

Discussion of "Getting Credit to Microenterprises: An Informational Intervention"

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- Most Important Results
- Demand for capital
- Empirical results
- Future Directions

- Previous Evidence Demonstrates that Capital has High Average Return (50% per annum)
- Why aren't firms getting capital?
 - Firms don't want to borrow
 - Too complicated
 - Not bankable
- Fantastic (!!!) research agenda

Firms don't want to borrow

- Interest rate too high
- Authors quote 16% interest rate (flat)

Principal	Flat	Interest	Monthly Interest	Monthly Principal	Monthly Total
10,000	16%	1600	133.33333	416.6667	550

- Calculation: 44% effective rate (including fee and savings)

Principal	10,000	Term (Months)	24
Loan Fee	2.5%		
"Flat" rate	16.00%		
Monthly Yield to Bank	3.101%		
Effective Yield	44.258%		

Week	Disbursement	Repayment "Principal" + "Interest"	Fee	Saving	Total Cash Flow
1		-10000	550.00	250.0	250.0 (8,950.00)
2		550.00			550
23		550.00			550
24		550.00			550

Firms don't want to borrow

- Cost of borrowing too high
- If monthly repayment is 490 (as authors report), recover savings, still 24% rate. Without fee, 20%
 - Financial literacy matters!
- Applying is a drag
 - 24 Visits to MFI Branch, 3.6 km away
 - Finding a guarantor
 - Endorsement from five competing microfinance intermediaries
 - Residence verification (Possible)
 - Oath of attestation (maybe)
 - Open a savings account (Rs. 250)
 - Application fee (Rs. 250, research paid)
- Stigma from rejection?

Firms don't want to borrow

Borrowing increases risk of firm

- Increasing leverage increases volatility of earnings and value
 - Average profits: Rs. 5,000, or \$45. (Per capita monthly income 6,100)
 - Monthly repayment of Rs. 500, or 10% of profit margin
 - But once subtract living costs, the 'interest coverage ratio' may be quite small
 - Given interest rate is high, might 'tip' the scales
- Cost of financial distress
 - Default on loans?
 - Sell stock / household assets
 - Reduce consumption?
 - Reduce option value of future loan?
- Calibrate risk as in previous paper

Reconciling the results

- Equity has no transaction costs
 - Transactions costs in microcredit are huge
 - Weekly/monthly repayment
 - Screening, monitoring
- Equity reduces leverage, credit increases leverage
 - Could affect investment decision?
- Low financial literacy may be driving firms claim that biggest impediment to growth is finance
- Mystery: receipt of grant uncorrelated with lending

Firms don't know how to get credit

- Experiment supports this view
- But, special setting allows alternative interpretations: firms want to stay in good relationship with experimenters
 - Take-up rate for informational program extremely high; absentees use 'illness' as excuse
- Might have compared with small incentives to borrowing
 - Cole, Thompson, and Zia (2008): \$5 incentive more effective than literacy training, for deposit accounts

Firms are unbankable

- Many still cannot find a single guarantor
- Ruhuna has 8.51% portfolio-at-risk for normal loans
- Subsidized credit?

- Quibbles
- Selection into attendance
- Selection into loans
- Power

- Not a randomized evaluation
 - But variation is plausibly exogenous
- Time effect an important concern
- Comparison group potentially very different: in a district not covered by bank
- Randomization inference, or other flexible test?
- Generally, result is convincing
- Credit-shifting: maybe moved lending behavior forward to take advantage of streamlined process

- Into attendance. Attendees are:
 - More likely to be married
 - Less educated
 - Poorer
 - More likely to keep business records (?)
- Anticipating higher returns to capital?

- Into application. Applicants:
 - Have lower cognitive ability
 - Have many more assets
 - More capital
 - More likely to be registered
- Anticipating higher returns to capital?

Returns on Capital: Power

- Take up is low:
- Wald IV, with $p_T - p_C = .07$
- Admits return on capital from 0-10% per month
- Ignoring time-effect clustering (or no power)

Returns on Capital: Bank's Problem

- $5/38 = 13\%$ late at least 30 days, and loans not yet paid off
- Higher than Ruhuna's regular 8.51% portfolio-at-risk
- Firm attrition from survey panel in 18 months, 617 to 574 or 7%
- One realization of possible outcomes

- Replicate experiment for non-survey households, to understand credit demand
- [Indonesia, Cole, Thompson and Zia find literacy training does not affect demand for savings products; small incentives do]
- Policy prescriptions a little unclear
 - Would guarantor-free loans be repaid?
 - Are endorsements from other lenders major barrier?
 - Credit bureaus only helpful after you get first loan

Conclusion

- Very good idea, follows naturally from earlier work
- Convinced that encouragement design increased formal borrowing
- Would have preferred a control group
- Consider varying other constraints (Guarantor)

- Would firms already holding a loan be ineligible to borrow again? Should they be thrown out of the analysis, or taken as a second comparison group?
- Show that there are not pre-existing trends in returns to capital; and that treatment and comparison groups move similarly