Recent Developments In Microfinance

Robert Lensink

Myth 1: MF is about providing loans.

- Most attention to **credit.**
  - Credit: Addresses credit constraints
- However, microfinance is the provision of **diverse financial services** to low income individuals.
- Diversification represents an essential step in the development of microfinance.

From microcredit to microfinance

- MFIs collect savings: addresses inability to save informally
- MFIs provide insurance products: Addresses exposure to risk
-     Life insurance/ health insurance
- Importance of regulation
- MFIs start to look like normal commercial banks: Commercialization of microfinance

Should credit be combined with training?

- The initial microfinance movement promoted specialization
- Capitalism at its best: The poor can fend for themselves if provided with capital
- However, many microentrepreneurs are unproductive and lack best business practices
- Thus, in addition to credit, MFIs also provide various trainings, including financial literacy; entrepreneurial skills; gender

Myth 2: High repayment rates due to use of group lending with joint liability

- Group liability perceived by writers of economic analyses as the key innovation driving high repayment rates of microcredit programs.
- To become eligible for a loan, one should form or join a group. Mostly about 5 persons, same sex (mainly female) and not from your own household
- Each group member is liable for all loans. So if one group fellow does not repay, others have to do so.

Joint Liability: Theoretical discussion

- Advantage:
  - It solves informational asymmetries by shifting the burden from the lender to the clients. JL ensures that borrowers screen and monitor each other.

- But, strict adherence to joint liability rules can have unintended consequences:
  - Excessive pressure may increase dropouts and inhibit growth.
  - If a critical number of group members cannot repay, members that would otherwise repay find it in their interest not to: strategic default

Joint Liability: Practice

- Strict Joint liability not so important
  - Group pressure, but no joint liability
  - Centre meetings more important than groups. 5-7 groups meet weekly with other groups to form a Centre in the neighbourhood. A Bank worker manager attends weekly meetings

Joint Liability: Other instruments

- **dynamic incentives**. Many micro lenders use progressive lending: loan sizes increases in different stages
- **frequent repayment schedules.** Lenders often ask loans to be paid in small installments, starting soon after initial disbursement
- **required savings.** If somebody wants to borrow an obligatory deposit of about 2.5% of the loan value will be deducted from the loan and placed in a Personal Savings account

Joint Liability: Grameen

- Many economists refer to Grameen system as main example of joint liability
- Yet, even the Grameen Bank did never intended the group to guarantee the loans of its members. Fellow-members have agreed to help in times of repayment difficulties
- Under Grameen II, no member is ever required to pay for other(s)

Myths 3: MFIs are both making profits and are serving the poor.

- MFIs are said to offer a combination of financial returns and positive social impact. However:
  - since lending to the poor may be very costly, outreach and financial sustainability often conflicting
  - Unit transaction costs are higher for smaller loans. For this reason, achieving financial sustainability reduces outreach
  - Mission drift: focusing on wealthier clients

Double bottom line?

- Most MFIs are still heavily subsidized. There are only a few exceptions.

- In general there is a tradeoff between outreach and financial results of MFIs. Hence the double bottom line is a myth!

Myths 4: MF has a clear social impact

- Until recently, micro**credit** enormously popular:
- Magic bullet against poverty
- Lifts millions out of poverty
- Raises poor peoples income and consumption
- Helps poor cope with poverty

Popularity of microcredit even further increased due to

- 2005: Year of microcredit
- 2006: Muhammed Yunus wins nobel peace price

Popularity decreases

- Recently the practices of MFIs are subject to growing ethical concerns
- MFIs have been criticized for their lending practices that led to overindebted clients.
- The southern Indian state of Andhra Pradesh even plunged into a microcredit crisis after the microfinance-induced suicides in 2010.

Popularity decreases

- Former supporters of microcredit have become more critical. Microcredit may not be the panacea for reducing world-wide poverty after all.
- Some even go further: microcredit constitutes a main obstacle to sustainable development.

What does research show?

- Until recently, empirical testing of the impact of microcredit was extremely weak, and controversial.
- Fortunately, several rigorous impact analyses on the impact of microcredit are now available
- These studies provide surprisingly similar findings for different countries

Some examples

- Banerjee et al. (2009): Spandana : a large microlender in Hyderabad, India
- Spandana Program:
  - Group liability
  - Loans only to women
  - Weekly or monthly repayment
- Agreed to randomly phase in operations in Hyderabad.
- 104 neighborhoods: 52 treatment, 52 control

Spandana: results

- Take up of credit lower than expected
- Households in treatment area appear to more likely open a business compared to the control area
- And for households that already had a business, investments in durable goods increased substantially.

Compartamos Banco

- New study by Angelucci, Karlan and Zinman: Win Some Lose Some
- They study, using a RCT, impact of expansion of group lending by Compartamos

Compartamos: results

- Differential effects: some win some lose
- Not much impact on “wealth”indicators: consumption; assets and income does not increase on average. Evaluation period probably too short
- Much more positive impacts on qualitative indicators: borrowers are happier; more trusting and higher bargaining power.

Conclusion

- Microfinance is NOT only about credit: MFIs offer various financial and non-financial services to low income individuals
- Group lending with joint liability is becoming less popular
- The “double bottom”line is probably a myth
- Microcredit does not have a clear social impact

Conclusion

- Some win, some lose
- Uptake microcredit lower than expected
- On average, not much impact on wealth indicators: probably measurement period too short
- Much more positive effects on qualitative indicators: well-being; bargaining power; trust