STUDY SUMMARY

The Impact of Flexible Credit for Entrepreneurs in Colombia

Micro-loans are a promising means of promoting entrepreneurship[1], but conventional loan products are often unsuited to the needs of small businesses in developing countries. Offering microenterprise borrowers the ability to postpone loan payments when needed may encourage long-term investments in business expansion and help owners cope with financial hardship. An IPA research team partnered with Kiva and Fundación Mario Santo Domingo (FMSD) in Colombia to examine the impact of a flexible credit product on microentrepreneurs' demand for loans, business activity, and resilience to unexpected events and emergencies.

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COUNTRY
Colombia

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PROGRAM AREAS
Financial Inclusion, Small and Medium Enterprises

TOPICS
Behavioral Design, Financial Capability, Microcredit, Microenterprise, Product Design

TIMELINE
2015-2018

Policy Issue

Hundreds of millions of people in the developing world operate their own business, and micro-loans are a means through which these microenterprises can expand[1]. However, evidence suggests[2] that the loan products offered by most microfinance institutions (MFIs) do not suit the needs of microenterprise clients. Most micro-loans follow rigid repayment schedules that begin immediately after loan disbursement, which are not conducive to long-term investments in business expansion. Moreover, the seasonal and unpredictable nature of micro-entrepreneurs' income makes financial planning around repayment deadlines difficult. Researchers in Colombia are examining the impact of a credit product with more flexible terms of repayment on entrepreneurs' loan take-up, business activity, and resilience to unexpected events.

Evaluation Context

This evaluation is being conducted in partnership with Kiva and Fundación Mario Santo Domingo (FMSD), Kiva's local field partner. Kiva is an international microfinance organization that connects lenders in high-income countries-predominantly individuals looking to fund social projects-to borrowers in low-income countries. Kiva conducts its operations in northern Colombia through FMSD, a social services nonprofit that offers loans, job training and housing.

The study involves offering loans to entrepreneurs across the metropolitan areas of three major Colombian cities where FMSD operates (Barranquilla, Cartagena, and Bogotá). Participants are small business owners, the majority being one-person commercial enterprises. A third of the study sample had taken out another loan with another MFI in the past.

Details of the Intervention

An IPA research team is conducting a randomized evaluation to evaluate the impact of a flexible credit product on entrepreneurs' demand for loans, business activity, and resilience to unexpected events and emergencies.

FMSD approached small business owners through door-to-door marketing campaigns and community outreach events and randomly offered them one of two loan contracts with either standard or flexible repayment terms. In total 8,654 entrepreneurs were approached. Of those, 23% were randomly assigned to initial offers of the flexible loan product with the remaining 77% receiving an offer for a standard (rigid) loan. Among those who received a standard offer and were approved for a loan, 51% were "upgraded" to a flexible loan contract.

In total, 2,482 applicants were approved for a loan, 24% (584) with flexible contracts and an initial flexible offer, 39% (975) with a flexible contract after an initial standard offer and 37% (923) with a standard contract after a standard offer.

Unlike conventional loan products, recipients of the flexible loans had the option to pay only the interest portion of their debt and postpone the repayment of the principal, the amount of the loan, up to three times for every twelve months of maturity. Borrowers could also choose whether to pay this postponed amount as an additional installment, essentially extending the loan period, or to repay the postponed amount before the initial loan period had concluded.

To measure demand for flexible credit products, researchers measured the take-up of both credit products following the marketing campaign, and will compare the application rate of participants who received a standard loan offer against those who received a flexible loan offer.

To measure whether flexible loans help entrepreneurs invest more productively and cope with unexpected shocks to income, the research team will collect data on small business owners' business activity, investment decisions, likelihood of repayment, and resilience to financial emergencies.

The business activity analysis will have two parts: In the first, researches will study the effect of the flexible credit contract among those who received a standard offer by comparing the outcomes of participants who received both a standard offer and standard contract against those who received a standard offer and flexible contract. In the second, researchers will study how the *offer* of flexible credit affects the type of entrepreneurs who choose to borrow by comparing the outcomes of participants who received both a flexible offer and flexible contract against those who received a standard offer and flexible contract.

Results and Policy Lessons

Study on-going; results forthcoming

Sources

[1] Innovations for Poverty Action. Small and Medium Enterprise Program - Five Years in Review: 2011-2016. Retrieved from

http://www.poverty-action.org/sites/default/files/publications/SME-Program-Report-2011-2016.pdf

[2] Innovations for Poverty Action. Small and Medium Enterprise Program - Five Years in Review: 2011-2016. Retrieved from http://www.poverty-action.org/sites/default/files/publications/SME-Program-Report-2011-2016.pdf

[3] Field, E., Pande, R., Papp, J., & Rigol, N. (2013). Does the Classic Microfinance Model Discourage Entrepreneurship Among the Poor? Experimental Evidence from India*. American Economic Review*, 103(6), 2196-2226. doi:10.1257/aer.103.6.2196