

Microfinance: Transactions at the bottom of the pyramid

Jonathan Morduch
New York University

October 26, 2004
World Bank

What we don't know well (but should)

- Microfinance impacts
 - on poverty, economy, etc.
- Sensitivity of demand to interest rates
 - Can poorer pay more than richer?
 - Declining marginal returns vs. low skill/access/scale?
- Returns to capital of different segments
- Who exactly is served by which microfinance institutions?
 - Tradeoff of outreach and sustainability

Questions today

- What happens on the ground?
- What are the market segments?
- How is finance used?
- Dimensions of access?

The microfinance landscape

Microcredit Summit data

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
2005		100?	

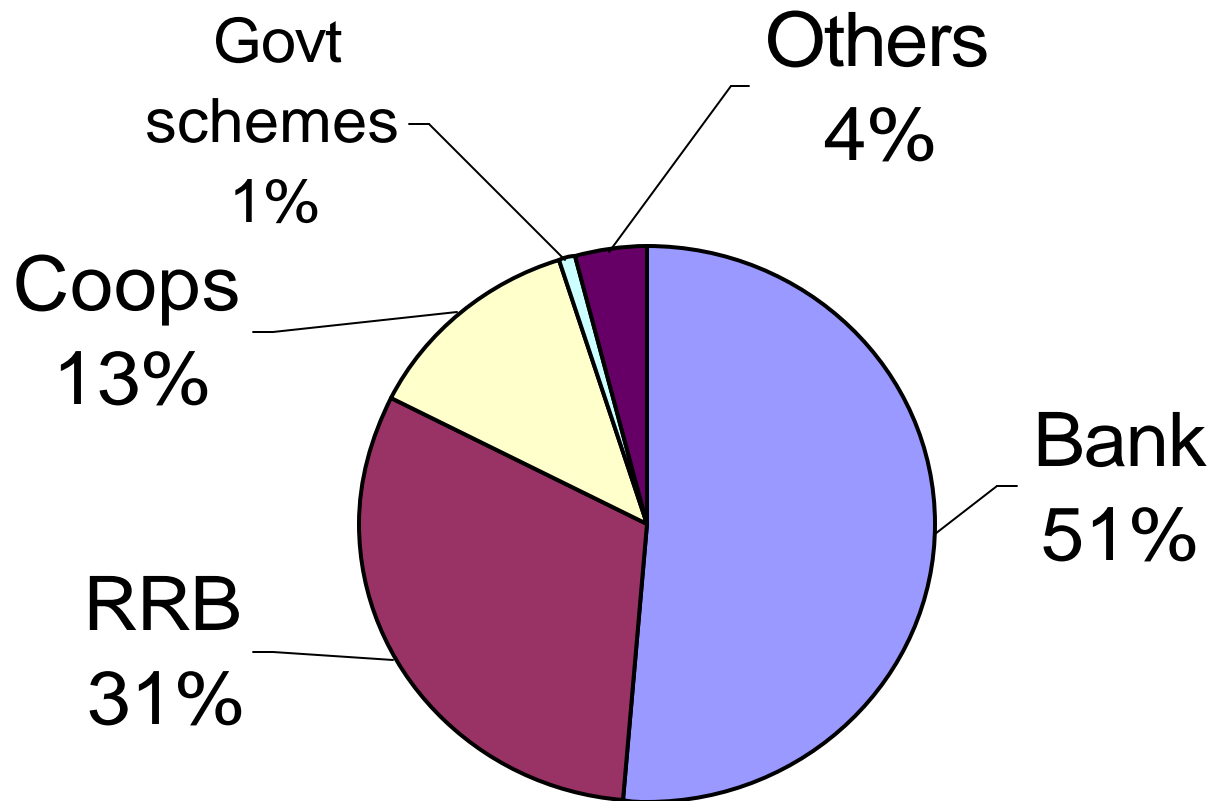
But it is a limited view of access

Also:

- Credit unions
- Commercial and government banks
- Informal finance

- No map from access to capability

Rural India (AP & UP): Formal credit outstanding by source



Bank Accounts?

India (UP and AP-rural)	48 %
Brazil (11 urban areas)	43
Colombia (Bogotá city)	41
Mexico (México city)	25
<i>Incl. compulsory savings (AFORES)</i>	<i>48</i>
<i>USA (households)</i>	<i>87</i>

Source: Anjali Kumar et al "Access to Financial Services - What Do we Know Across Countries? Preliminary Comparisons". Presentation at World Bank Finance Forum 2004

Demand for formal credit

	<i>Brazil</i>	<i>Colombia</i>	<i>Mexico</i>	<i>India</i>
<i>What proportion of respondents applied for a loan?</i>	15%	9%	14%	3%

	<i>Brazil</i>	<i>Colombia</i>	<i>Mexico</i>	<i>India</i> <i>(formal and informal)</i>
<i>Did the banks award them loans?</i>				
Approved	68%	72%	75%	20%

Source: Anjali Kumar et al "Access to Financial Services - What Do we Know Across Countries? Preliminary Comparisons". Presentation at World Bank Finance Forum 2004

Rural India: Source of last non-formal loan, by % of households

SHG/NGOs	2.89
Landlord	7.76
Moneylender	55.87
Friends/Relatives	31.36
Others	2.12

(Shamika Ravi: In Kerala, coops substitute for friends and relatives.)

Source: Basu et al, Scaling up, 2004.

India: Uses of last informal loan, by % of households

Invest in land, building	13.33
Purchase in machinery/equipment	2.36
Purchase livestock	5.83
Purchase inputs	3.92
Family emergency	28.76
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: Reported primary uses for savings

<i>Business Uses</i>		16%
Working capital	13	
Buy building, equipment, vehicle	3	
<i>Non-business consumption</i>		35%
School fees	14	
Medical expenses	3	
Household consumption	13	
Wedding/funeral/religious holiday/etc.	5	
<i>Finance and assets</i>		6%
Purchase land, housing	6	
Pay loan	0	
<i>Other use or not applicable</i>		39%

Source: 2000 Survey of 201 Bank Rakyat Indonesia clients. Unweighted.

Lessons from Financial Diaries

Financial diaries in S. Asia

- Poor, very poor and near-poor households were surveyed in detail about finances over a year.
- Very small samples (30-40 households, in some cases more). But rich data.

Main findings:

- 1) Respondents **patch** a wide array of informal services and devices together with semi-formal and formal services.
- 2) Those services are used intensively.

India example

In India, households enter a fresh financial arrangement – with a moneylender, money guard, savings club, or formal provider, among others – on average every two weeks.

Bangladesh diaries

- *Bangladesh example:*
- On average the Bangladeshi households push or pull through financial services and devices each year a sum of money (\$839) = 2/3 of their annual cash income.

In Bangladesh, a sample of just 42 households were found to have used, between them,

- 33 types of service or device during the year
- No household used less than 4
- 1/3 of them used more than 10.

Sum: Household financial management

- Active cash flow management
 - Turning small flows into large lumps
 - Smoothing income and consumption
 - Household is the economic unit
- Active portfolio management
 - Managing assets, jobs, income streams
 - Managing multiple lenders
 - Microfinance is just one component

Microfinance loans make up 10-15% of total capital of the households surveyed (USAID AIMS project).

“Access” has a quality dimension

Financial access is not a yes/no question.

Not just: do some people have access and others don't?

The real issue:

Do households have access to a reliable, reasonable-quality set of tools and mechanisms?

Financial ideals for improving portfolio management

- Reliability
- Convenience
- Continuity
- Flexible range of services

Reliable services

Rule-bound services in which transactions are made on the **promised date** in the **promised sum** at the **promised cost**.

- **Not** the same as **regulated** financial services.
- In Bangladesh NGOs are more reliable lenders than formal banks.

India: actual loan costs > nominal rates

Median interest rate per year

	Bank	RRB	Coops	Schemes	Others
Interest rate (median) % p.a.	12.0	14.0	14.0	14.0	14.0

Weeks until loan approval

	Bank	RRB	Coops	Schemes	Others
Time taken (weeks)	36.5	32.3	22.0	17.7	22.0

Bribes?

	Bank	RRB	Coops	Schemes	Others
Percent reporting bribes	38.8	47.4	19.2	28.0	19.0
Bribe as percent of amt approve	10.2	23.8	16.7	20.2	13.9

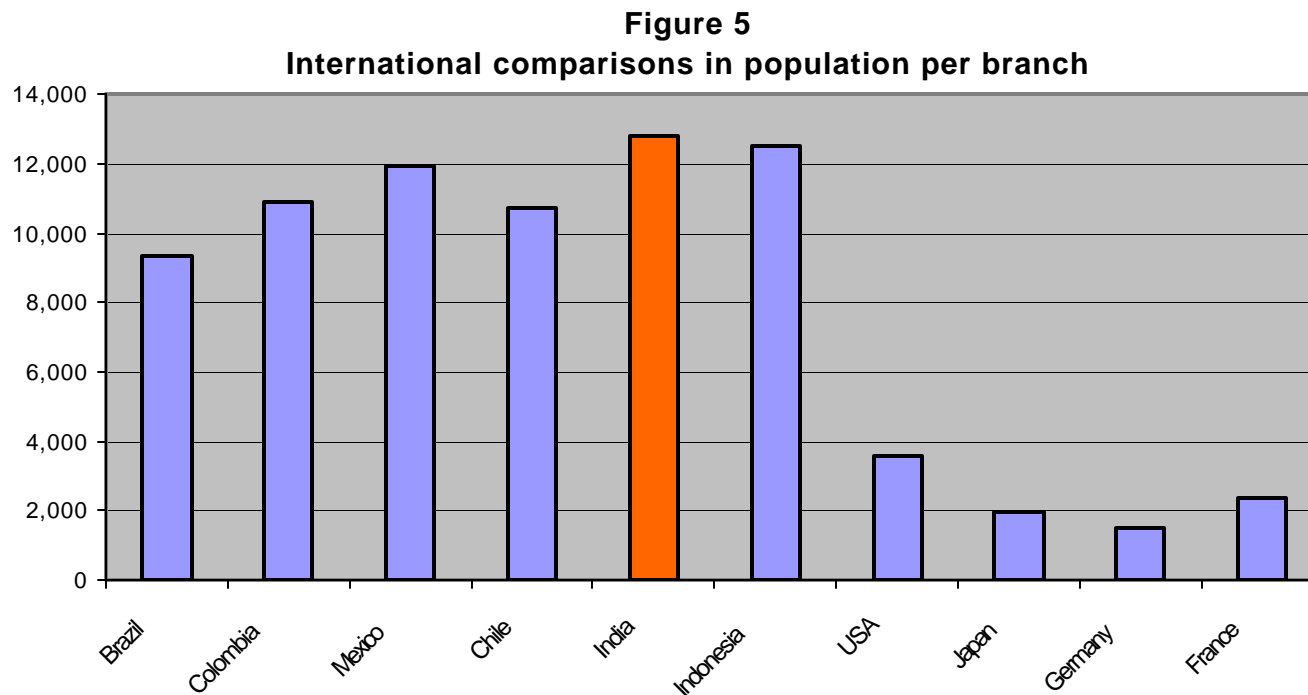
Source: Priya Basu / World Bank-NCAER Rural Finance Access Survey (2003)

Convenient services

The opportunity to make all kinds of transactions (loans and repayments, deposits and withdrawals) frequently,

- close to the home or business
- quickly, privately and unobtrusively.

Bank branches per person



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

Continuous

Services that cater to continuing and long term needs, such as a sequence of loans, or storing lifetime savings.

India's Integrated Rural Development Programme failed its intended users by lacking this: one study showed that only 11% of all IRDP borrowers borrowed more than once.

Flexible services

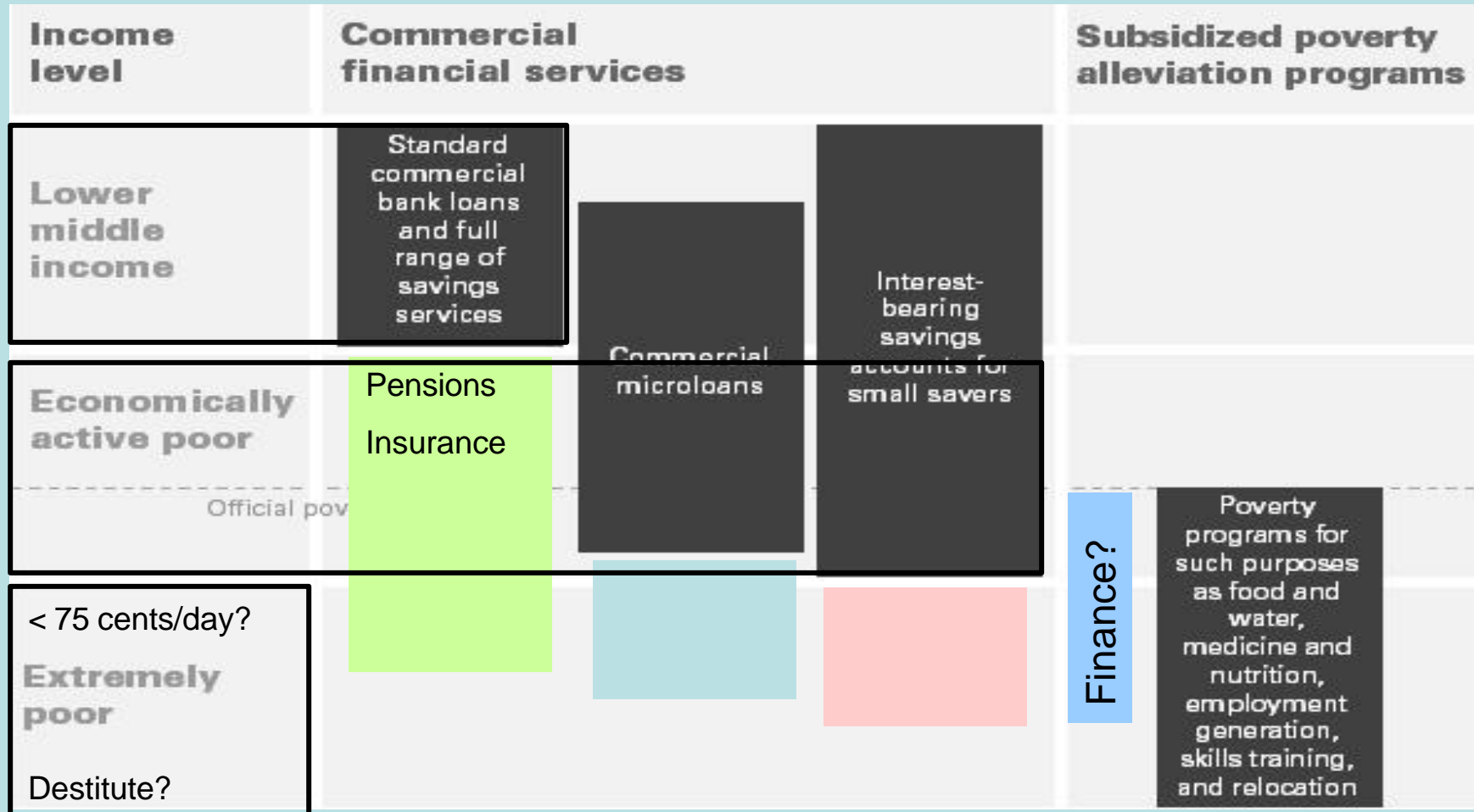
Allow poor people:

- to make **pay-ins** (savings deposits and loan repayments) in any sum at any time,
- and to **take out sums** (loans and savings withdrawals) in a wide range of values, quickly and conveniently.

Flexible services (more)

Services that are not flexible in this way fail to serve the poor well because they **fail to match** their fragile and unpredictable **cash-flows** and **spending needs**.

Supply side: market segments?



Marguerite Robinson: *Microfinance Revolution*. World Bank 2001.

Indonesia: direct “professional” assessment of credit-worthiness

**Enumerators were asked at the very end of
the survey:**

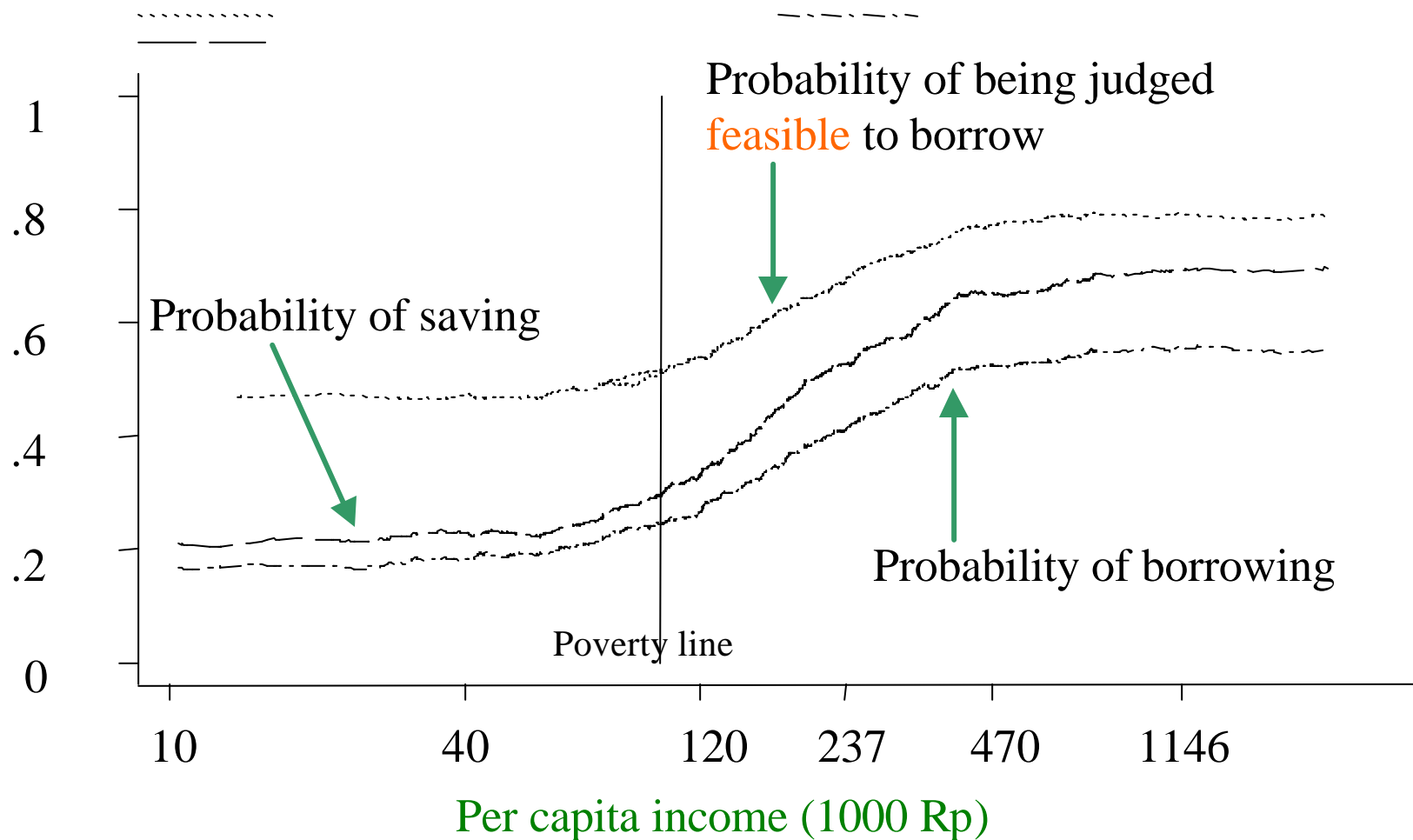
“Given the salary and pension income as well as the profit-loss calculation and balance sheet above, **would this household be feasible** to be granted a loan if needed?” [with detailed follow-up questions]

Would the enumerator make a loan to this household?

	%
<i>Poor</i> Bottom 50%	49
Top 50 %	43
<i>Not poor</i> 1-2 times z	59
2-3 times z	72
3-4 times z	82
4-7 times z	80
> 7 times z	88



Saving and Borrowing in Indonesia, 2002



Concluding thoughts

- **Quality matters:** “current access to a bank” does not mean “satisfactory access to banking”.
- **Frontiers have not been reached:** deeper outreach is possible, perhaps on a commercial basis
 - Need mechanisms tailored to cash flows, that fit into household portfolios
- Household surveys are needed to learn more.
- Experiments can help in assigning causality.
- Gains to both large, representative surveys and smaller, richer studies.