The promise and the perils of microfinance

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14.73
The case for microfinance

- What are the elements of the case being built up in the microfinance movie?
  - That the poor have poor access to credit
  - That they are reliable borrowers
  - That group lending may help repayment
  - That microfinance can play an important part in lifting people out of poverty
  - That microfinance increases earnings, mainly through new business creation
  - That the increased earning, especially of women, leads to greater investment in human capital
  - That there is no conflict between the commercialization of microcredit and its social role.
Questions

- We have some understanding of why credit access is bad
- How is that consistent with the poor being reliable borrowers?
- What role can group-lending play?
Questions

- Does microcredit have to lift out of poverty to be useful?
- Can microcredit help people even if they don’t set up businesses?
- How would they repay their loan if they don’t invest?
Questions

- Why does the gender of the business owner matter?
- What could be a source of conflict between the social role of microcredit and its commercial side?
How should we interpret the evidence provided in the film?

- **What is the nature of the evidence?**
  - ?
  - ?

- **What is problematic about it?**
  - ?
  - ?

- **Why do we need an RCT?**
  - What else could we do?
  - What are potential problems with it?
Spandana’s Program

- Traditional microcredit program
  - Group liability
  - Weekly or monthly repayment
  - Starting loan is Rs. 10,000 (~$250)
  - Interest rate changed over the period but was around 12% per year (nondeclining balance; ~24% APR)
  - A few individual-liability loans were also given

- Spandana was already a large MFI in South India
- Not previously operating in Hyderabad.
- Agreed to randomly phase in operations in Hyderabad.
Endline sample

- 104 slums: 52 treatment, 52 control
- ~7,200 households total

- 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 slum at least 3 years
  - Not rated as someone Spandana wouldn’t lend to

- Measures impact for households with these characteristics
  - Results for other types of households could be different
Households at baseline

- Family of 5
- Monthly expenditure of ~Rs 5,000 (~$125)
- 98% of 7-11 year olds, 84% of 12-15 year olds in school
- Borrowing (from friends, moneylenders, etc.) is common (69% of households); average interest rate 3.85% per month
- Almost no MFI borrowing.
Entrepreneurship at baseline

- 31% of the households run at least one small business (vs. OECD average of 12%)
  - Of these, 9% of households run more than one business

- But these businesses had few...
  - Specialized skills (mostly general stores, tailors, fruit/vegetable vendors)
  - Employees:
    - Only 10% have any employees; none has more than 3
  - Assets
    - 20% use no productive assets whatsoever.

- Scale of businesses:
  - Sales: Rs 13,000 (~$325) per month
  - Profits: Rs 3,040 (~$75) per month
Why do you want a loan?

- repay old loan: 30%
- start business: 25%
- capital for existing household: 20%
- household durable: 15%
- ceremony: 10%
- education: 5%
- crisis: 0%
- health shock: 0%
(Control) households at endline

- The average household is a family of 6 (4.7 adu)
- Monthly expenditure of Rs 6,375 (~$160)
- 96% of the 7-11 year olds, and 85% of the 12-15 year olds in school
- Borrowing is very common (89% of households)
  - average interest rate ~2% per month
- 18.7% have an MFI loan
What should we expect

- **Assume:**
  - fixed cost of starting a business
  - variable cost of running it

- **When credit access increases:**
  - Those without an existing business decide
    - Some will start a business (richer, lower opportunity cost, those with better ideas)
      - Starting a business might involve cutting consumption
    - The rest will just finance consumption
  - Existing business owners don’t face a fixed cost: borrow to increase consumption and variable capital
    - Their profits should go up

- **Overall consumption may go up or down**
2. TAKE UP?

- **Spandana loan**
  - Treat: 18.6%
  - Control: 

- **Any MFI loan**
  - Treat: 26.9%
  - Control: 18.6%
Impact on borrowing

- **8.3** percentage points more MFI borrowers (Spandana or other) in treatment slums
  - **13.3** percentage points more Spandana borrowers

- Average of Rs. **1,260** of additional MFI borrowing per household in treatment slums (ITT estimate)

- These relatively low rates of MFI loan take-up are similar to those found in other J-PAL projects.
Impact on business

** For those starting a business:
Impact on expenditure

- **PCE**
  - 1,457
  - 1,419

- **Durable PCE**
  - 138
  - 116

- **Business durables**
  - 12.1
  - *5.3*

- **Temptation goods**
  - 74.9
  - *83.9*
Child welfare and women “empowerment”

- **Woman's spending decision:**
  - 93.0%
  - 93.0%

- **Kids in school:**
  - 1.39
  - 1.42

- **Health expenditure:**
  - 138
  - 140

- **Child's major illness:**
  - 24.0%
  - 24.1%
Predicting who is a likely entrepreneur

<table>
<thead>
<tr>
<th>Feature</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own land in Hyderabad</td>
<td>7.5%</td>
</tr>
<tr>
<td>Spouse is literate</td>
<td>5.0%</td>
</tr>
<tr>
<td>Number of prime age women</td>
<td>2.5%</td>
</tr>
<tr>
<td>Own land in village</td>
<td>0.0%</td>
</tr>
<tr>
<td>Spouse works for wage</td>
<td>*</td>
</tr>
</tbody>
</table>
Start a new business

- **New business propensity** (treat): 14.0%
- New business propensity (control): 9.2%
- **Any old business** (treat): 9.8%
- Any old business (control): 8.7%
- **No old business** (treat): 2.6%
- No old business (control): 5.3%
Durable expenditure

- New business propensity (treat): 192**
- New business propensity (control): 137
- Any old business (treat): 235**
- Any old business (control): 180
- No old business (treat): 80
- No old business (control): 116
Non durable expenditure

- New business propensity (treat): 1,329**
- New business propensity (control): 1,587
- Any old business (treat): 1,639
- Any old business (control): 1,574
- No old business (treat): 1,517**
- No old business (control): 1,305
Temptation goods

New business propensity (treat) 29 **
New business propensity (control) 69

Any old business (treat) 68
Any old business (control) 82

No old business (treat) 111***
No old business (control) 85
The recent crisis

- Last few years have seen massive entry of for-profits into the microfinance sectors
- IPO of Compartamos (interest rate 100% or more) yielded huge valuation
- Inspired by this SKS, India’s largest microfinance had an IPO as well (interest rate 24% or less)
  - Again raised lots of money
The new usury

- Mohd. Yunus criticized this trend: called them the new usurers
- Why did they go for an IPO?
- Is it reasonable to criticize them for doing so?
The crisis

- The SKS IPO could not have been worse timed.
- This showed that they were rich and profitable.
- But this was also when a number of debt suicides happened.
- Set off a political process leading to the promulgation of a new law which is close to shutting the sector down.
- Suddenly everyone is against microcredit: does the evidence warrant that?
14.73 The Challenge of World Poverty
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