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Honour loans: a comprehensive mechanism to foster development by supporting MSMEs

ICReport in the series on Innovative Finances

Executive Summary

The honour loans mechanism is a multidimensional one combining financing free of interest or requirement for securities or guarantees, with support to entrepreneurs. It has several benefits for entrepreneurs:

- Firstly, it finances their development, serving as seed funds and strengthening their project's equity. It can therefore create financial leverage with microcredit or banking loans.
- Secondly, it can help structure businesses because entrepreneurs must go through a selection process and can then benefit from post-financing technical assistance. An honour loan is also a form of recognition from local and knowledgeable professionals that builds trust in the project.
- Thirdly, it enhances networking inside their ecosystems and sectors, accelerating commercial access to the market.

Honour loans are flexible in terms of amount, maturity, and beneficiaries. They are a complement to the local financial ecosystem and thus contribute to filling the finance gap. They can be integrated into national long-term public policies to support MSMEs and adapted to regional programmes.

Honour loans have gradually expanded in North and West Africa. More recently, such mechanisms have been launched in English-speaking African countries (e.g., Kenya and Nigeria) and have been adopted as a public policy tool (e.g., Morocco and Tunisia).

The development of honour loans nevertheless faces challenges:

- The absence of an official framework governing its activities.
- A business model that is sustainable only if honour loans operators can finance their operating costs by showing its value and impact to authorities, the ecosystem, and donors in order to receive funding for the benefits created (i.e., monetising the development impacts).
- Scalability to achieve and prove.
- The lack of awareness about honour loans' multidimensional development mechanism.

Key Findings

- More than 80 operators active in 17 African countries have already committed nearly 11 million euros to financing more than 3,000 entrepreneurs and creating nearly 9,000 jobs.
- Economic survival rates are in the region of 80 to 85%.

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Content

Honour loans: a comprehensive mechanism to foster development by supporting MSMEs

Background

Together with the adoption of the Sustainable Development Goals (SDGs), a new perception of the role of the private sector in the economic and social development process arose with a focus on its contribution to job creation. In recent years, the international community and national authorities have intensified their approach towards supporting the private sector. However, businesses in Africa, the Caribbean and the Pacific, especially the smallest, informal, and newly created ones, still struggle to fund their growth. **In 57 out of the 79 ACP countries, IFC estimates the financing gap for the 45 million formal MSMEs[1] to amount to $ 356 billion every year. The demand for financing from the informal sector is estimated to amount to an additional $ 327 billion**[2]. Indeed, local and international financial actors perceive these businesses as high risk, they rarely meet bank loan prerequisites (registration, rigorous accounting, collateral requirements, capital funds, etc.) and are considered too small, risky and fragile by capital investment providers. Although since the 1980s, the development of microfinance has improved access to financial products and services, the small, short maturity and relatively high interest loans provided by this instrument do not meet most productive projects' financing needs, especially those with a long return-on-investment horizon.

Other instruments exist that can contribute to bridging this financing gap and **this paper aims at presenting one of them: Honour loans**, **an innovative mechanism that can support MSMEs at an early stage, while creating leverage towards conventional financing.** This paper is structured around 5 parts:

- The first part introduces the honour loans mechanism and explains how it is more than just a financial tool.
- The second part showcases several regions of the world where it has already been implemented.
- The third part explains how it can be used as an agile public policy instrument to foster MSME development.
- The fourth part presents the main challenges to support and implement "*honour loans*" mechanisms.
- The last one proposes key recommendations for policy makers.

A multi-dimensional mechanism

The *"Prêts d'Honneur*" were set up in France in the early 1980s to fight unemployment through business creation and facilitate access to finance for entrepreneurs Sometimes translated into English as "Interest-Free Loans", we preferred to use the terms "honour loans" in English and "Préstamo de Honor" in Spanish to emphasize the personal engagement it entails.

Honour loans are often reduced to their financial component. They are, however, a **multidimensional mechanism** that fosters territorial development[3] by supporting MSMEs via three levers:

- **Financing**: honour loans are loans granted to a person creating or managing a business. They bear no interest or charges which make them compatible with Islamic finance. They are granted without security or guarantee which make them accessible to all entrepreneurs. Most of the time, they include a deferral period which makes them consistent with projects that possess a long return on investment. As a loan to the business owner (and not to the business), they are conditioned on being used for the creation or expansion of the business; those funds are therefore considered as equity and improve the balance sheet for credit requests.
- **Support to entrepreneurs**: the mechanism includes complete pre- and post-financing technical assistance to reduce the risk of failure. The content and quality of this assistance may vary from one operator to another. The pre-financing technical assistance generally consists in structuring the project and its business plan. The post-financing technical assistance can integrate financial education, monitoring of the progress of activities, networking and/or mentoring.
- **Territorial animation**: honour loans can be used at a national, regional or local level. The project sourcing and selection usually includes entrepreneurs, authorities, and financiers. As they regularly meet and discuss, the mechanism creates a positive dynamic among stakeholders and generates a common ground for understanding. It facilitates networking and local integration for entrepreneurs who meet other entrepreneurs, local authorities, and local financial institution representatives during the selection process and the mentorship program. It also induces positive social pressure for the entrepreneur to reimburse the loan.

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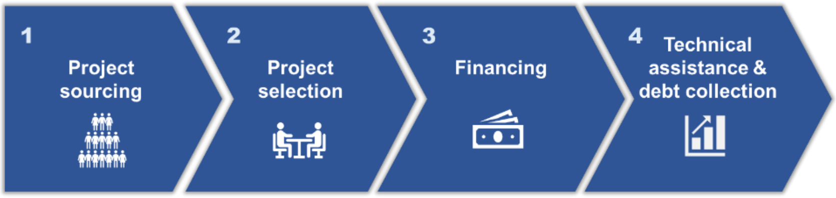
[1] MSME: micro-, small- and medium- sized enterprises

[2] IFC (2017) MSME finance gap, assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets – 57 ACP countries included in the perimeter. https://www.smefinanceforum.org/sites/default/files/Data%20Sites%20downloads/MSME%20Report.pdf

[3] For more information about Territorial development: [What is territorial development? - ECDPM]

The process of granting an honour loan generally follows these four steps:

Figure: ***Usual process for honour loans***



Thanks to such advantages, honour loans maximize the chance of success for the financed businesses and therefore their capacity to create jobs. According to the Overview of honour loans in Africa from the Honour Loans Observatory, the economic survival rates are estimated to be in the region of 80 to 85% in Africa.[4]

Generally, honour loans are implemented by private actors, which, most of the time, are associations (e.g., Initiative, Entreprendre), incubators (e.g., Etrilabs in Benin and Innohub in Ghana) or financial actors (e.g., Comoé Capital investment Fund in Ivory Coast and First City Monument Bank in Nigeria).

A large majority of them (which we will refer to as honour loans operators - HL operators) in ACP countries are financed by government public funding or international development institutions (AFD, World Bank, USAid, Hivos, QFF, etc.). Some initiatives have also received support from private funders such as Orange for the Afric'innov program, Zinox Group in Nigeria and several banks (Société Générale, BMCE, Bank of Kigali, etc.). The amount of the loan and its maturity can vary according to the projects' needs, the HL operator's policy and the country and region where they are located.

Case study: honour loans in Burkina Faso

Burkina Faso is home to a predominantly rural population (70% rural[5]), which is very young (17 years old on average) and has poor access to formal education (41% of the people over 15 years old are literate[6]). According to the national survey on employment and the informal sector (ENESI-2015), more than 95% of the working population (and more than 99% in rural areas) carry out their principal activity in the informal sector.

Honour loans first appeared in Burkina Faso within the framework of Franco-Burkinabe decentralized cooperation between the municipality of Chinon (Indre-et-Loire), the Touraine Chinonais Initiative platform and the urban municipality of Tenkodogo in 2010. As of today, there are 2 Honour Loans initiatives:

- **The national federation called "Initiative Burkina"[7] oversees a network of local associations** in Tenkodogo, Ouagadougou, Plateau Central and Bobo Dioulasso. **These platforms target micro-projects in different sectors depending on their local needs, such as livestock and agriculture for Bobo Dioulasso and agri-food processing for Ouagadougou**. They can also benefit from international programmes to target specific beneficiaries such as electricians (Schneider programmes) or women entrepreneurs (Occitane Foundation Programmes). They have strong regional roots and include local actors in their investment committee (local authorities, Chambers of Commerce, agricultural Chambers, etc.). Up to 2020, they had granted around 270 honour loans with an average amount of € 1,050 to small financially under-served projects, allowing them to create or maintain at least 500 jobs, formalise their business and get a banking account.
- **La Fabrique BF[8] is an incubator for social innovation projects based in Ouagadougou**. It is part of the Afric'innov program financed by AFD. It launched honour loans as a complement to its incubation offer in 2018 to facilitate access to funding for its incubated businesses. Its model is therefore based on a low number *of honour loans* offered with relatively high average amounts: in their first two years, 3 honour loans had been granted with an average amount of € 18,000.

It is interesting that in Burkina Faso, these mechanisms are operated by different kinds of operators and target different populations in different geographic areas. They all intervene at different stages in the funding continuum and in complementarity with the existing financing offer: for the businesses that do not yet have access to microfinance in the case of Initiative and for businesses in the Missing Middle for the case of La Fabrique. The reimbursement rate is also heterogeneous: according to the operators, it varies between 80% and 100%, reflecting different levels of risk taken and of maturity in their reimbursement follow-up processes. It must

[4] Cyril Rollinde, Ninon Duval and Bruno Casalan (2020), Panorama des prêts d'honneur en Afrique, Observatoire du prêt d'honneur (Prets-dhonneurs-VF-2.pdf (bondinnov.com))
[5] World Bank, World Development Indicators, 2018 data
[6] UNESCO-UIS, Burkina Faso | UNESCO UIS
[7] Le concept d'Initiative France pour l'entrepreneuriat se déploie au Burkina Faso (initiative-france.fr)
[8] La Fabrique, incubateur d'entreprises sociales ouest-africain (lafabrique-bf.com)

also be underlined that these HL operators show flexibility and readjust reimbursement calendars when needed, which is advantageous to entrepreneurs but decreases their capacity to offer new loans to other entrepreneurs.

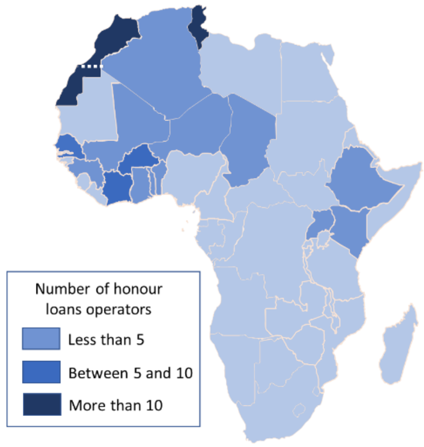
Increasing adoption in Africa

In recent years, solutions that combine business support and financing have emerged in African, Caribbean and Pacific countries. Honour loans is one of them. **According to the Honour Loans Observatory[9] in Africa and a study carried out by AFD in 2020, more than 80 operators covering 17 African countries have already committed nearly 11 million euros to finance more than 3,000 entrepreneurs and create nearly 9,000 jobs[10]**.

Historically, honour loans have gradually expanded in Africa through decentralised cooperation[11] as well as the internationalisation of "Initiative France" and "Réseau Entreprendre", the two main HL operators in France.

More recently, honour loans mechanisms have been launched in English-speaking African countries (e.g., Kenya and Nigeria) **and have been adopted as a public policy tool** (e.g., in Morocco and Tunisia).

Figure: Map of honour loans mechanisms in Africa



Source : Observatory of honour loans in Africa and a study carried out by AFD in 2020
The designations employed and the presentation of the material on this map do not imply the expression of any opinion whatsoever concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries

In **Nigeria**, the First City Monument Bank has set up the "SheVentues" programme which has so far assisted over 2,000 women-owned Small and Medium Enterprises (SMEs). SheVentures offers training and mentorship for Nigerian women entrepreneurs and a short-term interest-free loan (all charges/fees inclusive). The loan can range from € 1,000 to € 10,000 and no personal or real guarantee is requested.[12]

In **Morocco**, honour loans have been integrated into the Innov Invest Programme[13] for pre-seed financing for innovative startups. This programme is implemented by the Caisse Centrale de Garantie (CCG) with the financial support of the World Bank. The interest-free loans have a maximum amount of € 23,000 per project and a 2-year grace period. They require no personal guarantee and are granted by one of the 16 Business Development Service[14] suppliers certified by the CCG.

Honour loans are also part of the Intelaka Programme for startups and small businesses. This programme derives from a Royal Directive and is financed by the government, the banking sector and the Fonds Hassan II. The interest-free loans have a maximum amount of € 5,000 per promotor and a 2-year grace period. They require no personal guarantee.

Finally, the Social Development Agency (ADS) created the Réseau Maroc Mobadarate, which also distributes honour loans to support individual initiatives.

This nation-wide strategy highlights the complementarity and flexibility of honour loans's approaches to reach different kinds of businesses (startups, MSMEs or individual businesses). It is also an example of public-private cooperation to deploy this mechanism at a large scale and provide added value to different MSME ecosystems.

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[9] Cyril Rollinde, Ninon Duval and Bruno Casalan (2020), Panorama des prêts d'honneur en Afrique, Observatoire du prêt d'honneur (Prets-dhonneurs-VF-2.pdf (bondinnov.com))

[10] The characteristics of honour loans vary by operator and by country. For instance, amounts awarded are of € 1 M for I&P honour loans, compared to € 58,000 for the Bank of Kigali, and funds in Burkina Faso have awarded € 1.45 M, compared to € 160,000 in the Ivory Coast. Sharp differences also exit within countries: in the case of Tunisia, Réseau Entreprendre awards on average € 10,000 per entrepreneur, whereas Initiative Tunisia awards on average € 4,000 and the Labess Incubator € 20,000 per startup.

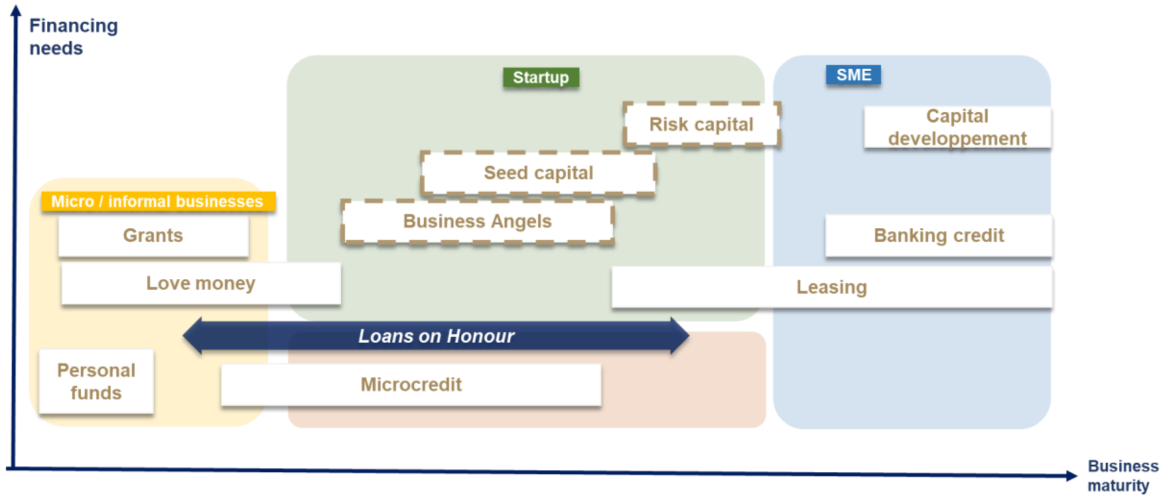
[11] Decentralized cooperation is a kind of development cooperation comprising all the relations of friendship, twinning or partnership established between the local authorities of a country and the authorities, equivalent or not, of other countries.

[12] For more information, see: SHEVENTURES | FCMB

[13] For more information, see: CCG | INNOV START

[14] BDS: Business Development Services

The concept of honour loans has also sprouted in the USA. For instance, the Honor Loan® Program includes an academic curriculum in entrepreneurship, a mentorship, and an interest-free loan with no collateral. In this variation of honour loans , interestingly, the loans carry no legal requirement for monetary repayment: students give a personal commitment by signing a pledge in which they promise based on the "honour system" to repay the Honor Loan® award if their entrepreneurial venture succeeds; or to volunteer their time to fundraise the amount borrowed.[15]



In the Caribbean and Pacific countries several initiatives with interest-free loans have been identified, but they mostly target university students and do not include mentorships.

An opportunity to fill finance gaps

For MSMEs, the funding continuum usually includes the following:

The most common finance gaps are:

- The **missing middle** which usually refers to entrepreneurs whose companies are too big for microfinance and informal investors, but that are too small or too risky for regular banks and private equity firms.
- What we call the **missing low** refers to entrepreneurs who do not have enough capital and/or collateral to start their activity and to access microfinance and other types of financing.

The honour loan mechanism can contribute to bridging both of these gaps. For example, in Burkina Faso it has been used by Initiative Burkina Faso as a financing tool for the informal sector in rural areas (missing low –€ 1,000 loan on average), by La Fabrique as a financial tool complementary to its existing incubation offers (€ 17,500 loan on average), and by Sinergi in preparation of a private equity investment (missing middle –€ 30,000 loan on average).

Limits to the finance gap concept: the concept of finance gap usually refers to existing lending to MSMEs by financial institutions compared to an estimation of the MSME potential demand for funding. Nevertheless, in many countries, entrepreneurs do not instinctively use the services provided by financial institutions both because the offers are not adapted to their needs (too expensive, too much collateral, etc.) and because they do not know or trust them. Instead, they find their own ways of financing their growth: tontine, informal debt, delaying payment to their suppliers, avoiding taxes, etc. **The honour loan mechanism can be especially interesting in those cases because it acts both on the supply side (interest-free, no personal guarantee or collateral requirements, etc) and on the demand side through mobilisation of the ecosystem and through financial education.**

The honour loan mechanism can also help entrepreneurs leverage additional funding:

- By lending to the entrepreneur instead of the company, it serves as seed capital and reinforces the project's equity and financial ratios. The business is therefore more attractive for potential lenders and investors.
- By providing pre- and post- financing technical support, it improves the business structure and its chances of success.

In France, the leverage effect is often significant: for 1 euro of an honour loan , banks grant on average 7.3 euros in additional funding via the Initiative France platforms and 13 euros in additional funding via the Réseau Entreprendre Network. In Africa, several cases of the leverage effect have been identified even if this benefit has not yet become systematic. Territorial animation, through the

[15] For more information, see: Honor Loan®

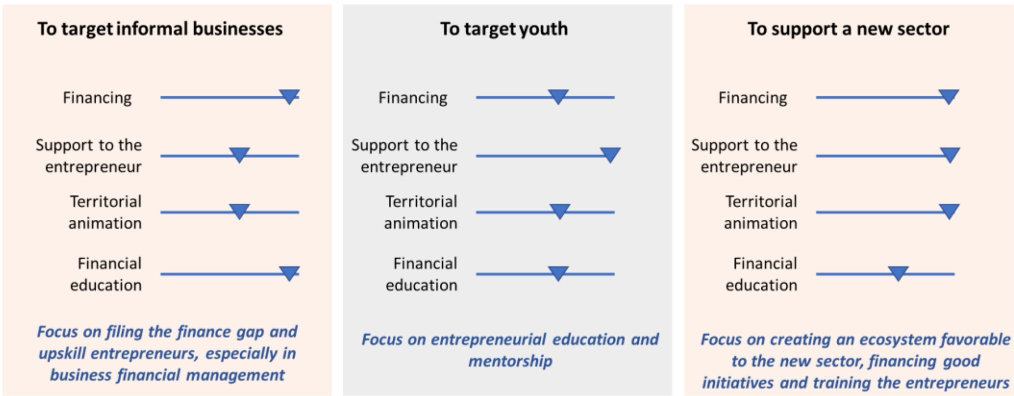
cooperation of ecosystem actors (local authorities, financial actors, business support operators, etc.), is key to increase that financial leverage effect and to create a participatory dynamic.

A flexible public policy instrument

As illustrated before, honour loans are already implemented in a diversity of countries (in Europe, North Africa, Sub-Saharan Africa, North America, etc.). They are also able to support access to finance for a variety of beneficiaries. They **can easily be adapted to specific targets in terms of population, size and maturity of businesses, geographical territories and priority sectors.** The mechanism is flexible enough to be adjusted to the needs of the targeted population.

It can be integrated into national long-term public policies to support MSMEs and customized into regional programmes.

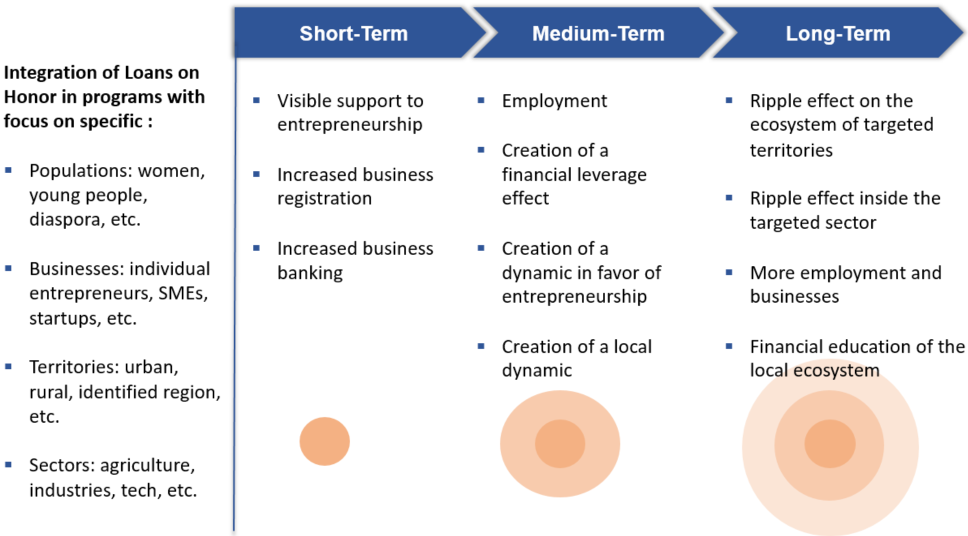
Figure: example of levers to answer to specific needs



In Tunisia, like in Morocco, honour loans have been integrated into a national strategy in favour of entrepreneurship and employment. For instance, honour loans are included in the funding instruments provided by Smart Capital, the organisation responsible for implementing Startup Tunisia, the national initiative which aims to make Tunisia a country of startups. This organisation receives support from the European Union, GIZ and the World Bank. Another example of this is the EnLien programme, which is implemented by Expertise France and the Tunisian Deposit and Consignment Fund (Caisse des Dépôts et Consignations tunisienne) with the financial support of the French Development Agency. Its objectives are to promote and support entrepreneurial initiatives (with a focus on social economy and women-led projects) and contribute to youth employment. It funds four components, out of which two consist of financial support to two HL operators: Entreprendre Tunisia and Initiative Tunisia. The two operators complement each other in terms of territorial coverage (coastal urban areas for Entreprendre / regions affected by high unemployment for Initiative). Additionally, thanks to strong integration of local authorities, Initiative Tunisia adapts its targets to its localisation, for example craftsmanship and the agricultural value chain in Kasserine; ecotourism, agriculture and breeding in Jendouba; financially excluded retail projects in Sidi Bouzid; and financially excluded agricultural projects in Medenine.

This agility of the mechanism and of the HL operators also allows for **quick reorientation of the action when circumstances require it.**

Figure: Impact of honour loans



The honour loan mechanism can deliver visible short-term results and enables a long-term impact.

The long-term impacts are conditioned to implementing national policies allowing the scale-up of the honour loans mechanism (see recommendations).

African, Caribbean and Pacific countries face development challenges. **While developing entrepreneurship and improving businesses' access to finance remains a long-term challenge for these countries, they still require access to agile mechanisms that can deliver impact on the short term while enabling long term policies. honour loans mechanisms can respond to such challenges and provide a real opportunity for emerging ecosystems.**

The four main challenges to developing honour loans

Despite increasing institutional support and financial backing from donors, the development of honour loans mechanisms is facing several challenges.

The regulatory challenge. **Each time an honour loan mechanism is launched for the first time in a country, the question of its submission to banking regulation arises** with several consequences:

- HL operators have to budget legal expenses to cover this legal risk.
- Their local and international donors can be reluctant to invest heavily until local authorities confirm that honour loans do not fall under banking regulation and supervision.

Nevertheless, since honour loans bear no interest or indirect charges and have already been recognized in the countries where the mechanism is developing, honour loans can *a priori* be excluded from banking and microfinance regulations. For example, in the West African Economic and Monetary Union (WAEMU), two laws regulate lending activities: the law on banking regulations (Article 6) and the Law and the decree regulating decentralised financial systems. In these regulations, the definition of a loan (or of a microcredit) is based on an essential notion which is that the loan is "for a fee".
It is therefore recommended that local authorities take a clear position in favour of not supervising honour loans in order to facilitate the launch of new operators and to attract funds.

In all cases, *honour loans* operators should respect best practices frameworks, including Anti-Money Laundering and the Financing of Terrorism (AMLFT), the protection of borrowers against over-indebtedness and the General Data Protection Regulation (GDPR). This can be challenging for some *HL* operators like associations or incubators since they are not always familiar with those rules nor equipped with the tools (processes and systems) to comply with them. There may also be a need to access national files of financial information on individuals and businesses and to foster relations with credit reference bureaus (when they exist) in order to facilitate the integration of these regulations into their process and practices.

The economic challenge. **The business model of** honour loans cannot generate profitability since it doesn't generate revenue (interest-free and no charges) and induces operating charges (administrative, support to entrepreneurs, territorial animation, debt, recovery, etc.). As a consequence, **the business model of HL operators is sustainable only if they can finance their operating costs by showing their value and impact to authorities, ecosystems and donors in order to receive funding for the benefits created (i.e., monetising the development impacts).** This constraint has two consequences:

- When starting, honour loans operators need time to mobilise their ecosystem, make themselves known and build efficient processes. Their operating budget needs to be almost completely subsidised upfront for the first few years.
- For the duration of the mechanism, honour loans operators have to prove their impacts to justify financing from donors. For example, they have to monitor the number of loans provided, jobs created, active businesses after 3 and 5 years, etc. **Their business model relies on the monetisation of the development impacts.**

This being said, the cost of honour loan mechanisms remains quite advantageous for two reasons:

- **The revolving effect on the honour loans fund**: when they get reimbursed, HL operators can lend those amounts back to new beneficiaries and therefore multiply their impacts. In order to optimise that effect, HL operators must be careful to keep the default rate of their loan portfolio as low as possible, which requires a good selection and risk assessment of beneficiaries and their business ideas as well as a robust follow-up process.
- **The strong involvement of the ecosystem and volunteering**: this reduces the overall cost of setting up and implementing the mechanisms.

The scale up challenge. Recent developments of Honour Loans in ACP countries have shown their capacity to provide support to entrepreneurship and financing to MSMEs on a small (local) scale and with very limited resources.

However, Honour Loan operators need **to scale up in order to achieve greater impact and better contribute to filling the finance gap**. To do so, honour loans mechanisms face several challenges:

- The lack of adequate funding to finance their growth, as funding is still limited and concentrated in the hands of international donors. Growth calls for new and sustainable financing models such as (i) creating incentives for local banks and microfinance institutions to refinance HL operators and (ii) a better monetization of HL impacts in terms of entrepreneurship capacity building and jobs creation.
- The need for **industrialisation and professionalisation of their selection, lending, technical assistance and payment recovery processes** in order to gain efficiency and to serve higher volumes of beneficiaries without negatively impacting their reimbursement rate and delays. Smart use of technology could play a major role in strengthening this.

National Entrepreneurship support programmes like in Morocco and Tunisia where the authorities use honour loans as a public policy tool may provide, in the near future, inputs on the scalability of that mechanism and its conditions to success in emerging countries.

The educational challenge. Honour loans are still poorly known at international level and are often reduced to their financial component. It is necessary to raise awareness both at local and institutional levels to facilitate their integration in the funding continuum and unlock their full potential to support development. This educational process takes time, which partly explains why the honour loan mechanism needs years before reaching its full potential in terms of volume of financed businesses.

Key recommendations for policy makers

Public institutions have a crucial role to play to support entrepreneurship, businesses and therefore employment. Promoting honour loans mechanisms is relevant because of **their flexibility and their ability to reconcile local and national considerations with short- and long-term perspectives. They can contribute to achieving goal 8 "*Decent work and economic growth*" of the Sustainable Development Goals (SDGs)** and, more specifically, the following targets:

- 8.3. Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.
- 8.10. Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all.

Our three key recommendations below aim at creating a virtuous circle where *honour loans* mechanisms support a growing number of businesses and create more and more jobs. This requires favourable conditions for HL operators to emerge and to reach economic sustainability.

Recommendation 1: Promote honour loans as a tool for national policies to support entrepreneurship and MSMEs

Since 2013, a significant number of countries have designed and adopted national entrepreneurship strategies and/or policy frameworks, often with the support of international organisations, for example Cameroon, Gambia, Ghana, Nigeria, the Dominican Republic, Tanzania, Zimbabwe, etc.[16]

In these national policies, should they target entrepreneurship, employment or MSMEs, honour loans can be integrated as one of the tools to facilitate access to finance for productive investments. According to UNCTAD, "*The effectiveness of entrepreneurship development strategies depends on how (i) the different elements of the strategy are integrated and (ii) how they are aligned with overall development strategies and (iii) with other national competitiveness and private sector development policies. Harmonisation with strategic processes pursued by different national ministries and national commissions are crucial to exploit synergies. (…) The third and most challenging task is alignment of the entrepreneurship strategy with the broader private sector development agenda*."[17]. The agility of honour loans and HL operators make them adaptable to a variety of beneficiaries. Consequently, they should be promoted as a tool to be considered by ministries and agencies promoting employment and MSMEs, in alignment with different policies and in addition to the existing financial supply.

[16] United Nations' General Assembly (2016) Entrepreneurship for Development, Report of the Secretary General, United Nations https://unctad.org/system/files/official-document/a71d210_en.pdf

[17] UNCTAD (2012) Entrepreneurship policy framework and implementation guidance, United Nations Entrepreneurship Policy Framework II and Implementation Guidance (unctad.org)

Recommendation 2: Facilitate and encourage collaboration between honour loans operators and financial actors

The integration of honour loans into national policies encourages co-financing from international donors, national authorities and the local ecosystem actors, especially local financial institutions.

Figure: potential beneficiaries of honour loans

By encouraging these synergies between honour loans operators and financial actors, public authorities contribute to improving access to finance for MSMEs beyond honour loans themselves. Honour loans allow for an important leverage effect with additional funds provided by partners from financial institutions. This leverage effect is also beneficial to the financial institutions because it allows them to serve customers who were excluded from the bank system. A good example of this is how Réseau Entreprendre Morocco has developed a partnership with Société Générale Morocco (€ 80,000) and BMCE bank (€ 100,000). Banks provide HL operators with an operating budget and a zero-interest credit line for the honour loan fund. This partnership also allows the banks to create a captive channel of SME clients with a reduced risk of failure (thanks to the technical assistance) while creating a strong leverage effect on current or future bank loans.

Recommendation 3: Promote best practices and reinforce existing honour loans operators for scaling-up

Once honour loans operators have emerged, they have to professionalise their practices and scale-up the volume of entrepreneurs and MSMEs they can assist. Authorities can support this process by:

- Encouraging the creation of a professional association which will promote best practices (governance, participants in the selection committee, content of technical assistance provided to entrepreneurs, etc.) and facilitate shared resources (contracts, AML-CFT[18] processes/ documentation, etc.).
- Plugging public agencies with honour loans mechanisms to provide them with a flow of potential candidates.
- Financing the reinforcement of technical capacities and tools.
- Financing HL operators (both their operations and their funds) by monetizing honour loan impacts. As seen earlier, the business model of honour loans operators relies on grants, volunteers and donations in kind (e.g., office spaces). To justify this funding, they have to monetise their development impacts, that is, to monitor the number of loans given out, jobs created, active businesses after 3 and 5 years, etc. This will allow both national and local authorities to analyse, for example, the cost per job created for vulnerable populations and compare it to other development ratios. It also shows financial actors the extent to which their partnership with HL operators minimises their risk (higher survival rate of businesses created).

[18] Anti-Money Laundering - Combating the Financing of Terrorism

Abbreviations

SDGs	Sustainable Development Goals
MSME	Micro-, small- and medium- sized enterprises
HL	Honour Loans
ACP	African, Caribbean and Pacific countries
IFC	International Finance Corporation
AML-CFT	Anti-Money Laundering and the Countering Financing of Terrorism
AFD	Agence Française de développement
QFF	Qatar Friendship Fund
CCG	Caisse Centrale de Garantie (Morocco)
WAEMU	West African Economic and Monetary Union
UNCTAD	United Nations Conference on Trade and Development

List of Figures

This paper was authored by Claire Neuschwander and Thameur Hemdane.

This paper is part of a series of ICReports on innovative financing solutions and financial regulations for startups, MSMES, social enterprises and inclusive businesses

Other ICReports in this series are:

- **ICReport:** Why public policies should facilitate the use of crowdfunding in ACP countries
- **ICReport:** National DFIs: Critical allies for climate action - Why and how can they be more involved in climate finance?
- **ICReport:** Social Enterprises and Inclusive Businesses across ACP countries: Variety and Access to Finance
- **ICReport:** Financing Variety: A challenge for impact investors

About the ICR facility

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The ICR Facility supports public and private stakeholders in African, Caribbean and Pacific countries to improve their investment climate and business environment via public-private dialogue. The Facility supports specific and targeted interventions at the economy-wide, sectoral, and value- chain levels with technical assistance for up to 90 days based on requests. It also works to strengthen national and subnational development financial institutions and compiles and shares good practices for improving the business environment and investment climate.

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