

## Grants for Income Generation

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Communities supported by World Bank rural development projects often cite support for the development of income-generating activities (IGAs) as a critical need. This note identifies some of the core problems encountered by Bank task teams that attempt to respond to this need, outlines the issues involved, and offers suggestions on some of the points that should be kept in mind when designing grant programs for this purpose.

Providing support for IGAs typically involves dealing with any combination of the following:

- Inadequate social and/or economic infrastructure and services to support increased opportunities for income generation by community members
- Lack of financial institutions that are willing and able to provide poor people with access to financial services, including loans for their IGAs
- Saturation of local markets for the products of existing economic activities, and lack of knowledge or facilities that would enable producers to expand their markets for these products
- Lack of knowledge of new technologies or opportunities for investment in nontraditional economic activities, and aversion to risk when the probable outcomes of such opportunities have not yet been demonstrated to the potential clientele
- Shortage of investment capital to start new economic activities or to expand existing activities



### GRANTS TO DEVELOP ECONOMIC AND SOCIAL INFRASTRUCTURE

World Bank-financed projects often respond to these concerns by providing grants for the following purposes:

**Investments that raise the productive potential of the community** that do not in themselves generate income, but rather facilitate income-generating activities. Examples of economic infrastructure that directly raises income potential include small-scale irrigation, market facilities, a harbor or cold storage for fishing, and even a building and safe for a village savings and credit association. Income-earning potential is also increased indirectly by investments that raise the productivity of labor, such as clean water, education and health facilities, and social intermediation, which increases the capacity of disadvantaged people, especially women, to more fully realize their potential.

**Development of local organizations** that can facilitate input supply, storage, processing, and marketing, either directly or in partnership with other private firms.

**Creation of linkages** between communities and the private sector.

**Capacity building of professional financial institutions** to enable them to downscale their financial services for low-income people. This can include technical assistance in developing products and service delivery mechanisms, acquisition of management information systems and efficiency-enhancing technology, and subsidies to help cover the cost of establishing new branches in underserved areas. Support may also include loans to these institutions to lend to their customers.

**Capacity building of community-based financial organizations**, when professional financial organizations are not willing or able to provide financial services to the poor (Ritchie 2006). Capacity-building assistance can include technical assistance to develop ownership and governance structures, policies and procedures to provide basic financial services such as savings, and financial management systems. It also





sometimes includes grants to these organizations to establish revolving loan funds (RLFs).

The provision of grants for the above purposes is generally not controversial, because these grants create or improve infrastructure that can be shared by many people. Thus, they are more similar to public goods than to private goods. However, the provision of RLFs as grants to community groups to lend to their members for their economic activities *is* controversial. In most cases, community-managed RLFs have not been effective in achieving the objective of sustainable financial services for the poor (Murray and Rosenberg 2006). RLFs often don't revolve for very long; thus, members who don't repay their loans capture all the financial benefits. In effect, the grants to the groups for on-lending become grants to individuals for their economic activities. In this situation, it would be better for the loan to be a grant from the outset, because loans that aren't repaid damage the credit culture and make it more difficult for professional financial institutions to operate sustainably.

In addition to having inadequate management capacity, groups often don't have the incentive to manage their funds as prudently as they would manage their own money. Savings within these groups are also often discouraged by access to easy money. Thus, grants to community groups for RLFs should be discouraged, and if they are provided despite the constraints, should be accompanied by measures to minimize the problems and enhance the sustainability of these groups (Ritchie 2005). It should be noted that the Bank's policy on financial intermediary lending states that subsidies may be an appropriate use of public funds, but only if they are transparent, targeted, and capped; do not give an unfair advantage to some financial institutions; and are economically justified, or can be shown to be the least costly way of achieving poverty reduction objectives. Furthermore, the Bank requires an assurance that financial institutions acting as on-lenders are viable institutions (World Bank 2004).

## **GRANTS TO ACQUIRE PRIVATELY OWNED PRODUCTIVE ASSETS**

Although financing of privately owned goods with public money is contentious, there are some instances when grants to finance productive assets can be appropriate. These instances include emergency or postconflict situations where families have lost most of their assets, and projects targeting extremely poor people, who have few assets and little capacity to earn an income. In addition,

poor people who have fragile livelihoods often cannot absorb entrepreneurial risk, limiting their ability to benefit from new technologies and economic opportunities. People in these categories may be too vulnerable to take on the risk of a loan from a financial institution for an IGA. Many poor people are already highly indebted, and should not be encouraged to take on additional debt if the revenue flows from the use of that debt could undermine, rather than enhance, their economic security. Furthermore, although it has been demonstrated time and time again over the past two decades that poor people can and do save, it can take many years for extremely poor people to accumulate sufficient savings for investment in economic activities that have the potential to lift them out of poverty. In these circumstances, grants to individuals for productive assets may be appropriate.

Projects should be careful to clearly separate the administration of grants for public goods from grants for productive assets. They should also separate the administration of a loan program for productive assets from a grant program for productive assets. The institutional arrangements, including staffing, need to be separated, because the eligibility criteria and operational guidelines will be quite different. If they are not separated, there is a significant risk that both staff and beneficiaries will be confused, leading to failure of the intervention.

Several issues complicate the provision of grants to acquire privately owned assets. One, they may be a temporary fix, unless the project is designed carefully and managed and monitored well. For example, a project may provide the asset as a grant, but fail to plan for the maintenance of the asset, or for the other costs of operating the asset.

Two, grants to finance IGAs are often used when there are no financial intermediaries willing and able to serve the poor. This enables the project to avoid the numerous issues surrounding the development of sustainable financial intermediaries in difficult areas. However, sustainable sources of financial services that will enable poor people to manage their households and economic activities over the long term are needed; indeed, grants have the potential to "crowd out" financial intermediaries that can provide sustainable services.

Three, there are many risks, including waste of public resources (common when assets are provided free of charge), political favoritism and corruption, and conflict among community members over grant allocation.

Four, many grant-making programs are integrating with participatory municipal planning exercises as the forum

for identifying microprojects. In these cases, there can be tensions between the public-good activities for which local governments are normally responsible, and the private-good aspects of the income-generating activities.

Five, projects often prefer to provide grants to groups of people rather than to individuals, so as to spread the benefits to a larger number of people, reduce transaction costs, and finance assets that cannot be financed by grants to individuals. However, conflicts can easily arise when economic activities are owned and operated by groups; examples are the amount of time that each member spends on the economic activity, the maintenance of assets, and the division of revenue from the activity. For these reasons, as well as the preference of most people for individual or family-owned economic activities, grants for commonly owned assets can be problematic.

Six, groups formed solely to capture grants from a project are often not strong. Chances for group solidarity are higher if group members have a common interest, past experience working together, and savings that can be contributed to the project. This solidarity takes time to develop. The short time span of projects makes it difficult for implementers to allow enough time for these processes to occur.

## **SUGGESTIONS FOR THE DESIGN OF GRANT PROGRAMS FOR PRIVATELY OWNED PRODUCTIVE ASSETS**

These issues are not easy to tackle, and require innovative approaches. Some suggestions that may be helpful to task teams in determining whether a grant program to finance privately owned economic activities is appropriate include the following:

1. Grants for productive assets should in most cases be limited to (a) extremely poor people who are too vulnerable to take on the risk of a loan, and (b) poor people who have some assets and earning capacity but cannot absorb the downside risk, or earn enough from the activity to pay off the investment cost within a reasonable time frame.
  - (a) Extremely poor and vulnerable people may need a package of assistance, including income support and training, as well as grants, if they are to earn income from an economic activity on a sustainable basis. An example of an integrated approach is shown in Box 1.
  - (b) For poor people who have some assets and income-earning capacity but have limited ability

to absorb downside risks associated with new technologies or economic opportunities, a portion of the investment can be financed with a grant, and the remainder with savings. Such grants can have a powerful demonstration effect if the technologies are successfully adopted by the grantees. An example is shown in Box 2.

2. Grants should be carefully targeted and monitored, with strong and transparent eligibility criteria to avoid the capture of benefits by elites. Participatory mechanisms such as wealth ranking can be used by communities to identify the poorest members who should benefit from a grant subsidy. Criteria that can be objectively monitored include agricultural landholdings and household assets.
3. Grants should be made on a matching basis; beneficiaries' contributions may be in cash or in kind, such as the provision of labor or locally available inputs.
4. To ensure that people value and care for the assets financed by the grant, they should contribute as high a percentage as is reasonable, given their overall economic circumstances.

### **Box 1. BRAC's Income Generation for Vulnerable Groups Development (IGVD)**

BRAC, one of Bangladesh's largest microfinance institutions (MFIs), initiated the Income Generation for Vulnerable Groups Development program for the "hard-core" poor in 1985; since then it has served more than a million people. These destitute people suffer from chronic food deficits, have no agricultural land, and survive in a situation of endemic economic insecurity. Thus, loans from MFIs are too risky, both for the very poor, who risk increasing their debt load, and for the MFI, which needs to ensure high loan recovery for its own sustainability. This program provides free food grains for an 18-month period, thus catering to the immediate consumption needs of participants, and freeing up their time for skills training in relatively simple economic activities, such as poultry rearing. When the training is complete, generally within six months, participants in the program receive the first of two loans that enable them to start up the selected economic activity. During this time, they also begin to save small amounts weekly. Following successful completion of the program, they are mainstreamed into BRAC's regular microfinance program. About two-thirds of beneficiaries have successfully graduated into the regular program over the years.

*Source: Bangladesh Rural Advancement Committee (BRAC).*

## Box 2. Participatory Agricultural Development and Empowerment Project (PADEP)

Grants given through the Participatory Agricultural Development and Empowerment Project are matched 80 percent/20 percent for infrastructure projects such as roads and bridges that enhance incomes of people living in rural areas, and 50 percent/50 percent for the adoption of new and improved agricultural technology. Farmers work in already established groups (preferably with advisers) to identify superior productive activities that they can adopt, and cost the additional expenditures needed for inputs, new implements, land preparation, etc. Once the inputs are costed, the farmers deposit 50 percent of the cost (their share) into bank accounts that they have already established. Farmers are expected to maintain the bank accounts over the period of program support (two to three years, depending on circumstances), regularly adding to their savings. Thus, when farmers leave the program, they will have higher incomes, sufficient savings to continue financing the working capital, and an established relationship with the bank. This arrangement addresses the issue of sustainability of the economic activities, and also builds a potentially constructive relationship between small farmers and the financial system.

*Source: Karen Brooks, personal communications with author.*

5. Development of a cost-recovery mechanism would help ensure that only people with serious intentions would receive grants, and extend the benefits to a larger number of people.
6. Innovative ways should be sought to reap the benefits of groups, such as greater access to expensive assets that cannot be provided by grants to individuals. But at the same time, it is essential to look for ways to avoid the conflicts that can arise from group ownership. Grants should be provided to carefully targeted individuals rather than to groups, if group ownership does not have clear advantages that significantly outweigh potential disadvantages.
7. Grants for income-generating activities should be, in many cases, combined with training such as the World Bank Institute's (WBI) Grassroots Management Training program, which includes household management, business skills, and financial skills. Such training can improve the ability of targeted groups (especially rural women) to manage their income-earning activities and finances. Such programs are sometimes linked with literacy and health programs.

### CONCLUSION

There is a role for grants for income generation, but such grant programs must be carefully designed and monitored. The use of grants for the development of social and economic infrastructure, including the development of financial institutions that serve the poor, is

usually considered to be an acceptable use of public money. Grants to finance privately owned productive assets are more controversial, and should in general be limited to the poorest and most vulnerable members of society, or to limit the downside risks to the poor of new technology adoption.

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