effect obviously hinges on the sector of activity and its labour-intensity. The incremental impact on “employment” varies from 1.2 and 4.5 jobs per firm. In some sectors such as fishpond farming borrowers hired even fewer new workers than non-borrowers and in construction there was even a negative impact on employment - suggesting labour saving investment<sup>25</sup>. Some sectors have the scope for technological innovations, others less so.

---

<sup>24</sup> See Doing Business website, World Bank, 2005

<sup>25</sup> Bolnick/Nelson, op.cit., 308

**Average Employment per enterprise, 1982**

<b>Sector/Sub sector</b>	<b>Total Labour</b>	<b>Contract Labour</b>	<b>Unpaid Labour</b>
<b>Agriculture</b>			
Paddy	7.6	2.6	0.1
Poultry	5.6	0.1	0.1
Sea Fishing	7.3	2.9	0.2
Fishponds	14.9	7.2	0.1
<b>Manufacture</b>			
Dry food, snacks	18.2	11.7	—
Garments	12.6	6.4	0.1
Shoes	12.8	9.1	0.2
Clay products	14.4	7.7	—
<b>Construction</b>	63.4	25.7	0.1
<b>Wholesale trade</b>			
Shrimp etc. export	8.7	2.7	0.1
Tobacco export	15.7*	6.1	0.0
Wood export	8.3	2.4	0.1
Furniture	9.5	3.2	0.1
Building Materials	13.0	2.7	0.1
Agricultural products	8.7*	6.5	0.1
Livestock	3.8	0.4	0.2
<b>Retail trade</b>			
Fuel	6.6	0.0	0.0
Automotive parts	4.1	0.2	0.0
Small wares	4.0	0.6	—
Basic foodstuffs	3.9	0.1	0.1
Goldsmith	4.1	1.1	—
Textiles	5.2*	3.8	—
Household goods	9.0	2.4	0.0
Books and stationery	6.4	1.1	—
Food seller	7.9	0.0	0.0
<b>Transportation</b>			
Public transport	3.8	0.2	0.1
Taxi**	2.8	0.0	0.1
Merchandise transport	3.0	0.5	—
<b>Services</b>			
Workshops	7.4	1.1	0.1

Notes : — indicates less than 0.05

\* Extreme values have been excluded. If they are included the figures become: tobacco 23.4, agricultural products 20.6, textiles 14.9.

\*\* An explained in the text, this is not representative of the actual taxi operators.

Source: Nelson (1984).

**- Long lead time and multi-variance**

Rather than being a one shot affair it may take several transaction cycles – and possibly of increasing volumes for improvements in the access to finance to work

themselves through the system and produce jobs; this makes it necessary to track over a fairly long period of time changes in the demand for labour. The longer the observation period, the more the analysis is exposed to influences from other factors. Access to finance is one binding constraint for investing units, there are others; if other constraints are dealt with at the same time – for example the opening of a new feeder road to the closest market - then it becomes a challenge to establish a causal link between access to finance, investment, growth and employment.

### **- Employment ... what “employment”?**

The ILO defines a person as “employed”, if he or she is 15 years and older and if the person has worked – even only one hour per reference week. No matter what the employment status is, i.e. salaried worker, own account worker or family labourer. Apprentices and paid interns are also counted as employed<sup>26</sup>. This definition does not mention “pay” or “wages” or “salary”, presumably because it is taken for granted that “work” is remunerated. As it happens, clients of MFIs tend to adjust to changes in the demand for labour largely by substituting paid by unpaid or partly paid labour.

Is this then “informal employment”? The 15th ICLS defined the informal sector as units of production within unincorporated enterprises owned by households. Those employed in the informal economy comprise all persons who, during a given reference period, were employed in at least one production unit that meets these informal sector guidelines, *irrespective of their status in employment* (own emphasis BB.) and whether it was their main or a secondary job.

One and the same person in the informal sector can have different employment types at once and with constant changes over time: *“a typical microfinance client is involved in many economic activities. In a given year, she works for herself (self-employment) for about 20% of the time e.g. in rearing cattle or working on her own agricultural fields or doing some small manufacturing. For the rest of the employment duration, she works for others, for instance, as wage labour on the fields of other larger farmers or at public works sites. Besides these, she may also take up community work for which she may or may not get remuneration.”*<sup>27</sup>

---

<sup>26</sup> The method of classifying employment by status is based on the 1993 International Classification by Status in Employment (ICSE), which classifies jobs held by persons at a point in time with respect to the type of explicit or implicit employment contract the person has with other persons or organizations. Such status classifications reflect the degree of economic risk, an element of which is the strength of the attachment between the person and the job, and the type of authority over establishments and other workers that the person has or will have.

<sup>27</sup> SHEPHERD questionnaire survey for ILO/GIAN study; S. is a MFI in India.

Being paid or not being paid largely overlaps with the distinction family – non-family, but there are exceptions. A survey by ISS found paid family labour in small scale foot wear production in Indonesia<sup>28</sup>. And inversely, apprentices who may not belong to the family often do not get paid wages, although they may be put up at no expense at the master’s home.

So there is a wide field to explore to have a sound knowledge base on the magnitude and directions of shifts in employment forms that can be attributed to more ease in raising small amounts of capital. In addition, one could explore the secondary employment effects of improved access to finance, i.e. at the level of suppliers and customers, or supply chain effects (home workers, contract workers), or even probe into the seasonality of employment effects or measure the quality of employment, defined according to the ILO by criteria such as opportunities for work, freely chosen and productive work, that is equitable and safe with safeguards for health, pensions and livelihoods (so-called “decent work” indicators)<sup>29</sup>.

## **5. What could microfinance institutions do for more employment?**

Leaving aside whether improved access to finance leads to a net addition in “hard” employment, i.e. paid non family labour that is pretty stable, and assuming that changes are more in terms of shifts from one status of employment to another (for example, from child labour to schooling and inversely; or from unpaid family labour to paid family labour; or from unpaid family labour to apprenticeships, or from unpaid family labour or apprenticeships to paid wage labour etc), then what could a MFI do to bring the client to produce the optimal employment effect? Is there room for adjusting the repayment period, fees and interest rate, the collateral requirements which would indirectly have an effect on employment? Or would the MFI need to offer parallel non financial services, information and guidance, to optimize employment? Or – and this is a legitimate question – should the MFI basically refrain from influencing the client and rather stay on the sideline and observe?

Assuming that most MFIs have the possibility to compose their client portfolio, then the employment profile of a MFI is determined by its client selection.

---

<sup>28</sup> Ines Smyth, Paid family labour in small scale enterprises: consideration from an Indonesian experience, WP series 156, ISS, The Hague, June 1993

<sup>29</sup> ILO Convention 122 (Employment Policy)

If the MFI owners and managers interpret “employment” broadly encompassing all forms of paid, partly paid and unpaid labour from within the family and outside, then it should go for clients characterized by the “household-enterprise”; if, on the other hand, the MFI considers only wage employment from outside family as genuine “hard employment”, then it would need to go for the 5 to 10% of micro entrepreneurs who are dynamic, accumulate capital and raise productivity, who develop eventually into small and formal enterprises – creating along the way real jobs, stable and well-paid.

As long as so little is known about the magnitude, direction and irreversibility of these shifts between different forms of labour, it may be unwise and premature to advise MFIs to be pro-active in their selection and appraisal of clients. It is therefore vital that this knowledge gap is closed soon. Having sound research findings at hand, it will be easier to take an informed position on the superiority or inferiority of different sorts of employment outcomes. It will also be possible to confirm, differentiate or invalidate Yunus’ statement<sup>30</sup> that “*wage employment is not a happy road to the reduction of poverty. The removal or reduction of poverty must be a continuous process of creation of assets...*”

What would be in it for the MFI? Greater selectivity in favour of growth oriented micro enterprises would allow a MFI to grow itself with its clients and diversify the range of its services, it could also respond to the new demand for consumer and housing loans from paid non-family workers employed in the growing micro-enterprise. The risk is obviously mission drift and a re-composition of the client portfolio. As Christen’s assessment of MFIs in Latin America<sup>31</sup> showed this is not a necessary outcome, MFIs can accompany the growth of their clients without losing sight of their mission.

The argument for a more pro-active involvement of MFIs in employment promotion is closely related to the formalization debate: should MFI help their clients to become progressively more formalized, for their own, the MFI’s and society’s benefits? Some say no, others point to instances like ABA, a MFI in Egypt, where its approach of accompanied graduation into formality seems to be working. Moreover, there is a deeper link between the two debates: in a household-enterprise employment

---

<sup>30</sup> Yunus, M., Credit for self employment: a fundamental human right in D.Gibbons (ed), The Grameen Reader, 1994, Dhaka, p.47

<sup>31</sup> CGAP, Commercialisation and mission drift – The Transformation of Microfinance in Latin America, Occasional Paper no.5, January 2001

relations are non contractual, they are based on family bonds and personal connections; in fact, they are so informal that statistically informal operators are considered as individual enterprises under the heading “household”. Any emerging contractualization in employment relations is a step towards formalization, small if it involves an apprentice from outside the family, big if it involves a paid worker from outside the family. The argument is that since MFIs<sup>32</sup> play a critical role in the transformation of self employment into wage employment, they might by the same token also instigate the transformation of informal into more formal activities.

## **6. What sort of employment should MFIs promote?<sup>33</sup>**

Assuming that one can trace employment effects following improved access to finance, one needs to look more closely at the quality of employment. Has the ease in the access to credit led parents to withdraw their children from school so that they can help in the income generating activity that was started with the micro loan? Or has access to credit allowed parents to put a child to school because the surplus produced more than compensated the marginal product of the child “employed”? This is still an open debate. A lot obviously depends on factors like the productivity of the child labour, proximity and accessibility of the school, number and gender of children in the household, availability of alternative sources of credit etc.

In economic terms child labor creates a trade-off between current and future income. Putting children to work raises current income, but by interfering with children’s human capital development, it reduces future income. However, the future income is realized by the children and not by the parents. If bequests are positive, parents can compensate themselves for foregone current income by reducing bequests. Instead, when parents do not leave bequests for their children (for example, if they are poor) or if financial market imperfections do not allow parents to trade off old-age income with current resources, parents will have their children supply too much labour. If households are credit constrained they might supply child labour as a consumption smoothing mechanism in case of income shocks.

---

<sup>32</sup> Obviously not all MFIs see this as their mission, but the age rand more mature MFIs could certainly sharpen their focus on growth oriented financing, without abandoning their poverty focus.

<sup>33</sup> This section has considerably benefited from inputs by Julika Breyer of the Social Finance Program. .

Faced with a trade-off between future returns to schooling and current return to child labour in household enterprises, access to micro finance can have two effects: the “family-labour-substitution effect”, where child labour is substituted by hired labour through the relaxed working capital constraints or the “household-enterprise-capitalization effect”, where the investment in machinery and other physical capital goods raises labour productivity and thus the opportunity costs for schooling. Hence, child schooling might actually decrease as a result of access to credit. Depending on the circumstances one of the two effects might be dominating.

Negative effects of access to credit on the schooling of children of the working poor have been found in several empirical studies: Menon’s paper <sup>34</sup> about the influence of credit on children's schooling using data from Pakistan shows that credit obtained for investment purposes may actually *reduce* the likelihood of schooling for children who currently work in their family business. On average, results of this research suggest that for a thousand rupees (approximately 17 dollars) increase in credit obtained for non-farm business reasons, the odds of schooling for children employed in the home enterprise decrease by about 9%. This may be because investment loans increase children's labour productivity, which in turn increases the opportunity cost of schooling. The results of this study suggest that improving access to credit may not, by itself, constitute a solution to the problem of child labour.

The study by Wydick on Guatemala<sup>35</sup> examined data from 236 operators of household enterprises and found to the contrary that in general the family-labour-substitution effect appears to dominate, except in those activities exposed to moral hazard where hired labour and child labour are not easily substitutable, like a shop where one would not like to entrust the cash handling to a person from outside the family; there are also family enterprises with specific skills that need to be kept within the family (e.g. in the fabrication of traditional clothes). Training of one’s own children is here a form of security for the financial support by children of their parents at a later stage.

---

<sup>34</sup> Menon, N., 2005, “The Effect of Investment Credit on Children’s Schooling: Evidence from Pakistan.”, Mimeo, Brandeis University.

<sup>35</sup> Wydick, B., 1999, “The Effect of Microenterprise Lending on Child Schooling in Guatemala.” *Economic Development and Cultural Change*, Vol. 47, No. 4, 853-869.

A World Bank study of household enterprises in rural Tanzania<sup>36</sup> finds that income shocks have a highly significant effect on child labour. If, on the other hand, a household has assets that can be used as collateral (as a measure for credit access), then this is significantly negatively correlated with child labour. The authors question the straight and direct relationship between poverty and child labour and point to imperfections in labour, education and particularly credit markets as roots for child labour.

Shocks are also found to alter the trade-off between schooling and child labour in Guatemala<sup>37</sup>, because of the need to compensate for unexpected loss of resources. Shocks substantially alter household decisions and a negative shock substantially increases the probability that a child will work. The inability to obtain credit significantly affects household investment decisions in human capital, rather than children's labour force participation. Better access to credit is thus not necessarily an instrument to facilitate removal of children from the labour force.

Lastly, a review of child labour household in the foot wear industry in the Philippines<sup>38</sup> found that schooling was a high priority for these poor households. However, child labour (some of it hazardous) is widely used in the footwear production sector. Peak seasons are characterized by high labour demand and low seasons by an income lower than necessary to sustain the household. Furthermore only few alternative sources of income such as trading grocery and selling food are available. Those sideline activities are nearly exclusively undertaken by women.

The small producers of footwear depend on the sub-contracts from a few larger producers ("managers") who also provide credit for the purchase of raw materials and who have the necessary contacts for selling the shoes. If the small producer does not require credit from a manager, she gets paid less per shoe. Most production takes place at home without any separation between living and working space. Usually parents arrange for a combination of child labour and schooling, but if production lacks behind schedule, full-time child labour is used. The households

---

<sup>36</sup> Beegle, K., R.H. Dehejia, R. Gatti, 2003, "Child Labor, Income Shocks, and Access to Credit." Policy Research Working Paper no. 3075, World Bank, Washington D.C.

<sup>37</sup> Guarcello, L., F. Mealli, F. Camillo Rosati, 2003, "Household Vulnerability and Child Labour: The Effect of Shocks, Credit Rationing and Insurance." Social Protection Discussion Paper Series No. 322, World Bank, Washington D.C.

<sup>38</sup> Kring, Thomas, 2004, "Microfinance as an Intervention Against Child Labour in Footwear Production in the Philippines." Working Paper No.12. Melbourne University Private Working Paper Series.

interviewed saw only limited possibilities to re-compose their economic activities through the provided micro credit (delivered by an NGO, group-based, forced savings, low efforts on repayment, default rates of 50% in the sample, 3-6 month repayment periods, loan has to be invested into economic activity, low flexibility caused by rotation principle). Moreover, micro loans were viewed as too small and too irregular to replace the dependency on “managers”. While households felt that loans failed to decrease the children’s workload, investment in sideline activities did increase the income in the low season.

Apprentices are strictly speaking employees, but they are usually not paid, to the contrary they have to pay a fee to the master. Traditional/informal apprenticeships are the most important mechanisms for skills transfers in the informal sector in many African countries. Seen from the angle of finance, the arrangements between the master, the enterprise and the apprentice raise a number of issues: the payment of fees by the apprentice is common, but not systematic; there may be an effective skills transfer in return for the fee, but not necessarily; some apprentices receive wages and/or in kind support, others don't.

Research suggests that there could be a relation between these financial arrangements of apprenticeship training and the credit needs of micro entrepreneurs: apprentice fees might substitute for a large part of working capital needs, in cases where the micro enterprise does not have access to finance. Once that changes, the master may be able to forego the fee – and possibly even the apprentice.

## **7. Should MFIs care about the employment conditions in their clients’ enterprises?**

The hours and conditions of work may in some cases be so abysmal that a MFI may be reluctant to be held indirectly responsible for having allowed exploitative working conditions, or induced families to take children out of school to work in the family enterprise. On the other hand, it has been said that there is only one thing that is worse than being exploited, and that is: not being exploited. One could thus take the standpoint that strictly speaking it is the business of a MFI to extend financial services to the working poor in a cost covering manner; any social benefit that may ultimately accrue is the better for everyone, whilst social costs that its operations may indirectly cause are regrettable, but not to be blamed on the MFI. The

debate is similar to the controversy on the corporate social responsibility of financial institutions.

Wherever one comes out in this debate, the fact remains that practically few MFIs know what goes on within the household-enterprise that its clients run, whether that relates to financial management, commercialization and labour use. So, the first thing a MFI would need to do is to get information, to establish client profiles, client management information systems. What aspect of employment should be covered? How frequently? How much does it cost to generate the data? Is this something that the MFI alone should bear? Who in the MFI uses the information for what purpose? Which MFI operates a system like this? What prompted it to set it up? Was there a business case? Incentives?

In conclusion, policy makers interested in optimizing the employment outcomes of microfinance could be well advised to think about ways to support MFIs that want to know more about what really is going on within the household-enterprises that their clients run.

## References

- Barnes, Carolyn Microfinance program clients and impact: an assessment of Zambuko Trust, AIMS project report, USAID, Washington, p.98
- Beegle, K., R.H. Dehejia, R. Gatti, 2003, "Child Labor, Income Shocks, and Access to Credit." Policy Research Working Paper no. 3075, World Bank, Washington D.C.
- Bolnick, Bruce and Nelson, Eric, Evaluating the economic impact of a special credit programme : KIK/KMKP in Indonesia, JDS, 26, 1990 pp.299-312
- CGAP, Commercialisation and mission drift – The Transformation of Microfinance in Latin America, Occasional Paper no.5, January 2001
- CGAP, Is Microfinance an effective strategy to reach the Millennium Development Goals? Focus Note 24, January 2004
- Chen, Martha and Snodgrass, Donald, Managing resources, activities and risk in urban India: the impact of microfinance, AIMS, USAID, Washington 2001, p. 98
- Dunn, Elizabeth and Arbuckle, Gordon, Microcredit and microenterprise development performance: impact evidence from Peru, SED, vol.12, no.4, December 2001, pp.22
- Idem, The Impact of Micro-credit: a case study from Peru, AIMS report, USAID, Washington, September 2001
- Gaile, Gary and Foster, Jennifer, Review of methodological approaches to the study of impact of micro-enterprise credit programs, AIMS, USAID, Washington, 1996
- Gauthier, Laure, Mésurer l'impact de l'accès aux services financiers sur l'emploi, Social Finance Working Paper (forthcoming), ILO, 2006
- Guarcello, L., F. Mealli, F. Camillo Rosati, 2003, "Household Vulnerability and Child Labour: The Effect of Shocks, Credit Rationing and Insurance." Social Protection Discussion Paper Series No. 322, World Bank, Washington D.C.
- Hossain, Mahabub and Diaz, Catalina, reaching the poor with effective micro credit: evaluation of a Grameen bank replication in the Philippines, IRRI conference, Los Banos, June 1997
- Hulme, David and Mosley, Paul, Finance against Poverty, London 1996
- Husmanns, Ralf, Measuring the informal economy: from employment in the informal sector to informal employment, Working Paper 53, Bureau of Statistics, ILO, December 2004
- Khandker, Shahidur, Samad, Hussain and Khan, Zahed, Income and employment effects of micro-credit programmes: village-level evidence from Bangladesh, Journal of Development Studies, vol.35, No.2, December 1998, pp.96-124
- Kring, Thomas, 2004, "Microfinance as an Intervention against Child Labour in Footwear Production in the Philippines." Working Paper No. 12. Melbourne University Private Working Paper Series.
- Marniesse, Sarah, La Dynamique des Micro entreprises, 1999

- Menon, N., 2005, "The Effect of Investment Credit on Children's Schooling: Evidence from Pakistan.", Mimeo, Brandeis University.
- Montgomery, Richard, Bhattacharya, Debapriya, Hulme, David, Credit for the Poor in Bangladesh, in Hulme/Moseley, op.cit. Volume II,
- Opportunity International UK, Annual Report 2004
- Schrieder, Gertrud and Sharma, Manohar, Impact of Finance on Poverty reduction and social capital formation, Savings and Development No.1, 1999
- Sebstad, Jennifer and Chen, Gregory, Overview of studies on the impact of micro-enterprise credit, AIMS report, USAID, Washington, June 1996
- Smyth, Ines, Paid family labour in small scale enterprises: consideration from an Indonesian experience, WP series 156, ISS, The Hague, June 1993
- Von Pischke, J.D., Poverty, Human Development and Financial Services, UNDP Occasional Papers 25, New York, 1999
- Wright, Graham, Examining the impact of microfinance services – increasing income or reducing poverty? SED, vol.10, No.1, March 1999
- Wydick, B., 1999, "The Effect of Microenterprise Lending on Child Schooling in Guatemala", Economic Development and Cultural Change, Vol. 47, No. 4, 853-869.
- Yunus, M., Credit for self employment: a fundamental human right, in D. Gibbons (ed), The Grameen Reader, 1994, Dhaka