



Microfinance: Impact and Design

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Why is it so difficult?

- Two sentences commonly heard:
 - Our clients are entrepreneurs. They are driven. They are doing everything they can to fight their way out of poverty
 - Look at our amazing impacts. Income and consumption for our clients have risen 20% since before they joined.
- What is wrong?





Why is it not obvious?

- Interest rates are high
- Financial literacy is low
- Other interventions perhaps less risky (health, education)





Key methodological shift...

- Randomized control trials
 - Common in health and education
 - Prescription drugs
 - Common for consumer finance businesses in developed countries (e.g., credit card offers)
- We are bringing these tools to microfinance in order to:
 - Measure impacts
 - Improve business decisions (product design, marketing, processes)





Two types of studies

1. Impact of credit (vs. no credit, savings vs. no savings, etc)
2. How to do microfinance better
 - Win-win for for-profits.
 - Teaching large banks how to go downscale





Market Failures

- Three basic questions for understanding credit markets and formulating policy:
 1. **Are there market failures, and can we specify more precisely what is happening (adverse selection, moral hazard, etc.)?**
 - Understanding markets
 - Understanding psychology of decision-making
 1. **What innovations can solve these market failures?**
 - Joint liability?
 - “Group versus individual liability” with Xavier Gine finds no difference
 - Credit bureaus?
 - work by deJanvry, McIntosh and Sadoulet in Guatemala
 - Dynamic incentives? Working, and in progress
 - Better screening? Credit scoring?
 - Can other non-credit interventions matter?
 - Teaching Entrepreneurship, with Martin Valdivia, GRADE-Peru
 2. **What is the welfare improvement from solving these market failures?**
 - Little data on this... earlier work from Bangladesh (Pitt & Khandker) and India (Burgess & Pande) say yes, but identification and micro-data always a severe challenge.
 - South Africa: randomized evaluation says yes, even at high interest rates!





Four Examples

- **Group/Individual Liability, Philippines and Bolivia**
 - Repayment rates remain high with individual liability
- **Credit with Education, Peru**
 - 18% higher revenue, 30% higher bad months
- **Credit Scoring, South Africa and Philippines**
 - Does it matter what the loan is for?
 - Consumer high-interest rate lending
 - 8% lower poverty headcount ratio, higher employment
- **Savings Product Design, Peru and the Philippines**
 - Reminder to save → higher savings





Punchlines

- Mistake #1
 - Wrong: Use evaluation to ask “how did we do?”
 - Right: Ask “what should we do next?”
- Mistake #2
 - Wrong: Think of an evaluation as a cost
 - Right: Think of an evaluation as an investment
- Mistake #3
 - Wrong: Fail to have a control group
 - Right: Use randomized evaluations in order to establish *causality*
- Mistake #4
 - Wrong: Evaluation merely to measure impact
 - Right: Evaluation to help improve business decisions

