

# Financial Constraints, Informal Financing, and Business Creation

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## Research Question

- Do **financial constraints** hinder the creation of formal businesses?
  - No access to credit
  - No access to insurance
- If **Yes**, cash transfers (or liquidity shocks) must have a *direct* impact on business creation (BC).
- If **No**, BC would depend on:
  - Investment opportunities
  - Cost of risk-sharing (Family, Friends, and Fools, FFF)
- Cash transfers have an *indirect* impact on BC.
  - Shifting the demand for non-tradables.
  - FFF more willing to help.

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# Intervention

- Large-scale cash transfer program in Brazil, *Bolsa Família*.
  - Small, steady liquidity shock on poor households.
- Not talking about firm growth and innovation
- Creation of small, formal businesses.
- Decomposition of the overall effect into:
  - *Direct* effect on recipients' behavior (from receiving the transfer)
  - *Indirect* effects on the local economy (from having the municipality covered)
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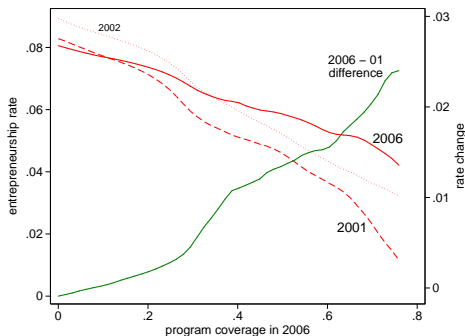
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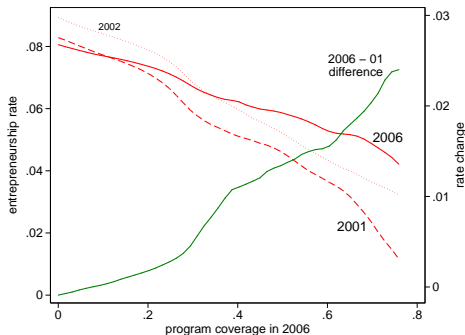
Figure: Relationship between Entrepreneurship and Program Size



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- Were those entrepreneurs financially constrained?

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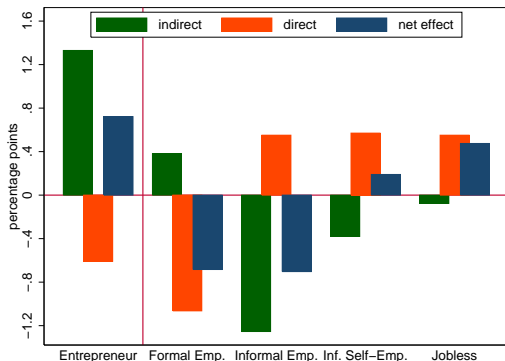
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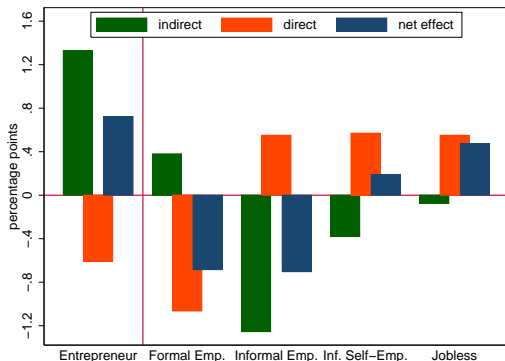
Figure: Direct and Indirect Effects on Occupational Choices



- Direct and indirect effects go in opposite ways.
- Indirect effect more than compensates the negative direct response.

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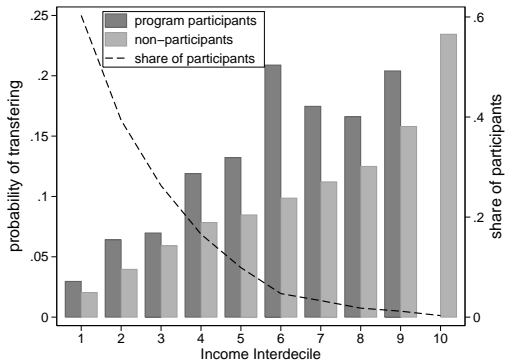
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- Negative direct effect is associated with more participation in the informal sector.
- Indirect component reduces participation in the informal sector.

## Indirect Effect and Private Transfers

Figure: Probability of Transferring Money to Another Household



- Participants are more likely to make transfers to other households.
- The liquidity shock is transferred to other household.

# Key Messages

- 1 The importance of designing evaluations to assess direct and indirect effects.
  - Different interpretations.
  - Distinct policy implications.
- 2 Financial constraints do not necessarily hinder BC ( $\neq$  firm growth and innovation).
  - Microloans and grants might just crowd out informal financing.
  - They should build upon the informal system.
  - Participation of local micro-investors and group monitoring.

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