



# Microfinance Panel: Demand **Impact** Psychology

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# A small and beautiful idea

## The poor are bankable

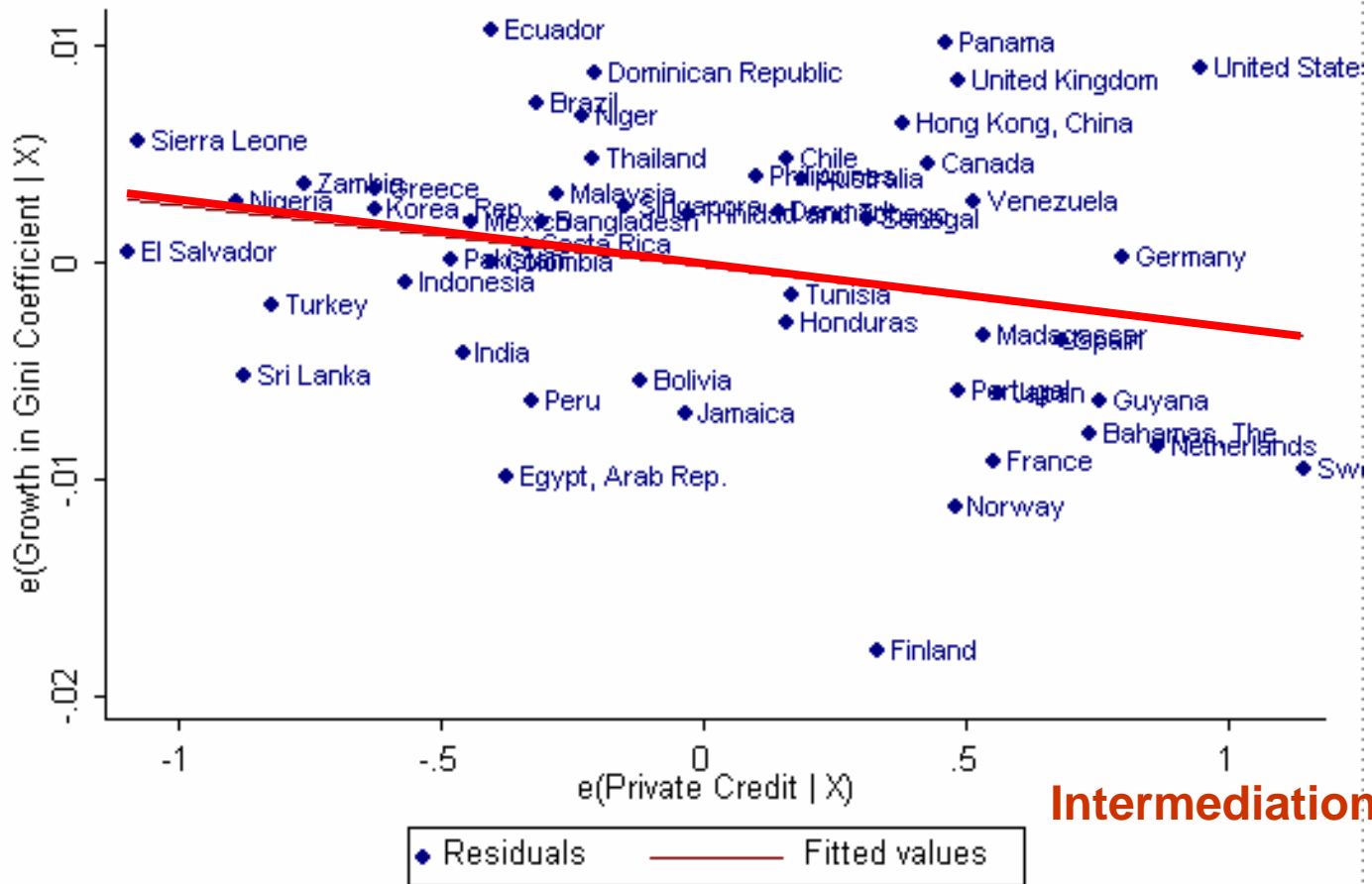
- Small, micro-sized loans are demanded
- Financial access can unleash their productive power
- A new way of poverty reduction
- A new way of thinking about banking



# Macro evidence: Financial development reduces Gini

Demirguc-Kunt and Levine

Change in inequality

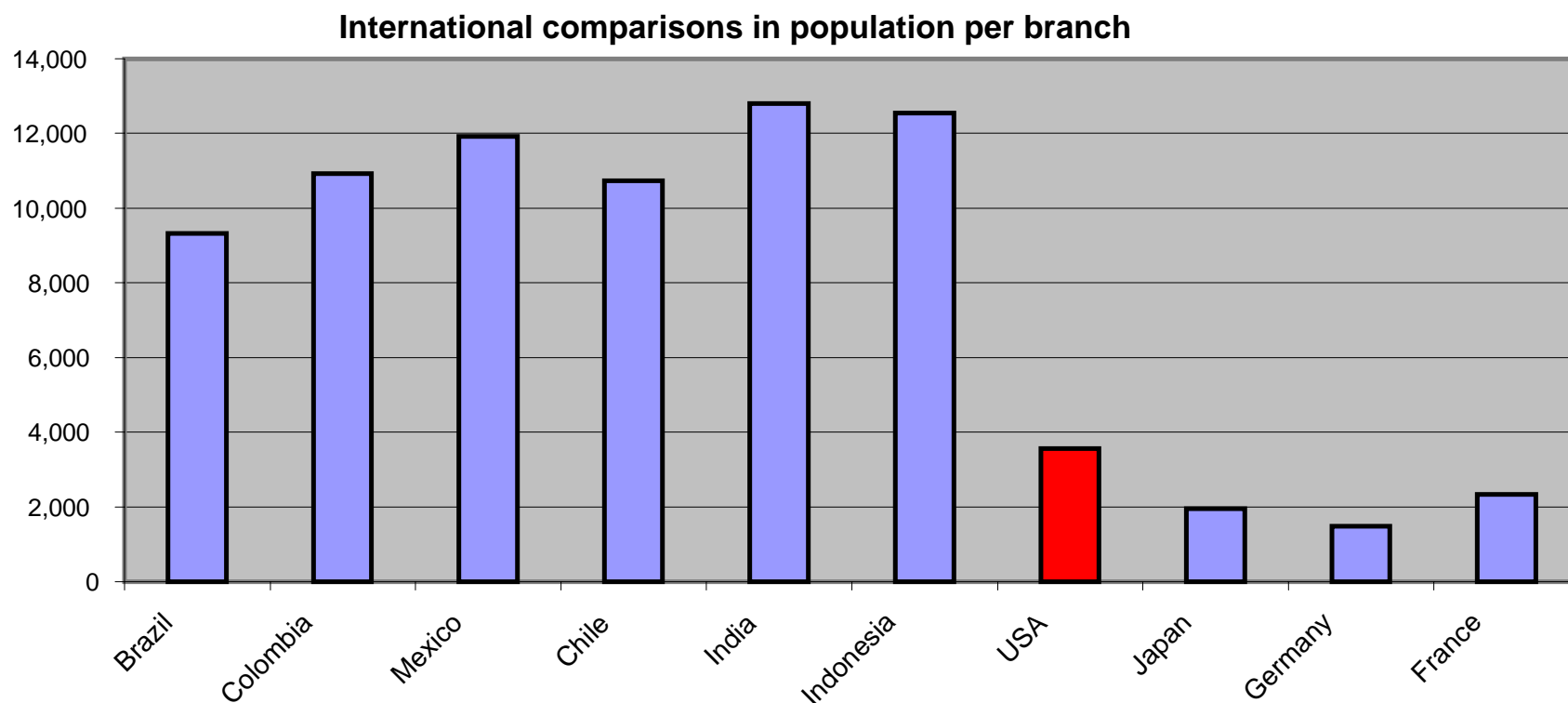


Intermediation



# Large gaps in financial access

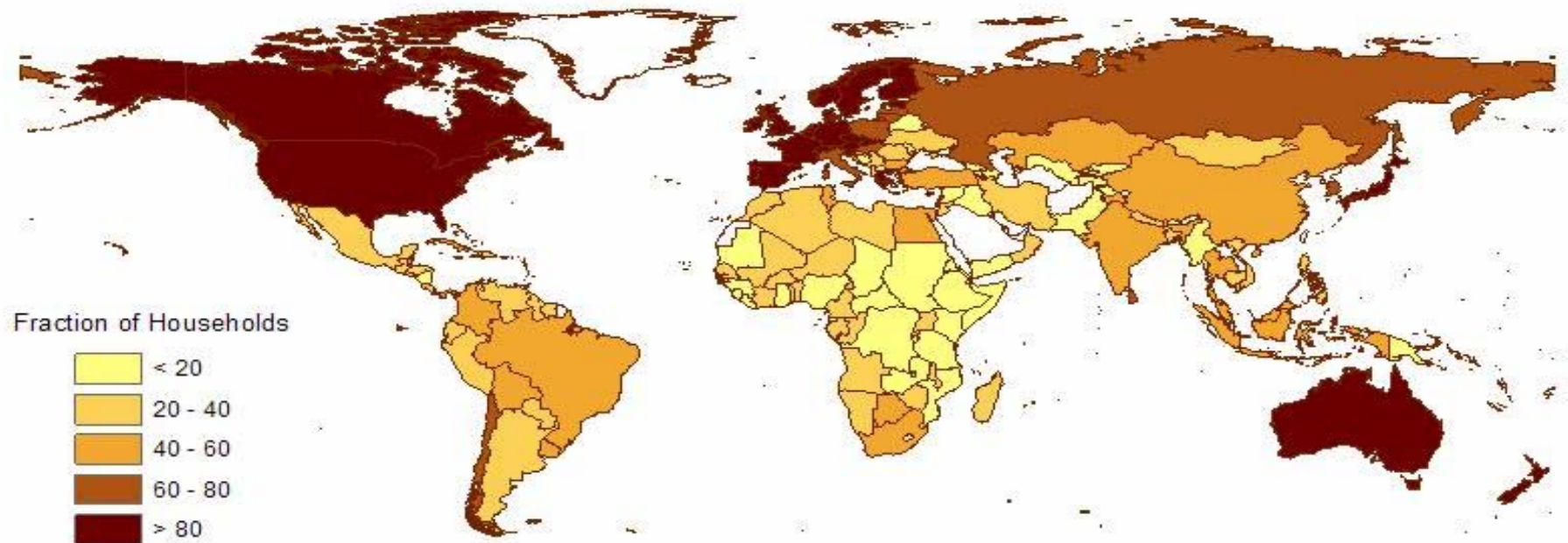
## People Per Bank Branch



Source: World Bank, Brazil, Access to Financial Services, 2003



# Fraction of Households with an Account in a Financial Institution



Source: *Finance for All?* World Bank, 2007



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# Microfinance continues to spread

End of year	Number of institutions reporting	Total number of clients reached (millions)	Number of “poorest” clients reported (millions)
1997	618	13.5	7.6
1998	925	20.9	12.2
1999	1,065	23.6	13.8
2000	1,567	30.7	19.3
2002	2,572	67.6	41.6
2006	3,316	133	92.9

2015		175?	
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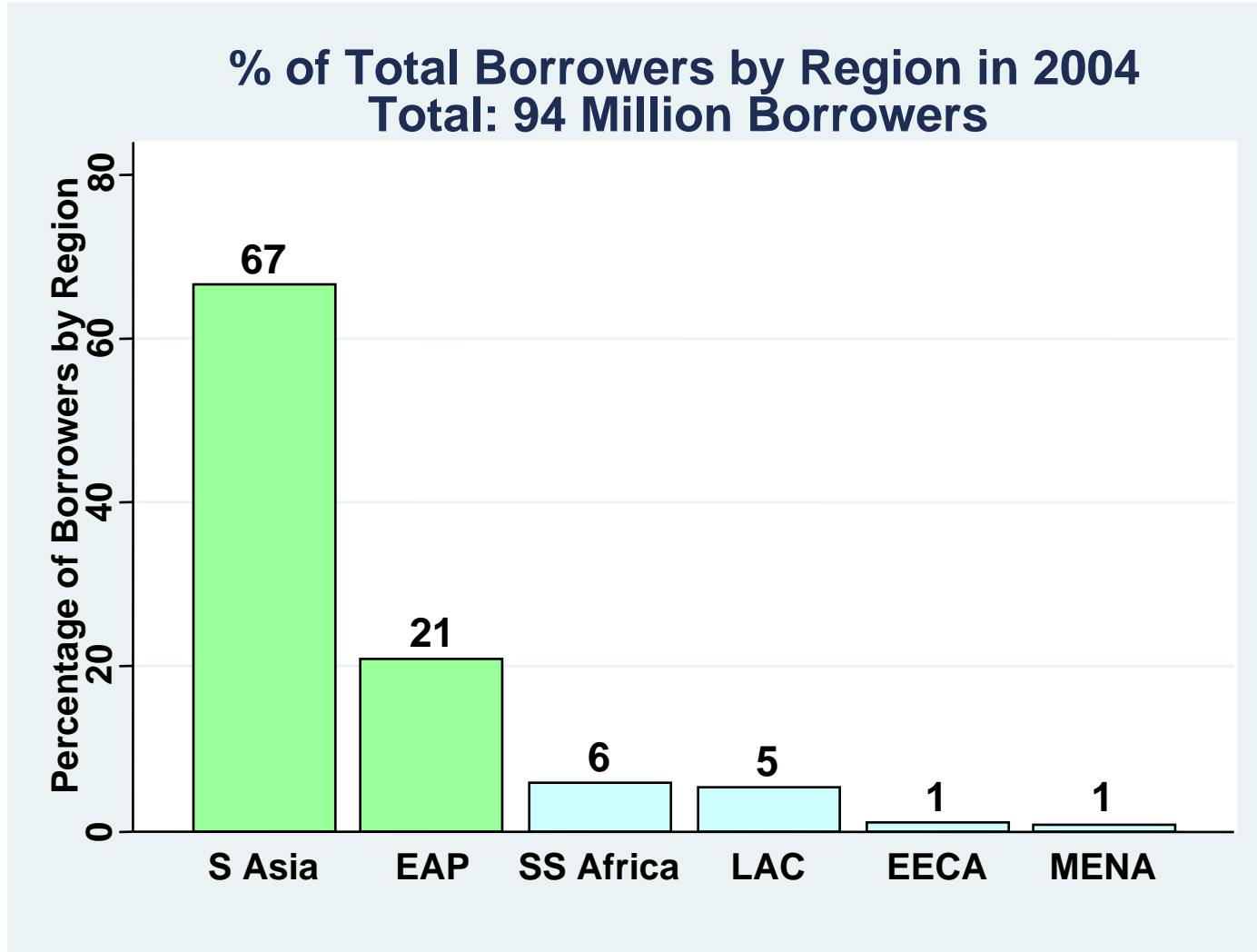
Source: Microcredit Summit Data

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# Microfinance at greatest scale in Asia

(Source: Gonzalez-Rosenberg 2006)





# The microfinance narrative

A compelling picture:

- Millions of poor and very poor households seek capital to build **small businesses**, especially women
- But their **lack of collateral** restricts access to loans
  
- Innovative “microbanks” meet the demand with more flexible collateral requirements
- “**Minimalist**” financial services can unleash untapped productive power
  
- Financial institutions can earn **profits**
- Access to finance can be **transformative**





# How to reach the next billion?

## 3 frontiers

1. Creating loan for general uses
2. Supporting livelihoods
3. Wisely deploying subsidies





# 1. Loan uses

Grameen Bank and others started by focusing on “microcredit for micro-business”

That strategy may be limiting when trying to serve the **poorest**, and **urban** residents.

Recent study of Hyderabad slums:

- Most households do not have a business
- Loans for non-business purposes are common



## Rural UP: Uses of last informal loan, by % of households

Invest in land, building	13.33	} 25%
Purchase in machinery/equipment	2.36	
Purchase livestock	5.83	
Purchase inputs	3.92	
Family emergency	28.76	} 59%
Illness of livestock animals	1.44	
Social expenditure	18.54	
Routine household expenditures	11.61	
Repay other loans/debt	1.12	
Others	13.08	

Source: Basu et al, Scaling up, 2004.



# Indonesia: Current Usage of Loans (%)

	<b>Below poverty line</b>	<b>Per capita income = 1-3 times poverty line</b>	<b>Per capita income &gt; 3 times poverty line</b>
<i>Loan use</i>			
Business	49	55	57
Household	35	43	45
Other	23	6	7
Observations	69	208	271



Source: Johnston, Morduch, The Unbanked: Evidence from Indonesia, 2007



# Frontier questions

Dangerous territory?  
Opportunity?

Since money is fungible, it's **not a question** of whether loans should be used for consumption. They are now. They will continue be. Question is how to best embrace the reality.

## Trade-off:

- Discomfort at lack of investment supporting loan
- Fear of debt cycles/repayment problems

## *versus*

- Gain to household to smooth consumption, address emergencies, make non-business investments.

Fact is: Many households with businesses want general purpose loans. Many households don't have businesses.





## 2. Livelihoods

Original vision: “Less is more”

Credit is the missing link

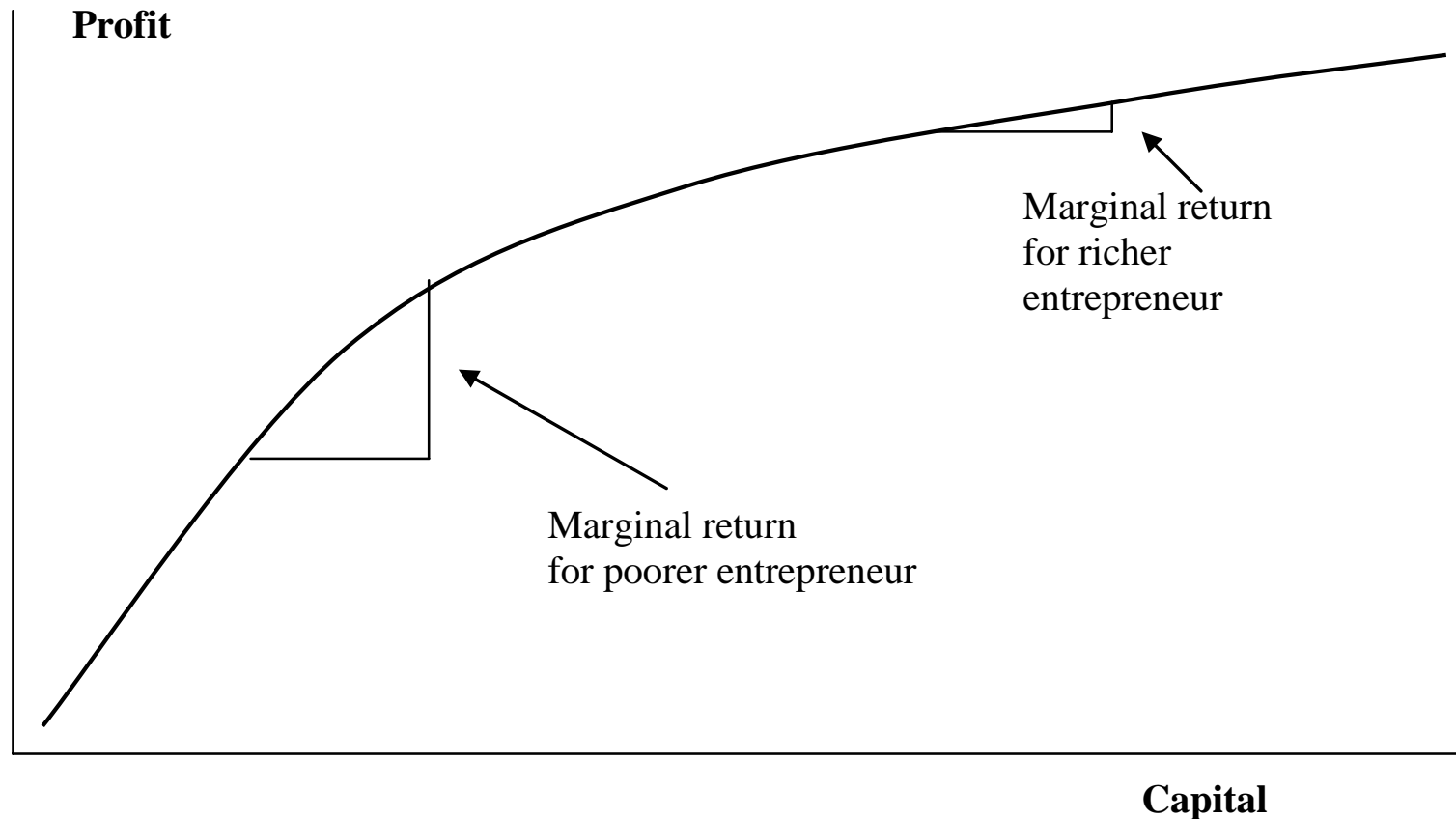
No training, no healthcare, no infrastructure

Donors favor simplicity, accountability

But is it enough? Is “more” more?



# Microfinance Logic



**Figure 1.1:** Marginal returns to capital with a concave production function. The poorer entrepreneur has a greater return on their next unit of capital and are willing to pay higher interest rates than the richer entrepreneur.



# Returns to Scale

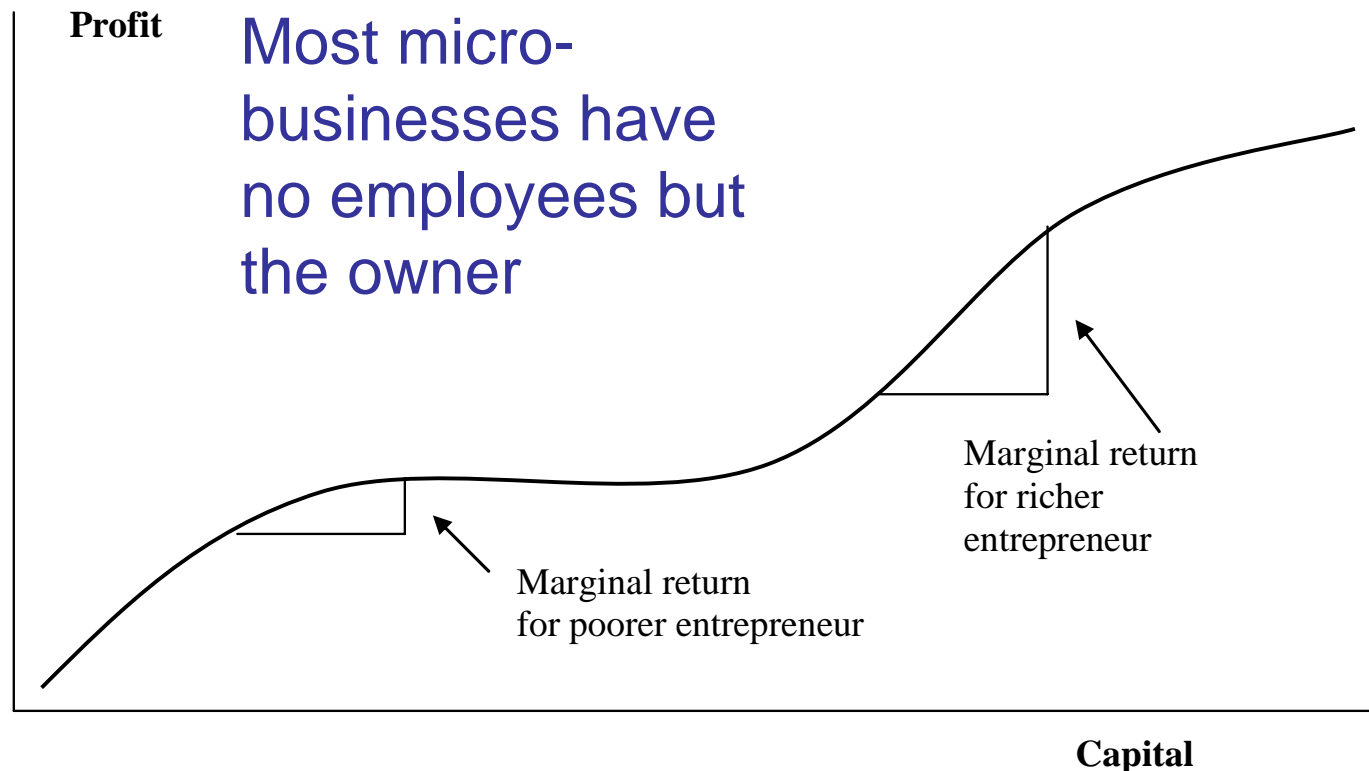
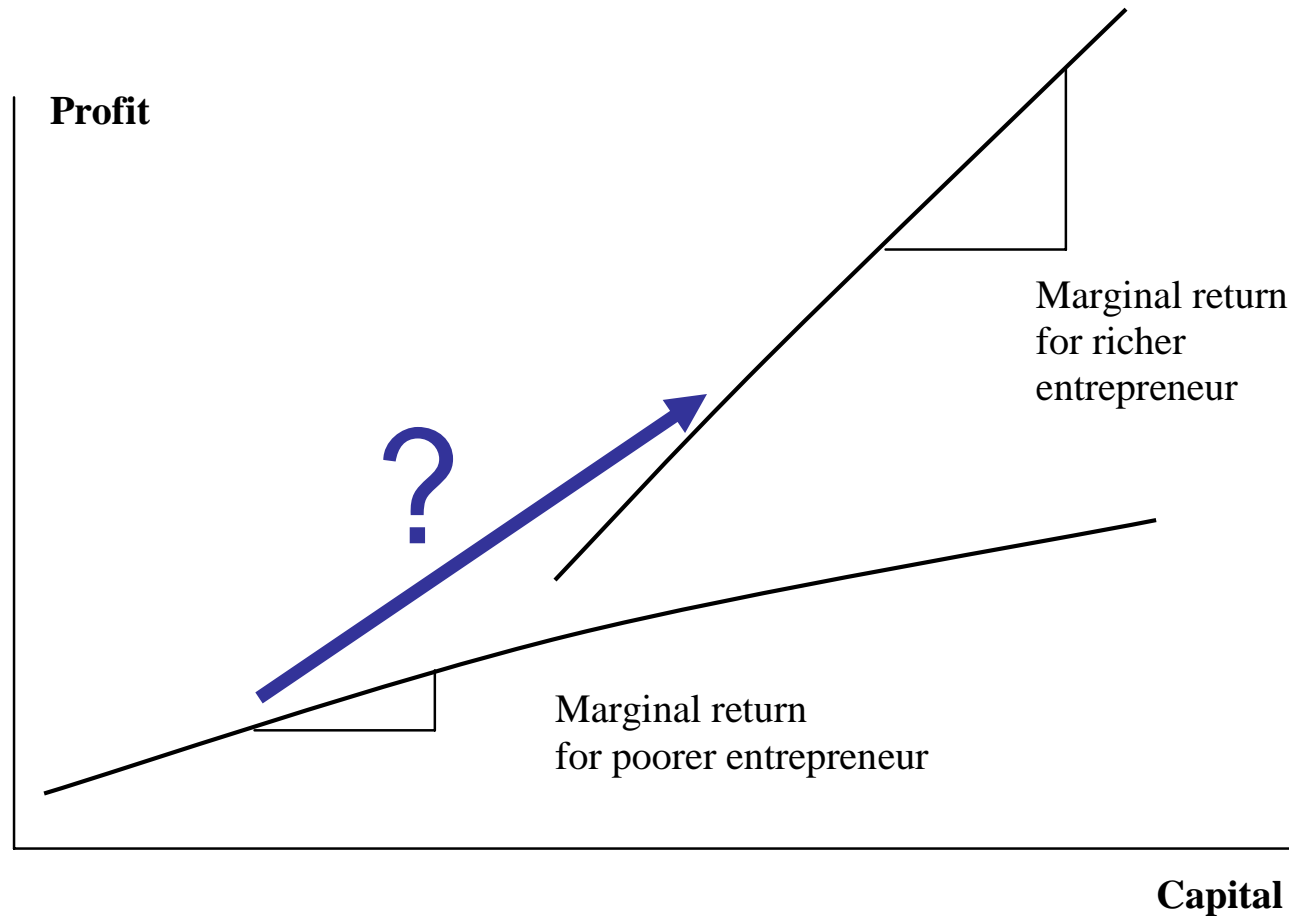


Figure 1.4: Marginal returns to capital with a production function that allows for scale economies (while everything else is the same). As in Figure 1.3, poorer entrepreneurs have lower marginal returns despite having less capital.



# Scarce Other Inputs



**Peru:**  
Adding  
business  
training

**S. Asia:**  
adding  
marketing

**“Ultra-  
poverty”  
Programs**

**Figure 1.3: Marginal returns to capital for entrepreneurs with differing complementary inputs. Poorer entrepreneurs have lower marginal returns despite having less capital.**





## 3. Profit and commercialization

For MFIs, earning profits is a way to expand:

- Through retained earnings
- Through attracting private, commercial capital.

But profitability by itself is not adequate to attract private investment:

- Investment returns must be competitive
- Perceived riskiness of underlying assets

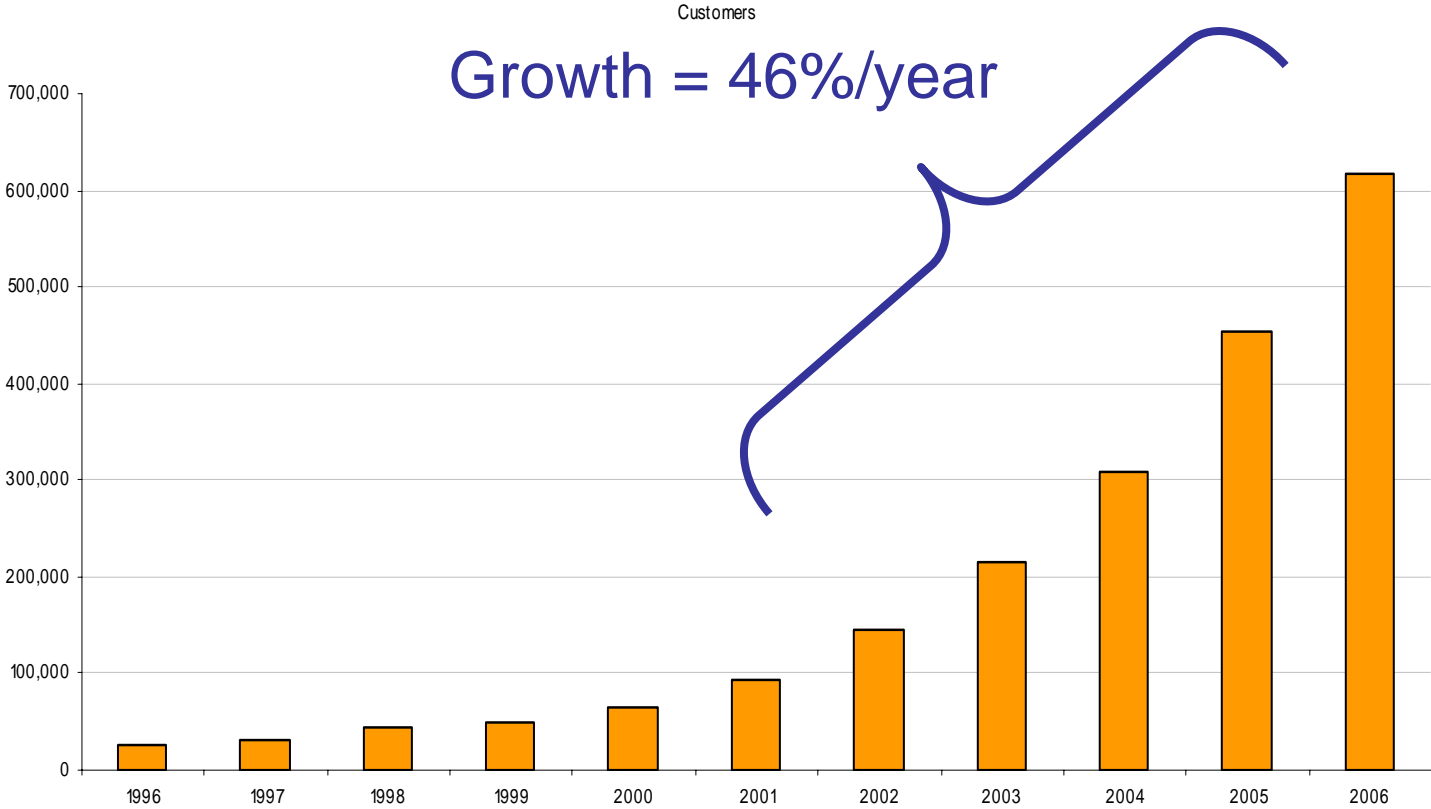
Two big frontier questions

- Commercialization and mission drift?
- Role for “social investment”/subsidy?





# Growth of Compartamos





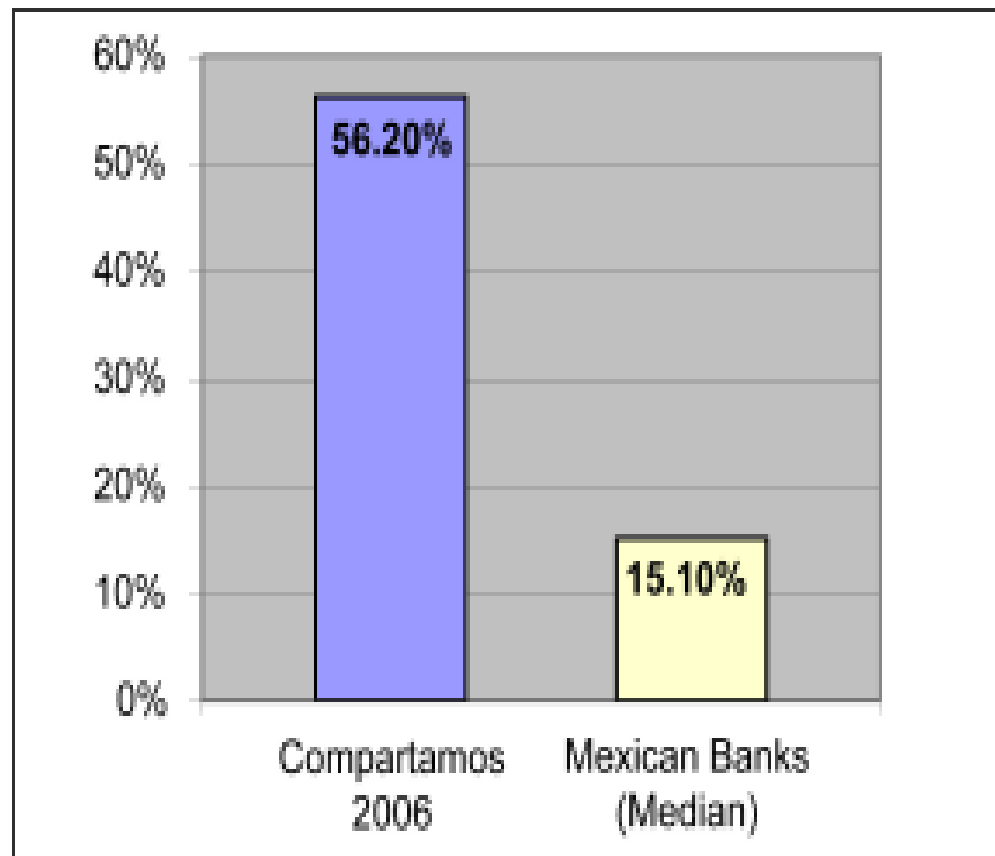
“Compartamos may not be the biggest bank in Mexico, but it could be the most important.”

*The Economist*, November 2005



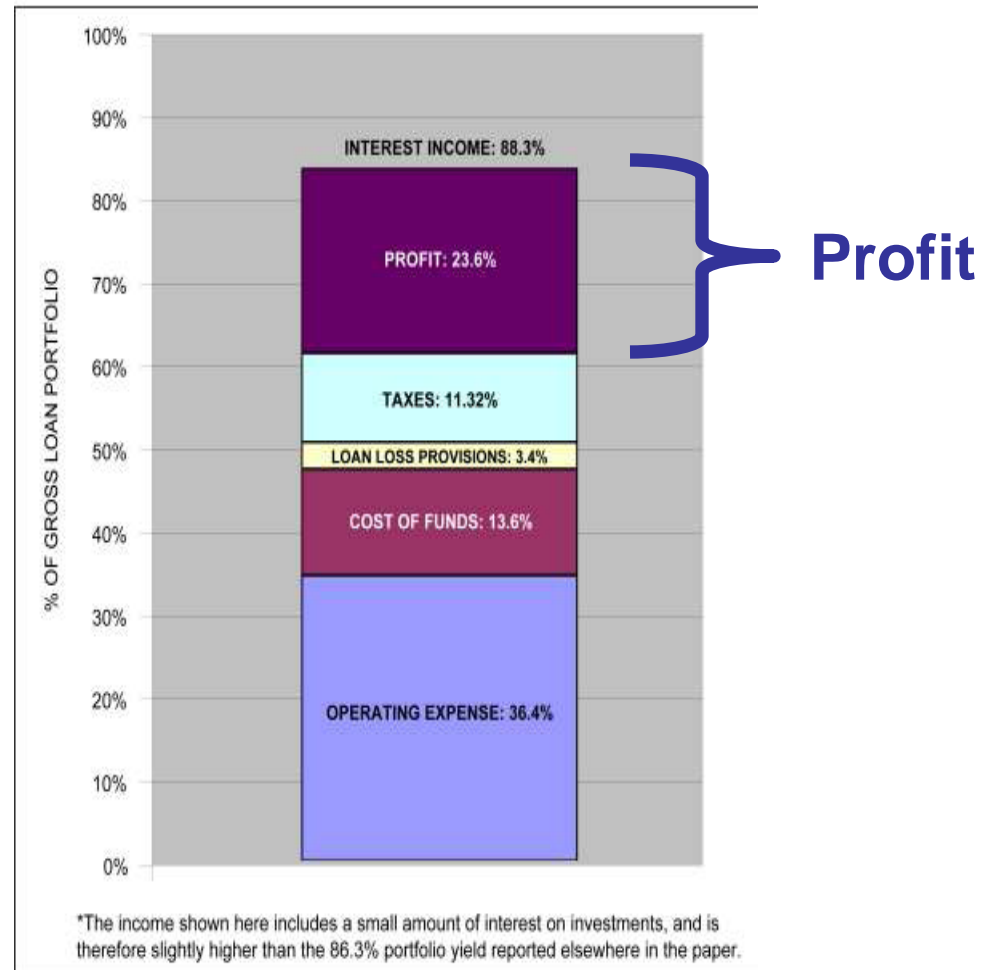
# Compartamos vs. Others

Return on Average Equity:  
Compartamos vs. Mexican Banks



# High interest rates

Application of Compartamos Interest Income, 2005





# Specialized MFI investment funds

About 45-50 last year. Only one is fully commercial.

Over 80% of funding is in hard currency.

Most of this money goes to the same 114 regulated MFIs.

- 70% of funding goes to the 114
- 85% of private equity

But there are thousands of MFIs struggling to serve their communities.





# Frontier questions

- Potential gain in scale, sustainability

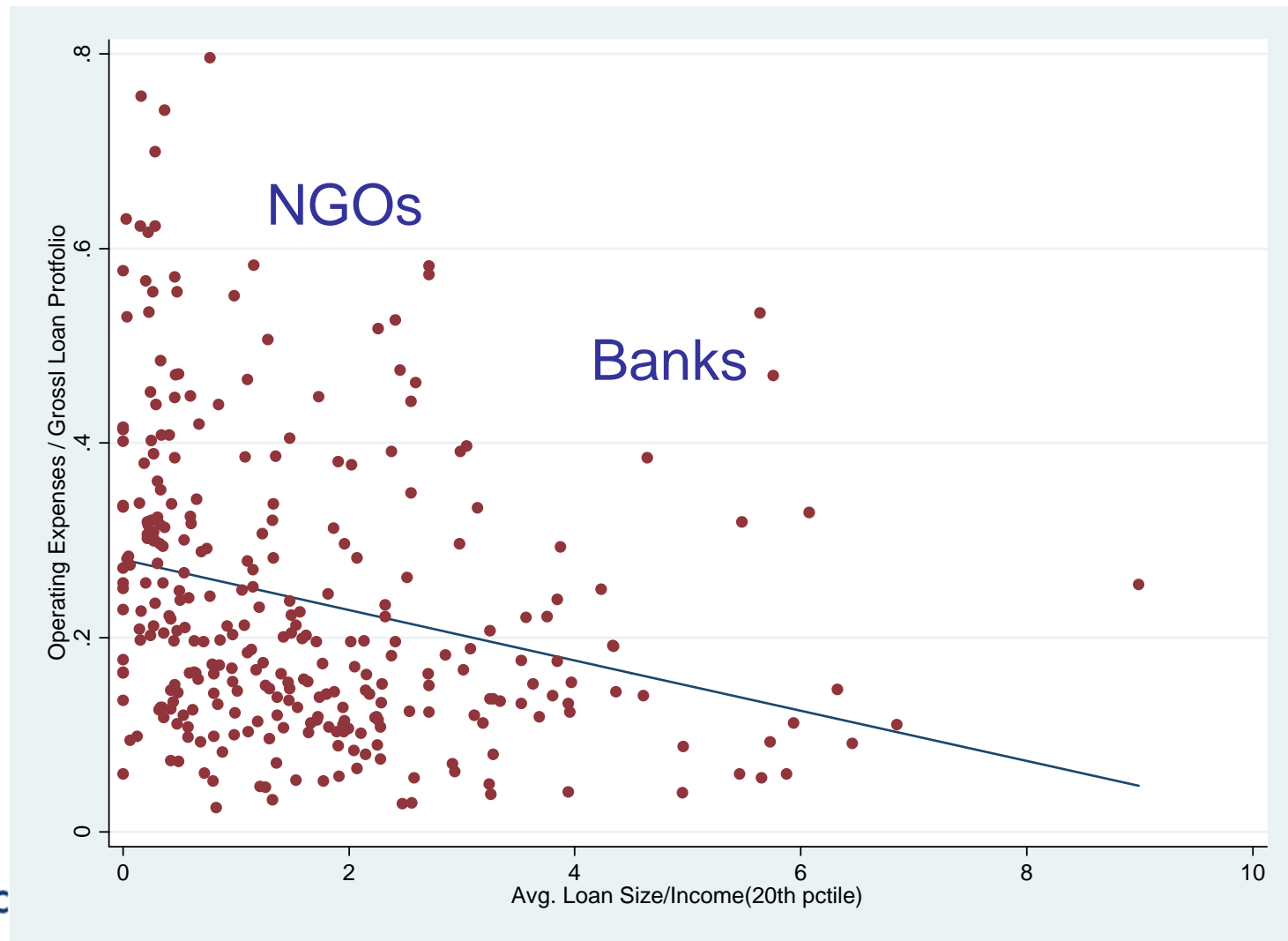
## *Versus*

- Risk of mission drift with commercialization
  - Pressure to increase prices
  - And/or pressure to move to customers able to take large loans



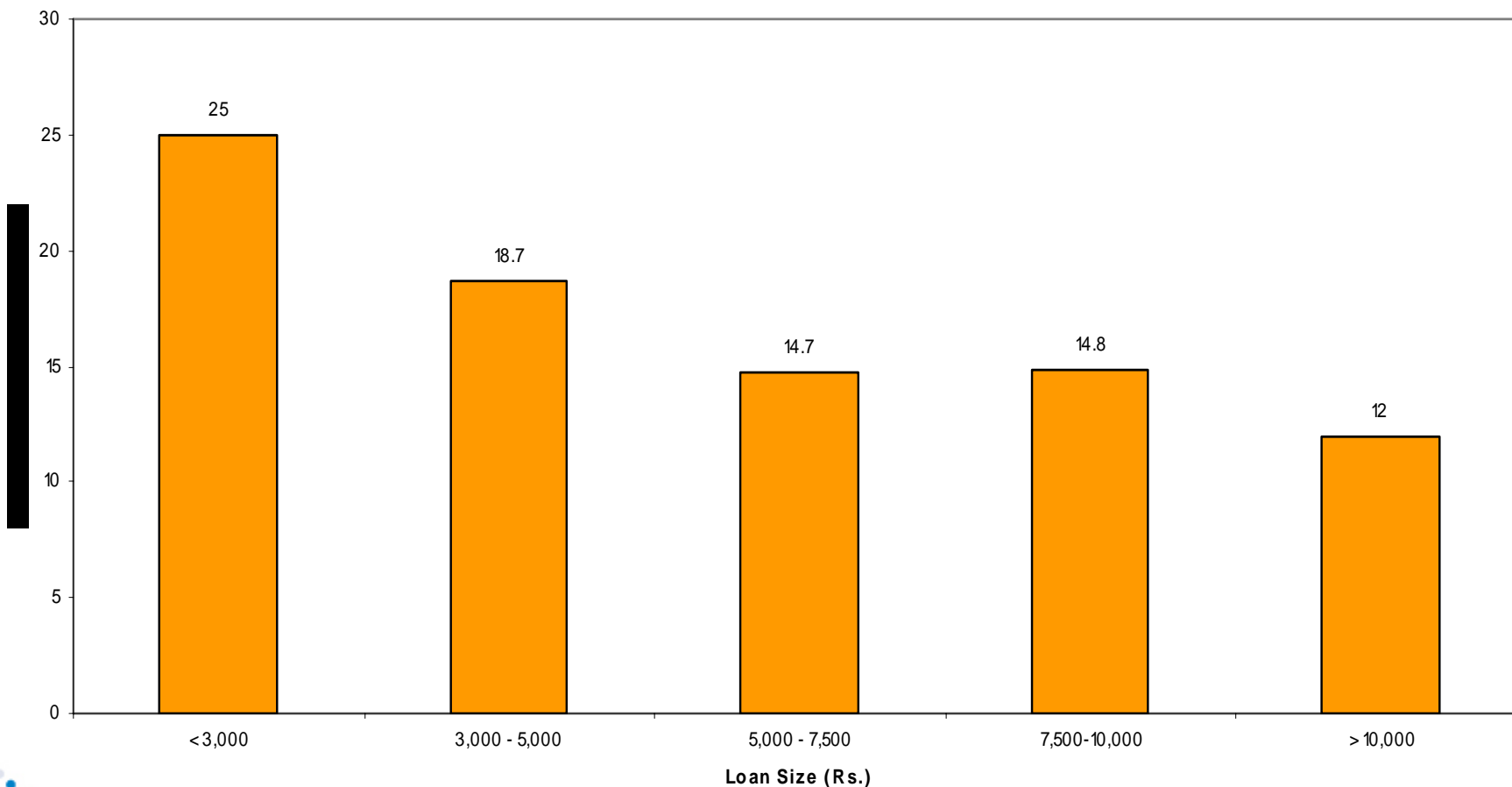
# Global: Average costs per dollar lent fall as loans get larger

(MBB data: 346 institutions)

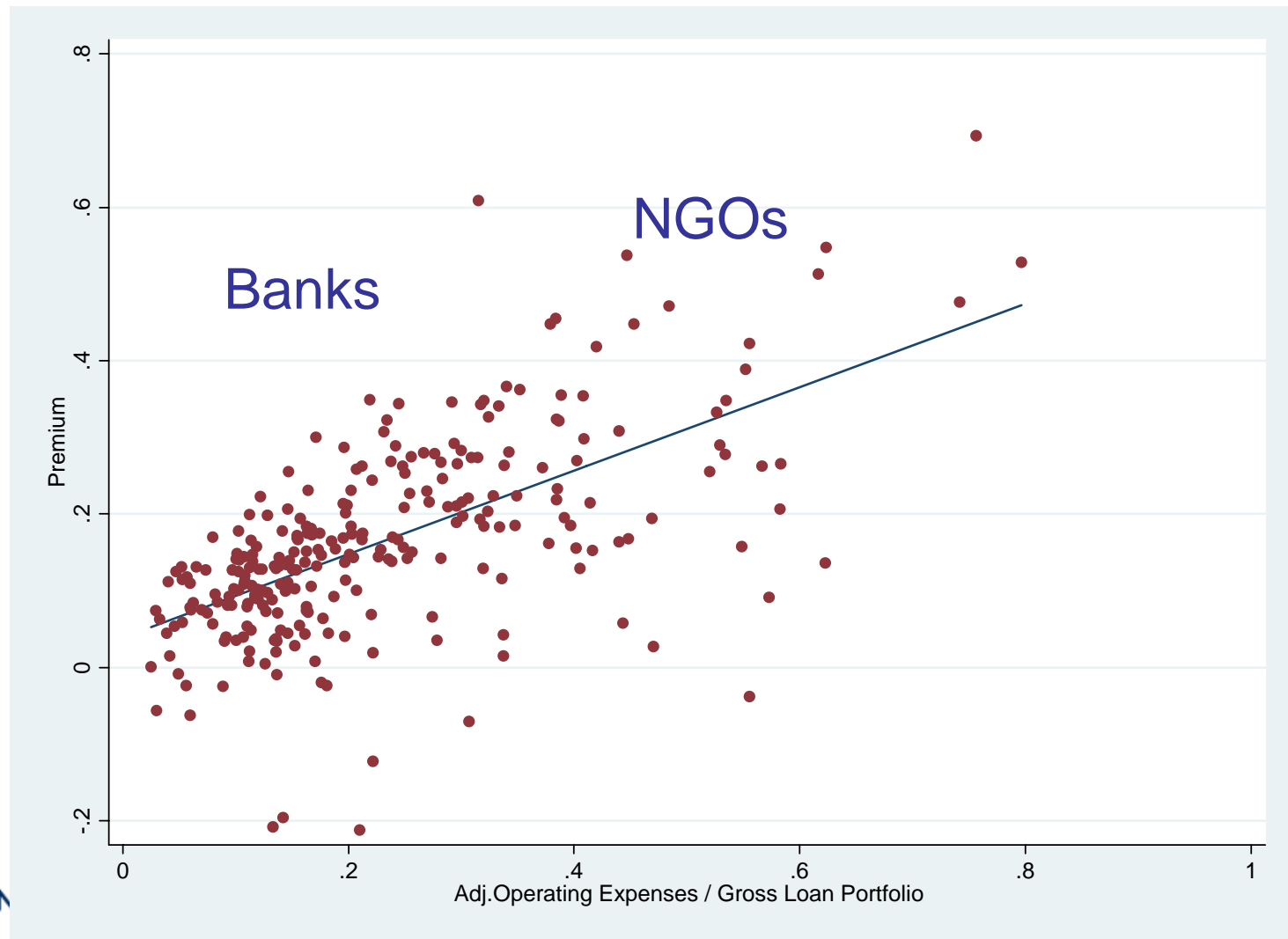


# India: Average costs per rupee lent fall as loans get larger

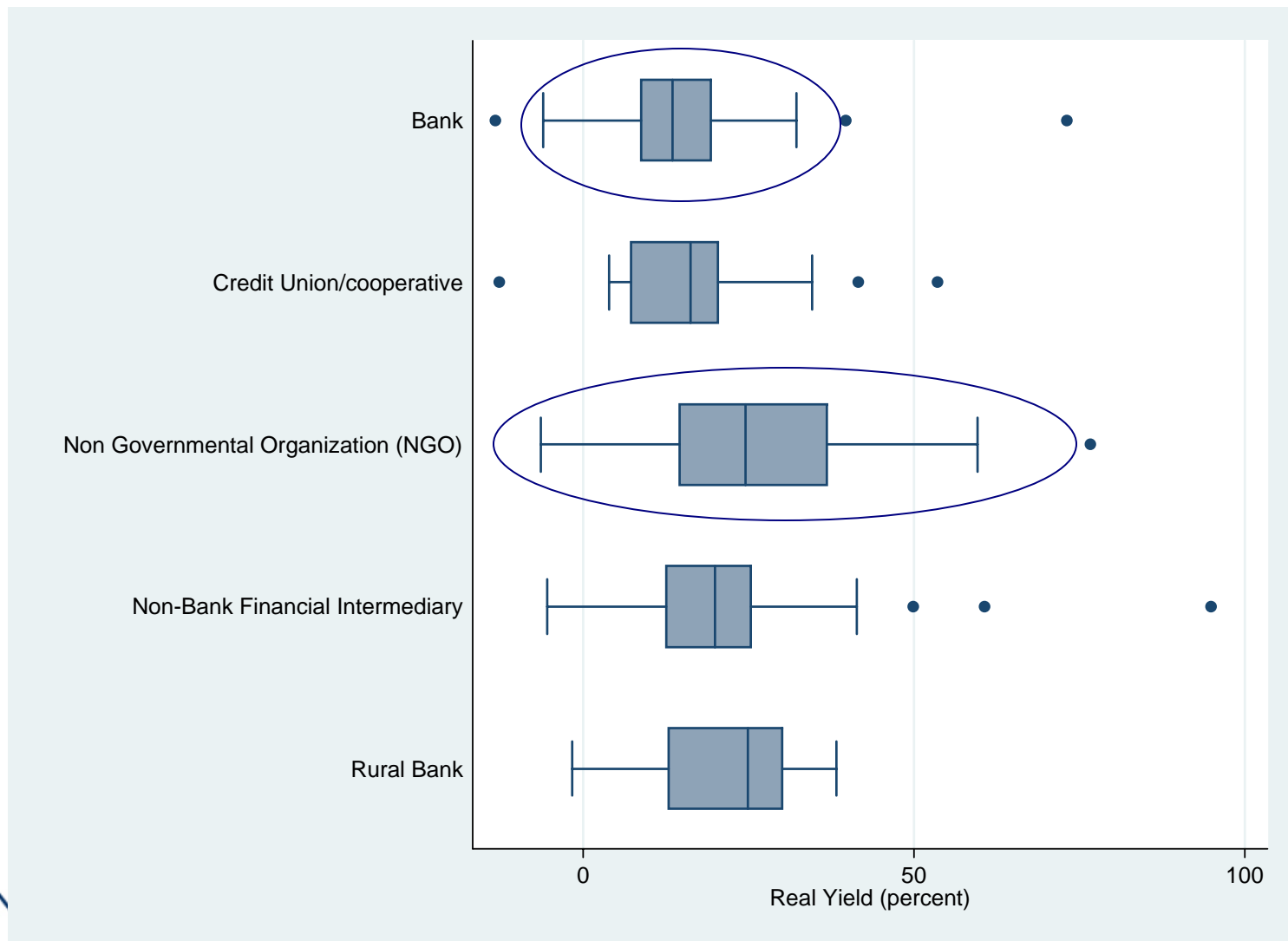
(M-Cril: 58 MFIs 2007)



# Global: Interest rates rise with costs



# Global: Interest rates on loans, by institutional type





# Frontier questions

## Impact and demand

- Would important populations be screened out by charging higher interest rates? (i.e., price sensitivity).
- How would higher interest rates affect
  - Impacts on customers?
  - Repayments

## Costs

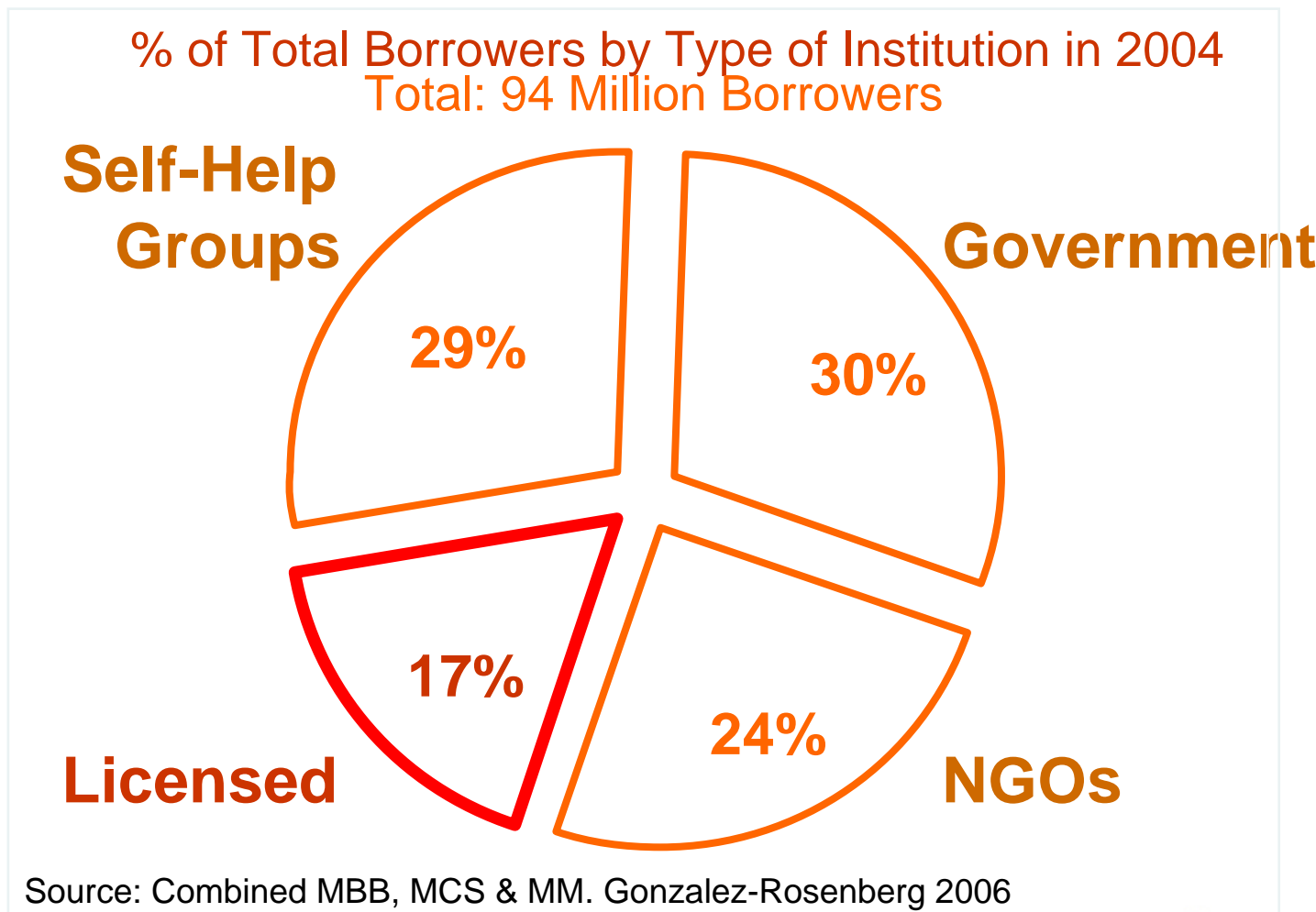
- Can technology reduce costs (but with other added costs)?
- Will costs fall with scale?
- Does competition reduce costs?

## Trade-offs

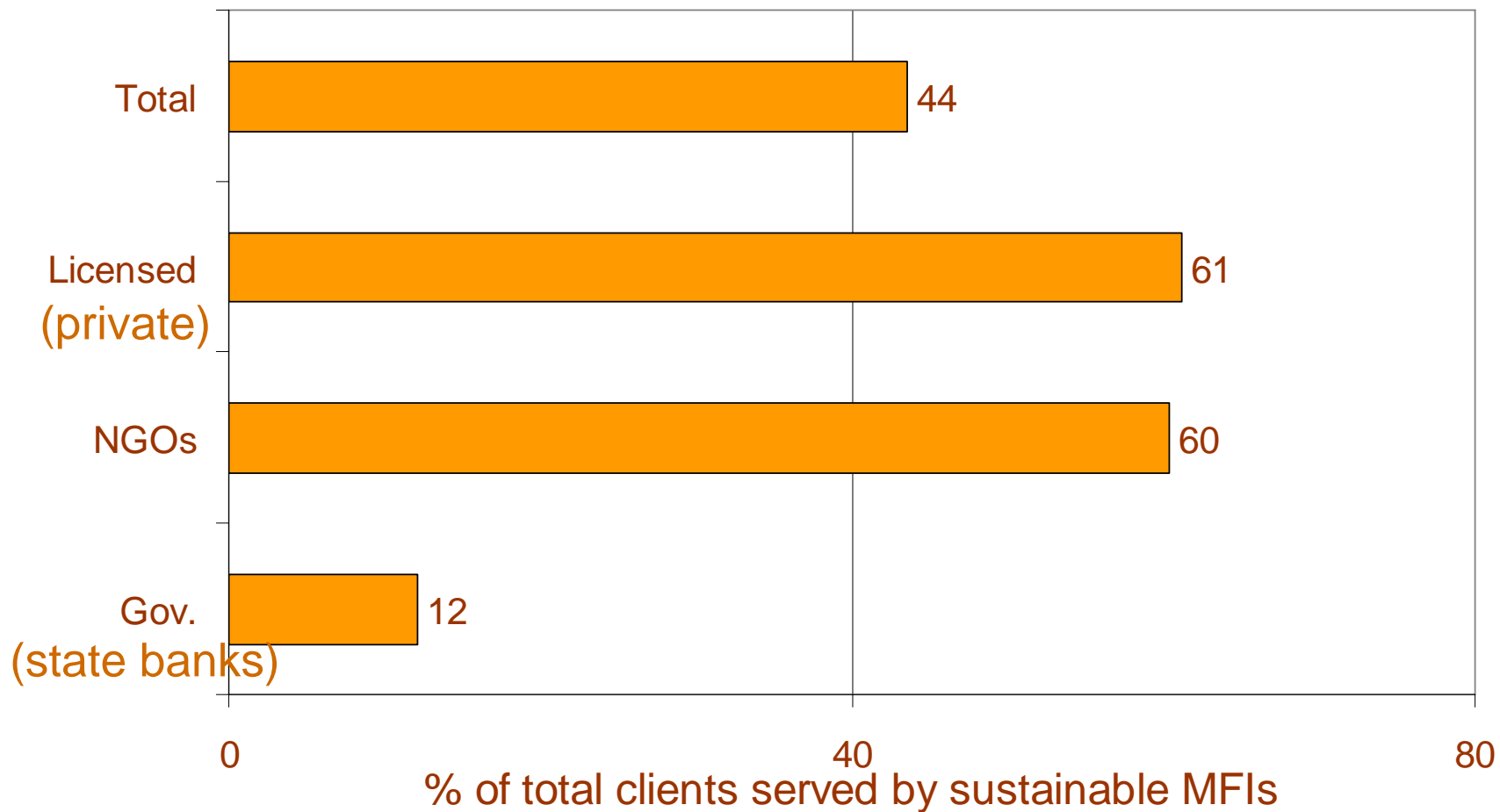
- Ultimately: trade-off in institutional sustainability versus welfare and outreach to customers.



# Licensed institutions serve < 20% of borrowers



# How Profitable is Microfinance?



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Source: Combined MIX & MCS data

Gonzalez-Rosenberg, 2006

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# Global: NGOs vs. Banks

from “Microfinance and the Market”

	NGOs		Banks
	Median (2)	Median if profitable (4)	Median (6)
Percent women	85	86	52
Average loan size/income at 20 <sup>th</sup> percentile (%)	48	60	224
Age	9	9.5	10.5
Assets (\$PPP million)	6.0	12.2	30.4
Active borrowers	7,416	11,115	20,262





# Commercialization: trade-offs

**Profitable NGOs have better outreach than banks**

**Question: scale vs. (subsidized) outreach**

**– or can a large, profitable, and broad-based bank be best for the poor (weaker targeting but larger absolute coverage)?**

**Sustainability does not equal commercialization**





## Final words

- Microfinance opens many doors.
- Forces us to rethink assumptions at many levels.
- There's room for innovation, more research to push forward.
- Must begin by keeping an eye on trade-offs behind “double bottom lines.”





# Thank you



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