

Getting Credit to High Return  
Microenterprises:  
The results of an information  
intervention

David McKenzie

(with Chris Woodruff and Suresh  
de Mel)

# Motivation

- Access to finance the most common constraint to growth according to SMEs around the world
  - Microenterprises particularly unlikely to have formal credit
  - But randomized experiments giving grants of US\$100-200 to firms in Sri Lanka and Mexico show returns to be very high
- => How can the formal financial system get credit to these high return microenterprises?

# So why aren't more getting credit?

- 1) Limited demand: perhaps they don't want credit
- 2) Supply constraints: they want credit, but can't get it due to collateral requirements, other lender forms, etc.
- 3) Information and financial literacy: they want credit but don't know how to get it.

# An intervention to increase access

- Aimed to increase credit use without subsidizing interest rates
- Main elements of intervention:
  - Provided information/specific financial literacy on loan product offered by an existing microfinance bank
  - Reduced number of guarantors required for loans from two to one.
- Intervention doubles number of firms receiving a loan, but
  - Still only 10% of those invited get loans
  - Inability to find guarantor and lack of credit bureau limit access.

# Setting

- Sri Lanka: population 20 million
- Wide range of institutions in financial sector, heavy state presence
- Credit bureau only reports on loans over SLR 100,000 (US\$1000), limited accessibility
- Our previous work on panel of microenterprises found returns to capital averaging 5% per month, with returns highest for those with higher ability and lower wealth.

# Firm characteristics

- SLMS covers microenterprises in Galle, Matara and Kalutara districts with no paid employees, less than US\$1,000 capital stock (excluding land and buildings)
- Evenly split between men and women
- Average owner 43, 9 years education
- Mean profits June 2006 ~US\$58/month
- Mean capital stock ~US\$400
- Only 20% registered
- 21% had received some form of loan in the year prior to the intervention.

# Financial literacy

- Follow Lusardi and Mitchell (2006), ask question on whether understand compound interest and inflation
  - 70% got both questions right, higher than older Americans in Lusardi/Mitchell
- Product specific financial literacy more limited
  - 36% say didn't think RDB lends to small businesses
  - 62% no idea of interest rate RDB would charge, only 10% know correct interest rate

# The loan product

- 5,000-25,000 SLR (\$50-250)
- 16% per annum interest
- 2 years, equal installment
- No collateral
- Number of guarantors lowered from two to one
- Require endorsements from other financial institutions
- Business registration not required
- 250 SLR application fee paid by us

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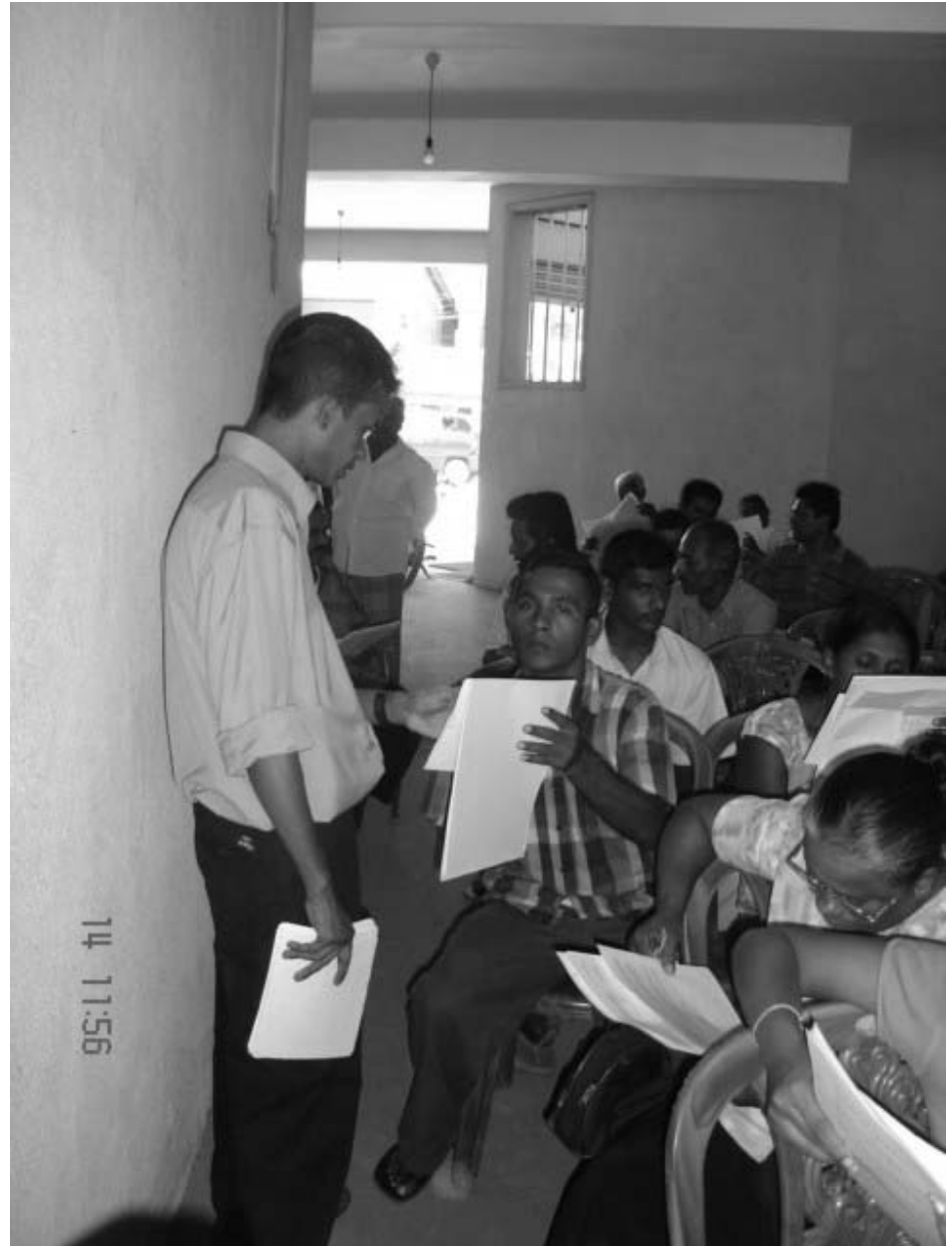
# Information intervention

- Sent letter to the 383 microenterprises in Galle and Matara in our survey informing them of loan scheme
  - Loan amounts
  - Interest rate and instalment
  - Application fee would be waived
- Those interested invited to information meeting
- Loan application forms explained and distributed
- Firms get third-party endorsements, organize guarantors, and apply for loans
- Bank decides whether to grant loans
- 41 applications received, 38 accepted.

# INFORMATION MEETING



# ASSISTANCE FILLING OUT FORMS



# Results: Attendance

- Meeting attendance
  - 237 out of 383 owners attended meeting
  - Probability of attending is lower for those with more education, Muslims, those with higher household assets, and unmarried owners.

# Results: Loan applications

- 41 submitted application, 38 have application accepted
- Most loans for 25,000 SLR (\$250)
- 19% didn't know where branches were before intervention, 38% didn't think RDB offered loans to small businesses like theirs, only 15% had any idea on interest rate.

# Why didn't more apply

- Main reasons given are:
  - Inability to find guarantors
  - Process of getting endorsements from other banks
  - Don't have use for loan, or interest rate too high.

# Who was more likely to apply among meeting attendees

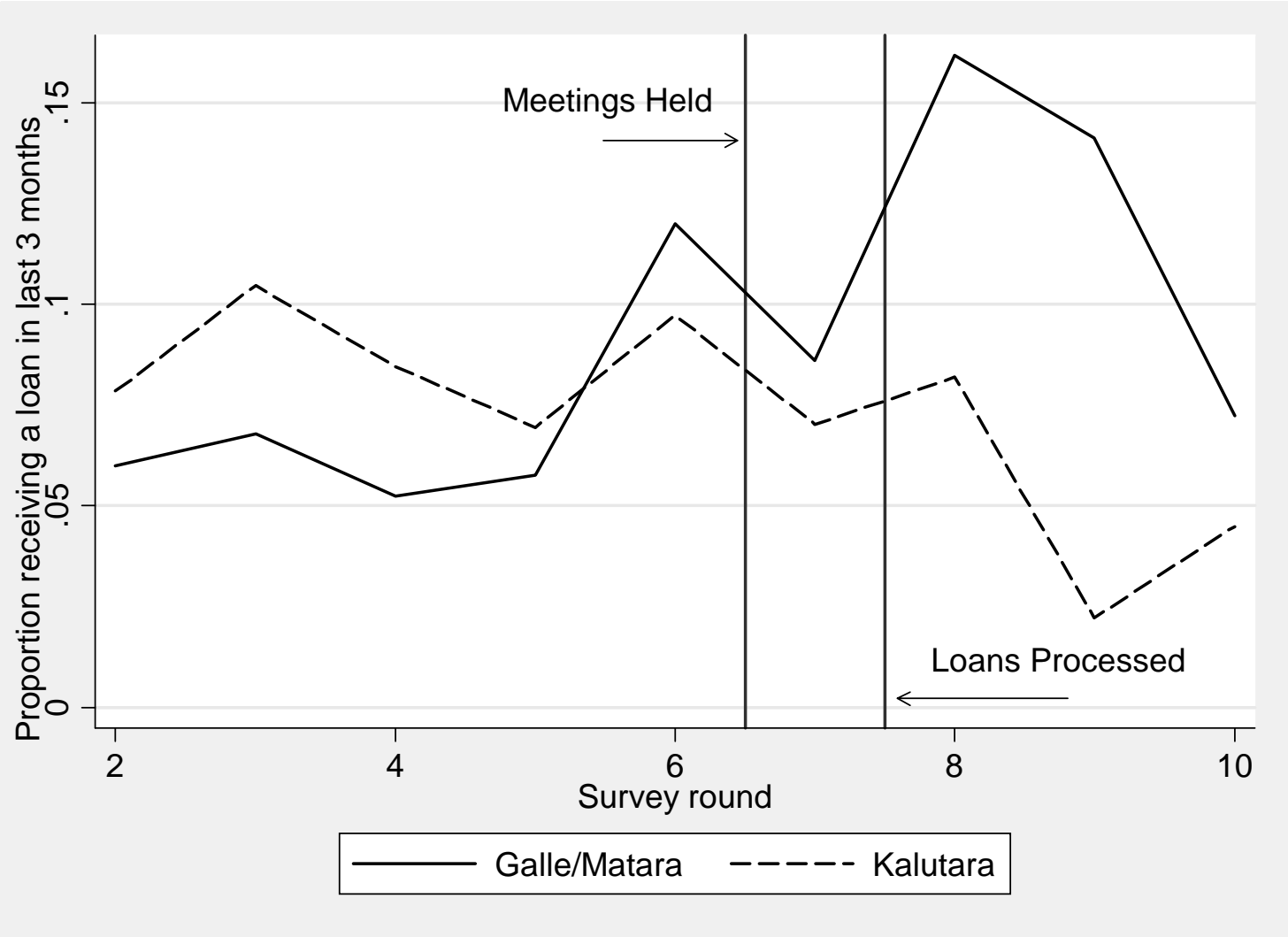
- Non-Muslim firm owners who had:
  - More household assets
  - Higher capital stock
  - Registered firm
  - And who hadn't received a formal loan in the last year
- These are NOT the characteristics that our previous work has found to be associated with the highest returns to capital
  - Males with high education and low assets have highest returns, not the ones more likely to get credit.

# What did the intervention do?

**Table 7: What do firms receiving loans see as the most important part of the intervention?**

	% saying very important	% who rank this as most important
Providing information that RDB would lend to small firms like theirs	75.7	51.4
Providing information that RDB would lend without collateral	62.2	13.5
Providing information that business registration wasn't necessary	59.5	24.3
Showing them how to fill out the application forms	56.8	0.0
Reducing the number of guarantors from 2 to 1	40.5	8.1
Providing information on terms and requirements of loan	24.3	2.7
Paying the 250 SLR administrative cost charged by the bank	10.8	0.0

# Did the intervention increase access to credit or just crowd out other credit?



# Impact on credit

- Matched difference-in-difference estimate using Kalutara as control suggests effect is 5.5-7.0 percentage point increase in the proportion of firms receiving loans in a three month period
  - A doubling of the proportion receiving loans
  - No effect on use of informal credit – not substituting for loans from moneylenders or friends.

# Impact on firms

- Most common use was buying inventories
- Find capital stock 7,318-18,824 SLR higher
- Find firm profits 295 SLR to 895 SLR higher per month
- Estimated return on capital is 5.7-6.6 percent per month
  - Return similar to what we find as average return to grants
  - Consistent with idea that loans not going to firms with the highest returns.

# Repayment

- Almost one year after the loans given out, we find all firms begun repayment, no defaults, but 5 of 38 firms had delayed a loan instalment.

# Conclusions

- Intervention resulted in one in ten microenterprises being offered the information receiving the new loan; a doubling of proportion with new loans
- While basic financial literacy was high, product specific information seemed to have effect.
- Both demand and supply constraints help explain why majority did not receive loans
  - 36% give reason as lack of demand at prevailing interest rate
  - 44% give reason related to requirements of the bank for a loan (guarantor, endorsement from other financial institutions)

# Policy implications

- Need for credit bureau to include microfinance information
  - Directly removes barrier of seeking endorsements from other lenders
  - May allow reputational collateral to develop
- Financial institutions can expand customer base through product-specific financial education
- Continued need to develop new innovative ways of delivering collateral-free individual loans to microenterprises.