Microcredit: miracle or disaster?

The evidence gap on microfinance

- We know a lot about some aspects of microfinance
  - Number of clients
  - Repayment rates
  - Even information on clients
  - Demand for microfinance
- What is missing?
  - To what extent are clients and communities better off than they would have been in the absence of microfinance?
  - Are there ways to structure the product to preserve the good aspects, but bring down the price?
  - How beneficial is complementary training, etc.?

Measuring impact of microfinance is hard

- Standard ways
  - Compare those with and without microfinance in the same community
  - Compare communities with and without microfinance
- Those who sign up for microcredit are different from those who don't
- Communities where microfinance organizations go first are different from those that receive microfinance later
- Want to compare those who did sign up with someone who would have signed up if given the chance
- J-PAL has conducted about 80 randomized evaluations about microfinance

The traditional microcredit model

- Loans given to women
- Weekly repayments
- Group liability
- Weekly meetings

The results

- Loans given to men work also very well…
- Monthly collections reduce costs and did not increase default
- But clients are not good at pacing their work
  - Work harder just before collection time
  - With monthly collection, very high work load just before collection time
- Group lending seen as key to achieve low default rates
  - Randomized giving individual loans (to existing and new clients)
  - Same default rates
  - Is the promise of future loans what keeps default low?
- Weekly meetings improve solidarity, mutual help, if the group is homogeneous
- Training during the weekly meeting did not help

With Spandana, in India

The Spandana Program

- Traditional microcredit program
  - Group liability
  - Loans only to women
  - Weekly or monthly repayment
  - Starting loan is Rs. 10,000 ($250)
  - Interest rate: 24% per year
- Spandana was already a large MFI in South India, not previously operating in Hyderabad.
- Agreed to randomly phase in operations in Hyderabad

Evaluation design

- 104 neighborhoods: 52 treatment, 52 control
- 7,200 households surveyed
- Households with the following characteristics were surveyed (more likely to become microfinance clients):
  - At least one woman aged 18-55
  - Household has lived in the neighborhood at least 3 years
  - Not rated as someone Spandana wouldn't lend to
- The study measures impact for households with these characteristics; results for other types of households could be different

Average impact of microcredit

- Borrowing from MFI 27% in treatment, 19% in control
  - (89% of HH borrow from someone)
- New business creation increased by 1/3
  - 5,3 new businesses per 100 HHs in Control, 7 in Treatment
  - 1 in 5 additional MFI loans led to a new business that would not have been started otherwise
- Spending on durable goods increased by 1/5
  - Spending on durables used in a business more than doubled
- No overall impact on non-durable spending
  - Spending on "temptation goods" falls by 11%
- No impact on health, education, women's participation in HH decisions

Results by type of person

- Those with existing business (31% of sample)
  - Invest more in durables (Rs55/$1 more a month per capita)
  - No increase in profit, no change in current expenditures
- Those with a propensity to start a new businesses
  - 32% of sample
  - Cut down on "unnecessary" expenditures (by Rs168 per month per capita) and increase durables
  - A commitment device to help people save?
- Those with a low propensity to start business
  - 26% of sample
  - Increased non-durable spending (Rs 212 per month per capita) but no change for durable goods

One lesson :The poor own their enterprise

- In Peru, 69 % of the urban households who live with less than $2 per day, have a non-agricultural activity
- In Indonesia, in Pakistan and in Nicaragua, the percentage goes from 47% to 52 %
- Most of the rural poor own their own farm
- Additionally, many of them also own a non-agricultural enterprise: 7 % in Udaipur (India) and 36 % in Panama

- Within the OECD countries, 12% of the people own their enterprise…

But would prefer not to!

- The poor's businesses are very small: no employees, no assets, little specialization
- A huge difference between the poor and the middle class of developed countries:
  - not that the middle class tends to be more entrepreneurial
  - not that they invest more in their businesses
  - but when they don't own their business, they have a steady job!

Conclusion

- We need more rigorous evidence on the impact of microfinance in different places with different people
- Current evidence suggests microcredit is a useful financial tool
- It is not the solution to all the problems of poverty—maybe some claims have been exaggerated
- Improving the design of microfinance products is important—could help bring down the cost
- Microcredit is not for everyone
  - Be careful about claims on take-up
- Ongoing work on insurance and savings