Microfinance, entrepreneurship and the poor: some open questions

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Microfinance and the poor: What we know?

- Microfinance has proved to be an effective way into the lives of the poor.
- Large numbers of the poor clearly want microfinance
- Moreover MFIs have created a large cadre of non-poor who have a stake in the economic well-being of the poor.

Emerging evidence

- That it has a positive impact
- More business start-ups
- More business assets purchased
- Less wasteful expenditure
- Less hunger
- Less job losses etc.
- Higher income.
- Etc.

However

- No clear impact on the average person's consumption
- No clear impact on measures of empowerment.
- They might take time:
  - In the case of consumption because theory predicts that the short-run impact may be negative when there are non-convexities
  - Income might go down if investment takes time
  - And empowerment might wait till income goes up

But many puzzles emerge

Puzzle 1: Heterogeneity in behaviors: Why do some people take up and others do not? Hyderabad versus Guntur

- People just do not want start a business:
  - Why if average returns are high as the data seems to suggest?
    - May be there is a lot of heterogeneity:
- They have better uses for their time:
  - Other jobs, “homework”, demand for leisure, risk aversion (all suggesting limited potential for growth)
  - Does that mean that these high returns fall off very quickly?

More possible answers

- Loan size too small:
  - Fixed costs
  - Or a lack of an alternative vision for the future
- Lack of skills
  - What about skill training for participants?
  - Who should pay for the training
- Why not borrow to repay loans
  - Does everyone who has a high interest loan take up micro-credit
    - If not why not?

Puzzle 2

Lack of default: Why hasn't there been more default?

- Promises of future loans?
  - But why not default and hold on to your capital (Bulow-Rogoff)?
    - Awareness of self control problems: need a commitment device to manage to save?
      - Then we should expect default among the most productive borrowers: Do we see this?
      - Implications what will happen if better savings products

More answers

- Shame/pride:
  - But then why just micro-credit loans?
    - Importance of the "social" aspects of MFIs
- Harassment:
  - What is the difference with money-lenders?
    - Is it just lower transaction costs that make lower interest rates possible which legitimizes harassment?
    - What cannot money-lenders t lower transaction costs?
- Lack of understanding of the possibilities for default: implications for learning and financial literacy

Puzzle 3

Why hasn't competition been more damaging?

- People understand how much they can repay
  - But why repay if you can borrow from someone else?
    - Others will tell on you? But why? Why not have your whole group default and move to a different group?
  - Why do we believe that they are so good at figuring out how much to borrow given that they have all kinds of self-control problems and lack financial literacy
    - More likely some people are over-borrowing and somehow finding a way to repay.

Puzzle 4

What is the role of group lending? What is the extent of enforcement of group liability? What about groups which have group responsibility without group liability?

- Peer selection
  - Who do groups reject? Are they right people?
- Peer monitoring: do people really know enough about other people's businesses to be useful?
- Public shame? Why here and not elsewhere?
- Just transaction costs (including the transaction cost of arranging for money to deal with shortfalls)
  - Why not have one person bring the money? Is the risk of theft so large given that there is so little default? Other empathy building functions?

Puzzle 5

- What is it about women?
  - How do we think about gender effects in repayment?
  - “Women have adverse selection, men have moral hazard”
    - Do women have greater self-knowledge ?
    - Or men are over-optimistic ?
    - Or different sample selection?
  - How do we think of gender effects in rates of returns?

(Unresolved) Design issues

- Flexibility: Do we need weekly repayment? Should prepayment be allowed?
- Insurance, encouraging risk-taking: “equity” like contracts?
  - For MFI clients—how do you measure output?
  - For slightly bigger firms, can we have VC like contracts:
    - how sophisticated do you need to judge the performance of firms
- “Graduation”: Do loan officers know their clients?
- Credit scoring: Does it help or hurt?
  - Closely related to the previous question.
  - If learning about fixed investor types, then ex post competition hurts
  - If learning about past bad behavior is key then information is good
- Self-reliance: should MFI’s charge “market rates?”

Beyond microcredit

- Health/life insurance: often convenient for MFIs but not necessarily liked by borrowers
- Health/education communication
- Channel for increasing /improving investment in health/education/infrastructure
  - Conduit for vouchers/government funding
  - Regulator
  - Supplier
- Should we go beyond?
  - Mission drift?
  - Or self-discovery

Mission drift?

- Depends on our theory of what makes people join/repay
  - If people think of it primarily as just another source of credit
  - If people react to the 'social" aspect of MFIs
  - If people think of it an opportunity to "transform" their lives
- Under the two last theories the extra resources that you deliver are complements for the loan (and for subsidized loans)

Way beyond microcredit..

- Is entrepreneurship is the way forward for the poor?
- Or is it a way-station, an (inefficient) way of creating jobs for themselves because the market is not doing so
  - At least for the large majority of the borrowers
- For the long run:
  - is the most important contribution of microcredit to be the identification of potential large, successful business people who will employ the rest?
  - Or is to create a new form of people's capitalism?