

Loans to Skills Graduates for Self-Employment

Concept Note

Introduction

Fostering enterprises and developing microenterprises is critical to expand employment and earnings opportunities and to reduce poverty. Robust macroeconomic conditions and business environment including infrastructure, regulation, and legal environment have been typically emphasized to improve labor market opportunities. While these remain relevant, an increasing attention is being paid on the role of policies that aim to enhance productivity and reduce constraints among the self-employed in developing countries. This is particularly pressing in case of Pakistan and Punjab where wage and salary employment is limited and most the jobs are created and operated in self-employment. The demographic pressure in Punjab adds an urgent need to create more jobs. Government of the Punjab realizing this need clearly articulated a response in its 2018 Growth Strategy. The Strategy talks about skilling at least 2 million graduates by 2018. Whereas, this supply side target is on track, the government realizes that it is still far away from creating such many employment opportunities. Hence, fostering self-employment and small-scale entrepreneurship can indeed ease the pressure while representing a source of wage and job creation.

In recognition of the importance of self-employment in job creating, the Chief Minister has desired to launch a loan/credit scheme for skills graduates managed by the Bank of the Punjab. This concept note provides some evidence from other countries of the success of such a programme and based on these provides a set of options that can inform the actual design of the scheme.

International Experience

International evidence show that the frequently used interventions include training (technical and vocational skills, business and management skills, financial education, and life skills), financing support (loans and grants), counseling and other advisory services, mentoring, micro-franchising, enabling value chain inclusion, small business networks, support for technology transfer, business incubation and many others.

Based on the evidence that some entrepreneurial traits and skills are strongly related to business set up and success, some interventions have focused on entrepreneurial education through school curricula, while others cover those who are already in labor market. The key focus of these intervention has been on labor market performance such as employment, business creation, hours of work, earnings, and profits and business performance to supply side changes such as improved technical and non-cognitive skills, business knowledge and practice, attitudes, aspirations and more active financial behavior (borrowing, saving).

Although evidence on the effectiveness of entrepreneurship promotion programs is still scarce, findings from existing impact evaluations are widely heterogeneous. Early evaluations from Latin America's Jovenes program targeted to vulnerable youth suggested that vocational and life skills training combined with internship in private firms, could be potentially useful to improve employment and earnings although the effects in Dominican Republic were not as significant as those in Colombia. Similarly, evaluations of skills training for vulnerable individuals in Malawi, Uganda, and Sierra Leone, for instance, found generally positive effects on psycho-social wellbeing, but mixed results in labor market.

The complexity of evidence increases as the training programs combine other financial and advisory supports. Importantly, the effects of financing through microcredits or grants also widely vary across studies. A series of studies in Sri Lanka and Uganda suggested that the returns to capital were large and grants significantly improved labor market (business) outcomes especially for. However, evaluations on the effects of expanding access to credits in Mongolia, Bosnia and Herzegovina, India, South Africa, Morocco, and the Philippines suggested that the access to credits did not automatically improve entrepreneurial activities, but required it to be combined with a robust entrepreneurial management training.

These interventions suggest that providing credit to young skills graduates is probably putting 'too much responsibility' on them without providing 'adequate training.' The evidence studies argue that skills graduates may be trained well in their respective trades but are far from good / adequate managers of money and business. Entrepreneurship is skill that does not come naturally and must be created among young skills graduates. Hence, any credit programme of self-employment must ensure

that its clients have adequate exposure to managing small business transactions and managing money.

Proposed Design

The Scheme may have the following design structure:

- 1. Objective:** Self-employment Loan Scheme aims at providing a loan facility to 'skills graduates'¹ who intend to become self-employed either by; (i) setting up an individual business that may or may not employ other skills graduates; (ii) setting up a business in partnership with a group of skills graduates. (a maximum of three can form a group)
- 2. Categories of Graduates:** The Skills Graduates will be split into two categories. One category is graduate of a three-year diploma (DAE Courses) and the other category of graduates are those who have passed the 3-8month short vocational courses.
- 3. Pre-requisites to Apply:** The Skills Graduate applying for the loan must obtain the following minimum documentation:
 - a. Possess a valid certification from an approved institution/body in the relevant field/skill that qualifies for the loan programme
 - b. A minimum practical experience / on job training for at least 3 months
 - c. Certification for attending a one month entrepreneurship boot-camp that results in a business plan developed on a pre-determined template. This is designed to support the beneficiaries of the loan programme and will be managed by PSDF.
- 4. Eligibility Criteria:** Any individual between the age 18-29 with a valid residential address/domicile in Punjab is eligible. However, the individual must have a valid record of skills training received and completed satisfactorily with a valid certificate/dipoloma through TEVTA, PVTC and PSDF funded training service provider. The Government of the Punjab may from time to time add further courses or training institutes that may be included in the scheme.

¹ Skills Graduate will have to be defined; it is only someone coming from TEVTA, PVTC, PSDF-funded training and also the trades will have to be defined.

- a. List of Training Courses:** There are currently 4 DAE courses; all of these may fall in the eligible courses for the scheme. For short vocational courses the programme may start with a small number of courses such as auto mechanic, auto-cad, cad-cam, masonry, electrician, plumbing, carpentry, tailoring and cooking and hospitality.
- b. Age Limit:** Proposed is 18-29 as the target group.
- c. Minimum Qualifications:** Given most of the skills graduates usually have low levels of basic of education, this may be kept at lower-secondary. However, each graduate must have the required certification from the approved institution/body.
- d. Minimum Document Requirement:** In addition to 3 a, b, c above the applicant must have a valid ID-Card and some proof of residential address. In case the current residential address duration is less than 3 years, proof of previous address may be provided. However, the mechanism for this should be simple.

5. Size of Loan: The size of the loan may be determined by the category the applicant falls under. The following is proposed:²

Category	Size (PKR)
setting up an individual business that may or may not employ other skills graduates – (Vocational Graduates)	Up to 150,000
setting up a business in partnership with a group of skills graduates – (Vocational Graduates)	Up to 450,000 ³
setting up an individual business that may or may not employ other skills graduates – (DAE Graduates)	Up to 350,000
setting up a business in partnership with a group of skills graduates – (DAE Graduates)	Up to 1,050,000 ³

² International evidence suggest that loans of such sorts have varied between US\$300 to US\$10,000.

³ Maximum grouping of 3 reflecting the loan size of 3*150,000.

6. **Eligible Expenses:** The loan may be used to pay for buying equipment, tools and setting up some area as place of business, paying initial rental or security deposit and working capital support. However, all transactions will be via cheque paid through the loan account.
7. **Rate of Interest:** Interest rate may be charged linked to the base rate of Bank of Punjab charged on average loan accounts. However, the interest may be charged on 'simple basis' i.e. no compounding during the agreed gestation period given to set up the business. A minimum proposed gestation period is six months. No repayments of capital of interest may be required during the agreed gestation period. A 1% interest concession may be provided in case of early repayment of the loan.
8. **Management & Processing Charges:** The Bank of Punjab will not charge any management and processing charges from applicants. This cost will be negotiated separately and paid by the Government of the Punjab.
9. **Security & Collateral:** No collateral for the loans applied under the scheme will be taken by the Bank of Punjab. However, the Bank is required to verify all information provided and may use softer guarantees such as from parents etc. or other forms as used by microfinance institutions.
10. **Gestation Period:** To provide some space to the applicants, no repayments may be taken in the first six months of the business. However, if someone is willing to retire the complete loan during this period a 2% interest reduction may be provided.
11. **Repayment:** The repayment schedule may be specific to each loan category. A proposed schedule is provided in the table below:

Category	Size (PKR)	Repayment Terms
setting up an individual business that may or may not employ other skills graduates – (Vocational Graduates)	Up to 150,000	Up to 12 months from the completion of gestation period
setting up a business in partnership with a group of skills graduates – (Vocational Graduates)	Up to 450,000 ⁴	Up to 15 months from the completion of gestation period

⁴ Maximum grouping of 3 reflecting the loan size of 3*150,000.

setting up an individual business that may or may not employ other skills graduates – (DAE Graduates)	Up to 350,000	Up to 24 months from the completion of gestation period
setting up a business in partnership with a group of skills graduates – (DAE Graduates)	Up to 1,050,000	Up to 36 months from the completion of gestation period

Other Important Considerations

1. TEVTA has already partnered with AKHUWAT to develop a micro-finance for TEVTA graduates. The model may be studied in detail and details of their target group must be obtained to avoid any duplication.
2. Other areas of design may include safety measures to reduce defaults and also that the monies are properly used for the purpose stated. A robust monitoring and evaluation methodology will have to be developed for initial screening and post follow up of the loans. PSDF has established a robust and comprehensive 3rd party monitoring system outsourced to Ernest & Young. PSDF will provide guidance on setting up the monitoring system.

Institutional Design & Expected Costs

Cell in Skills PMU

The programme will be housed and managed by Skills Programme Management Unit (PMU) established under the Industries, Commerce & Investment Department. A new cell will be established to manage the scheme and will be responsible for creating awareness, ensuring smooth running of the process and monitoring implementation. The Cell will also be responsible for providing handholding support to loan recipients as they set-up their businesses during the gestation period. PMU will also have to build a diverse monitoring system to ensure proper tracking of beneficiaries.

Entrepreneurship Boot-camps by PSDF

PSDF will design and run a one month Entrepreneurship Boot-Camp for qualifying graduates. This will ensure that proper training is provided to each interested graduate to manage the loan and business. The camp will also offer opportunity to further

screen the graduates reducing informational asymmetries and hence lowering the risk of banks to lend. It is very probable that PSDF may not recommend certain individuals to benefit from the loan scheme based on their performance in the camp.

Bank of Punjab (BoP)

BoP will be the lending partner and will work with the Skills PMU to establish the risk matrix of potential borrowers under the scheme. However, the government will have to consider options for loaning facility.

Option 1: Using BOP's Funds with No Guarantee Against Defaults

This option is the least cost for the government, but may not mature into any significant lending. BOP may not be lending to skills graduates due to possibility of high default rates. Moreover, the interest rate on unsecured lending is around 30%, which will make the option non-feasible. The Prime Minister Youth Loan Scheme has had minimal participation by the Banks due to the very reason. Major lending under the programme has been through National Bank.

Option 2: Using BOP's Funds with Government Guarantee Against Defaults

The second option involves Government being the guarantor in case of default. BOP is willing to lend on these terms, the mark-up rate will be Kibor + 3%. This option will ensure a stronger voluntary participation by BOP, however, will increase the costs to the government for filling in defaults.

Option 3: Government Providing Funds for Loaning

Third option is where BOP acts as a dispensing agent on behalf of the government. This will require a significant amount of upfront capital. The cost in this case will be 3.5%-4% charged to borrowers.

Costs

Category	Cost (PKR)
Loan Facilitation Cell	25 Million
Design cost of entrepreneurship boot-camp	5 Million
Per student cost of running the boot-camp	10,000/Student
Banks processing cost per applicant	3,500- 5,000/application

For a target of 10,000 applicants in the first year the cost will be around PKR 180 Million against a loan portfolio of around PKR 4 Billion. This translates to around 4.5%.

Option 2 seems most feasible as if the scheme is managed well the default rates can be brought down to as low as 15% based on international experience. On a loaning of PKR 4 Billion this will be around PKR 600 Million.