

# Demand Side Intervention for BDS: Market Development or Distortion? Kenya Voucher Program Evaluation

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by

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# Market Development Approach to BDS

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**Vision: Diverse services adapted to meet demands of large share of MSEs affordably**

**Under market development approach:**

- Increased demand & willingness to pay
- Providers adapt methods & content to targeted clients, at affordable rates
- Sustained & expanding provision of services

# Potential Conflict in BDS Guiding Principles

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“Demand-side **incentives** to try BDS”  
(justifiable when market is weak)

**vs.**

“Subsidies on transactions are likely  
to be **distortionary**”

(preferable to subsidize product  
development, information, evaluation;  
especially to expand existing market)

# Potential Conflict in BDS

## Crux of the Matter

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- **Incentives** applied to transactions (whether on demand or supply side) **affect the price** and hence “distort the market”
- When market is weak (thin), there are few transactions:
  - **Market-creating effects** of incentives **may outweigh distortionary effects**
  - Distortionary potential grows with market

# Market May Be Weak Due to: Demand Side

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- Lack of **information** on what's available, lack of direct experience
- **Risk:**
  - Uncertainty about benefits of BDS, impact on revenues
  - Trained workers may leave [training has externalities, so demand tends to be low]
- Lack of **financing** inhibits getting experience [financial market imperfections spill over to demand for BDS]

# Market May Be Weak Due to: Supply Side

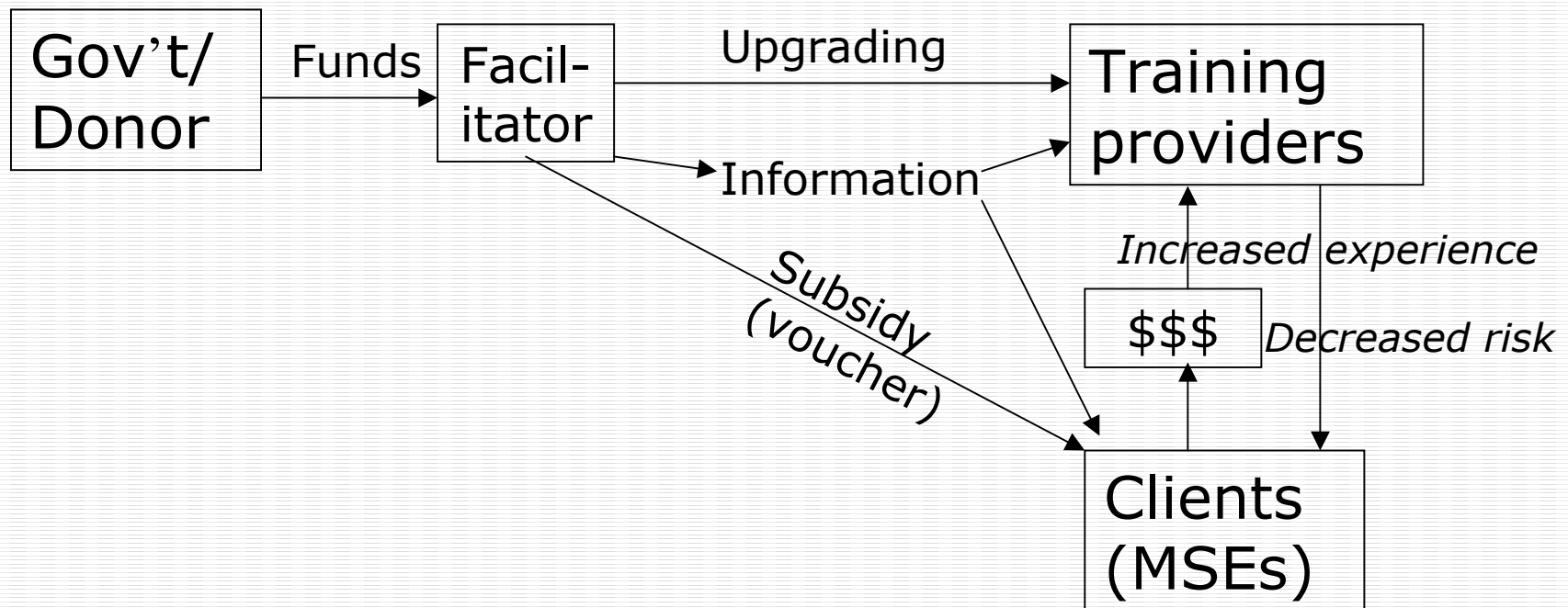
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- Lack of **information** on potential demand
- **Risk** of nonpayment, demand below break-even
- Lack of **financing** inhibits product development [financial market imperfections spill over to supply for BDS]\*

\*Voucher subsidies may help compensate for financial market imperfections.

# Facilitating Market Development

Facilitation of both demand and supply



# Market Development Benefits

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- Increased **information** on demand & supply
- **Risk** and uncertainty reduced; expectations & behavior changed
- Direct **financial** benefits to both firms & BDS providers (increased income to **finance** future demand and product development)
- **Externalities** of initial training/services (skills passed on by recipients to others)

# Market Development Costs

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## Direct:

- Time and cash costs of firm staff
- Operating costs of BDS provider
- Voucher subsidy

## Indirect:

- Program management
- Corruption to divert subsidies

## Additionality issues:

- Services that would have been purchased anyway
- Possible crowding out of non-participating service providers

# Net Benefit Depends on Long-term Market Impact

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- Flow of **future transactions** that would otherwise *not* have occurred represents largest externality
  - Depends on **long-term shifts in demand and supply** when subsidies removed
  - Have to assess increased willingness to pay for BDS and commitment of providers to continue
- Have to weigh against costs of subsidy and program administration

# Why Vouchers?

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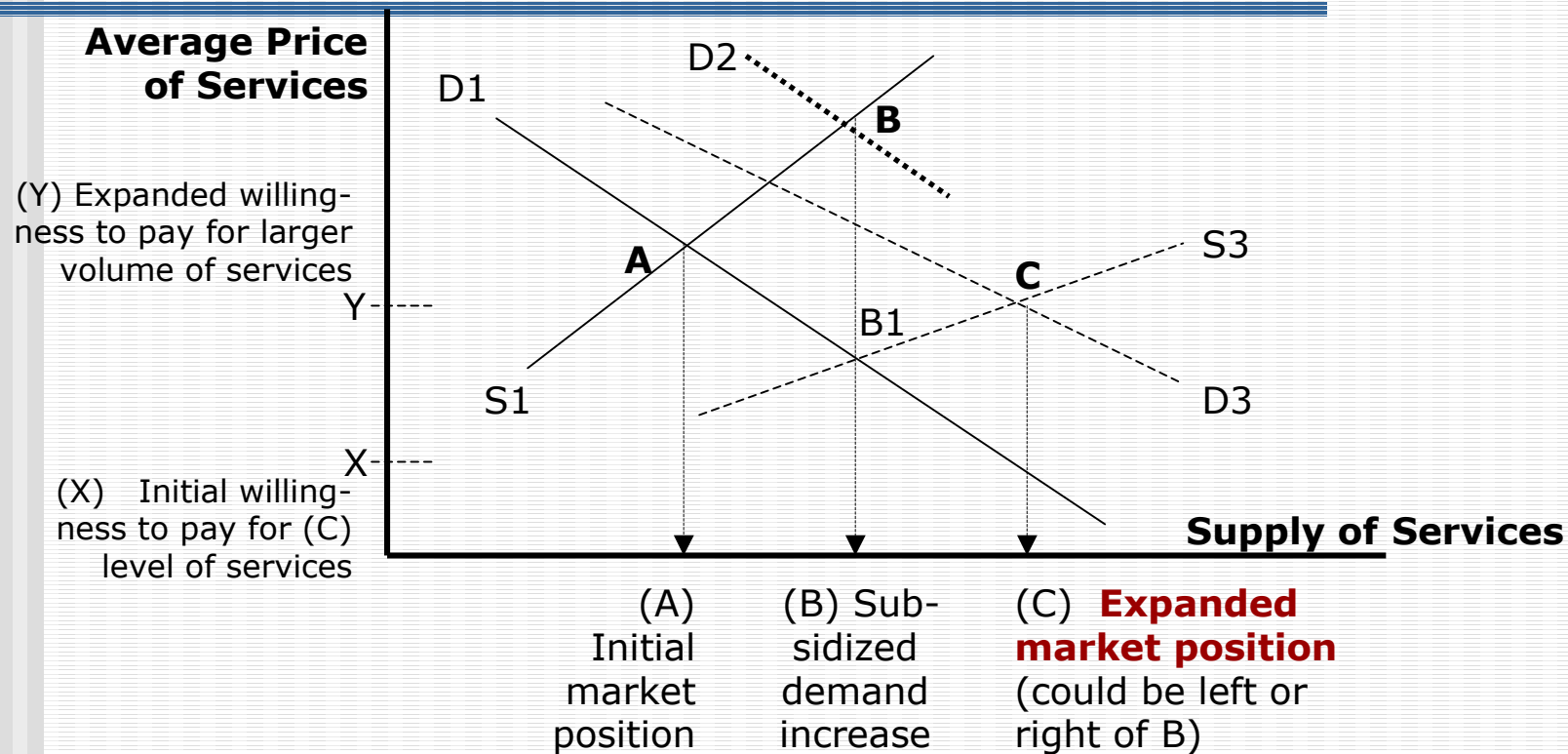
- **Demand-driven**
  - Trainee chooses and pays with voucher
  - Encourages private sector to respond
- Fills **information** gap
  - Directory of providers and services
- Incentives
  - Reduces cost to clients
  - **Reduces risks** and raises profits to providers
- **Transparent** way of delivering subsidy to jump-start market development
  - Subsidy is visible, on-budget

# Drawbacks of Vouchers

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- Complex, **costly** to set up  
[matching grants may be simpler for more limited, short-term objectives]
- Can **distort** true market by subsidizing the transactions  
[justifiable mainly to develop nascent market; or for other objectives such as basic skills training, income transfer]
- Subsidies can become addictive, politically **hard to eliminate**  
[make initial co-payments reasonably close to market prices, and steadily phase out subsidies]

# Subsidy-induced Shifts in Demand & Supply: Short-term and Long-term



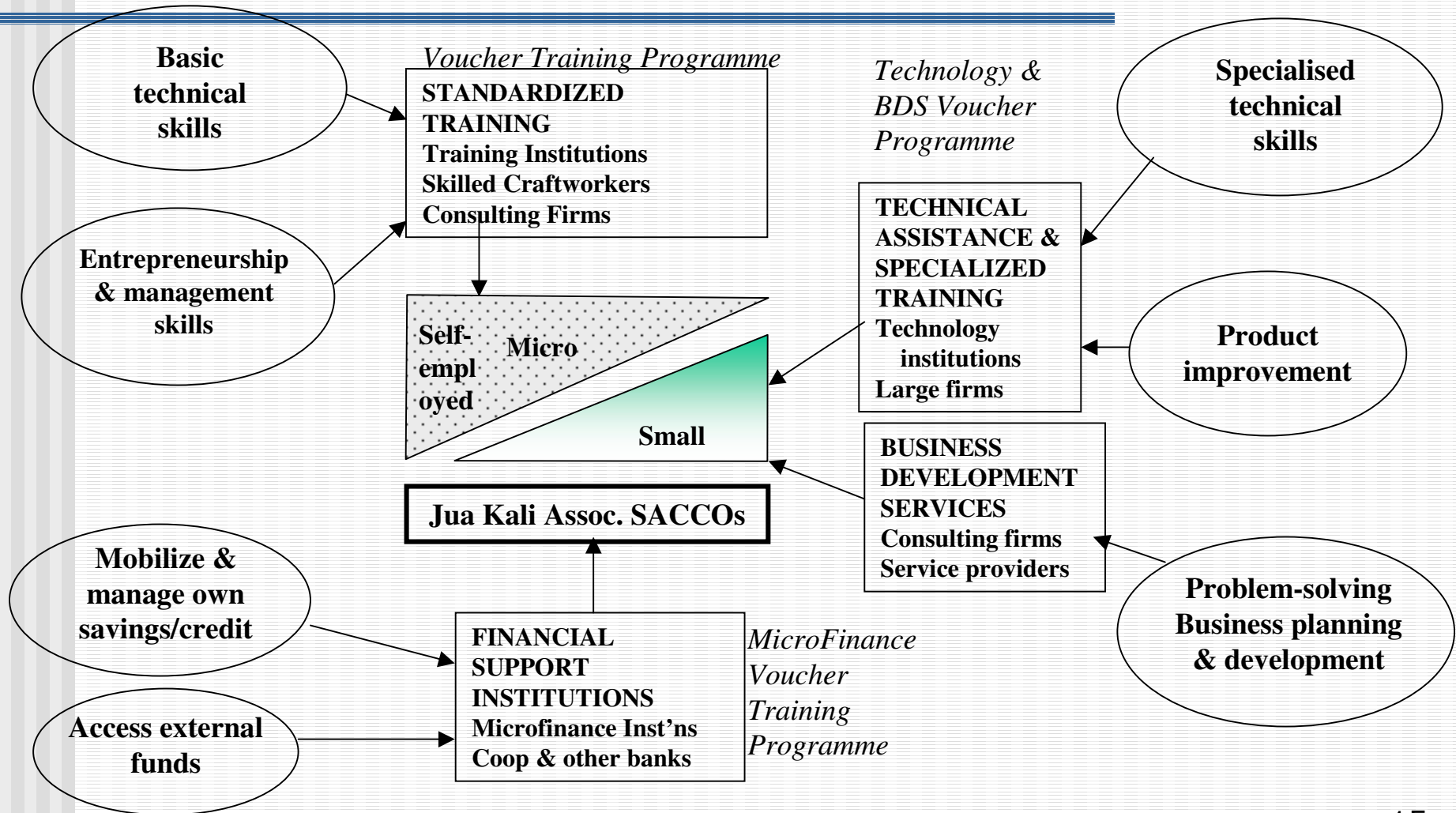
**Demand:** D1 Initial; D2 Short-term with subsidy; D3 Long-term shift, without subsidy  
**Supply:** S1 Initial; S3 Long-term response to demand increase      **BB1:** Subsidy

# Kenya Voucher Programme

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- Initially just for training delivery:
  - Upgrade technical & management skills in existing micro & small enterprises (MSEs)
  - Give women technical skills to start up
- Introduced upgrading for training providers (vouchers for training of trainers)
- Extended to other, more individualized BDS (consulting, tailored advanced training, technology, audits, financial management for SACCOs)

# Training, Technology/BDS, & Microfinance Vouchers: Micro & Small Market Segments



# Implemented Mainly through Private & Non-gov't Agencies

## Management

- Needs assessment
- Standards
- Prequalification/directories
- Voucher issuance/redemption
- Validation
- Evaluation

## Private allocation agencies

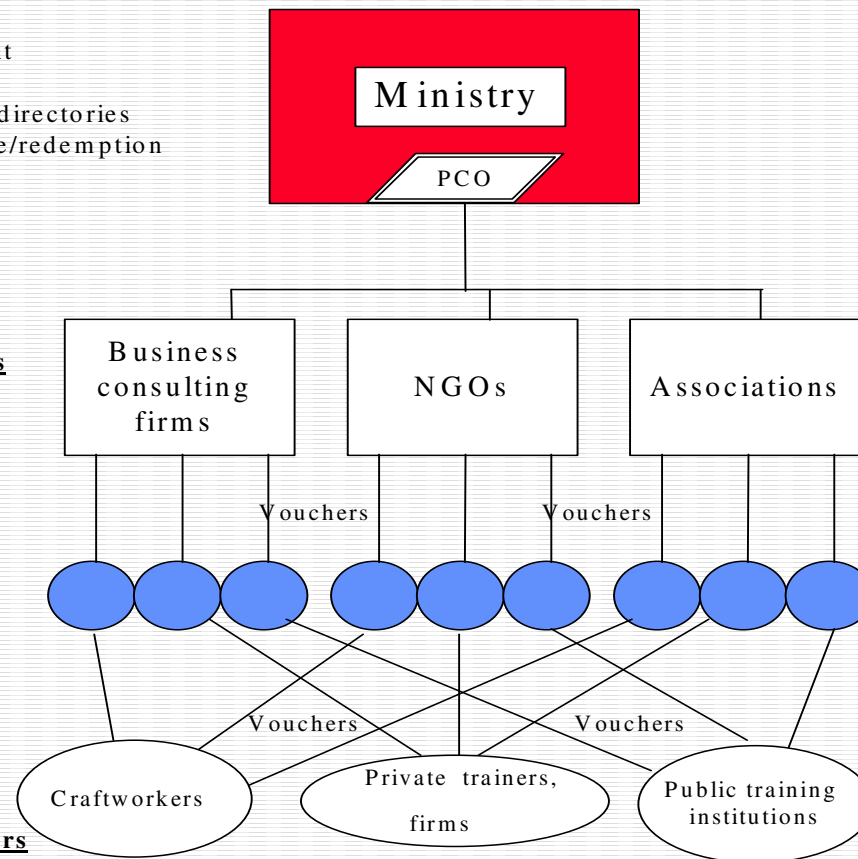
- Applications
- Sell vouchers

to



## Micro and small enterprises

## Training and business development service providers



# Kenya Voucher Programme: Performance 1997-2002

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- 39,118 training vouchers issued,  
34,778 trained (60% women) by 942 TPs
- BDS program: 1,275 clients
- US\$11.4 mil. disbursed
- Impaired by frequent changes of Ministry  
& “Permanent” Secretary (9 in 4 years)
- Retarded by slow, delayed flow of  
budgeted funds
  - Severe delays paying service providers
  - Trainers won't offer new courses (in  
programme) till paid for previous ones

## Indicators of Demonstrated Impact on Voucher Recipients (Tracer Studies)

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- 80% of trainees reported **business growth** (vs. 13% in control group)
- 61% added business **assets** (vs. 21% control group)
- Training providers (largely MSEs) raised **employment** by 78% (vs. 25%)
- 59% new **business start-up** rate (among clients without MSE)

# Indicators of Increased Demand During and After Programme

- Increased **willingness to pay** cash directly to providers for subsequent training (40% have done so)
  - Some segments (e.g., IT training) self-sustaining after vouchers ended
- Sample surveys: clients willing to pay ave. of 25-42% of original voucher value (vs. 10-20% at subsidized rate)
  - In some segments, gap still remains for sustainability at similar scale
- 74% of training **providers expect increased demand** for non-subsidized training

# Kenya Voucher Programme: Indicators of Increased Supply

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- **Investment** in space, materials, staff to serve MSE market (82% of sample survey)
- **Training adapted**: shorter, more focused courses
- Formation of BDS **provider association** to continue marketing courses
- Willing to **cut prices** by 40% from average voucher value

# Kenya Voucher Programme: Unanticipated Benefits

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- Skilled craftworkers in MSEs emerged as leading training providers (TPs):
  - Most-demanded by voucher clients
  - Adapted apprenticeship system to a more convenient format
  - Some have added training as a business line
- Jua Kali Associations empowered
  - Provide members with useful information & vouchers
  - Many have formed SACCOs to help address financing needs from own resources

# Kenya Voucher Programme: Net Private Benefits

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- To training beneficiaries:
  - Costs: Direct cash costs: \$0.7 m  
Opportunity costs (time spent): \$1.5
  - Benefits: Training valued at \$5.7 million
- Private benefits to training providers:
  - At least 40% of the \$5.7 m represents profits above variable costs (some of excess profits covered product development and risk, as well as financing costs of severe delays in payment)
  - Some sectors continue to offer at voucher co-payment rate (electronics, information technology)

# Kenya Voucher Programme: Public Costs

- Costs to Government: \$9.6 million
  - Project development & admin: \$4.0 m  
(high because of long delays in designing program and administrative arrangements)
  - Direct training costs: \$5.3 m  
(high because of high subsidy rate of 80-90%)
  - Government staff time: \$0.3 m
  - [World Bank staff, travel, consultants \$0.8 m]
- Estimated replication cost in Ghana for similar number of clients, 70% subsidy: \$4.8m
  - Adaptation & admin: \$0.8 m; Gov't \$0.2 m
  - Direct training cost: \$3.8 m [less if subsidy lower]

# Benefits of Expanded Market Are Hard to Estimate

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- Direct net profits from expanded market:
  - Annual flow of \$0.4 m if 40% of voucher recipients continue training at market rate and profits are 15%
  - Demonstration effect on others would increase demand further (but no basis for estimation)
- Impact on firms in expanded market:
  - Evidence indicates increases in profits, sales, employment and investment are likely
  - Hard to quantify

# Lessons Learned to Maximize Net Benefits

- Make **initial assessment** of extent of market failure, causes, ability to pay (by subsector)
- Keep **subsidy rate low**, decrease over time:
  - Make co-payment reasonably close to eventual market price
  - Extent of incentive needed may vary by subsector
- Intermediary associations to provide **information** can reap external benefits
- **Exit strategy** to avoid providers becoming oriented toward vouchers rather than developing better products for mass market

# Conclusions on Kenya Voucher Programme

- Positive **market creation effects** via shifts in long-term demand & supply
  - Entry of new BDS providers
  - New or adapted courses for MSEs
  - MSEs getting training for first time
  - Start-ups by trainees
- **Minimal initial distortion** in that this market was not being served (except via traditional apprenticeships); but **subsidy rate too high** for sustainability in most market segments
- Current decision more difficult: subsidize at greatly reduced rate, for gradual exit; or let new market find its own level?