Evidence from a Randomized Evaluation: The Miracle of Microfinance?

This study was the first rigorous randomized evaluation of the "traditional" microlending model. The findings from the study suggest that access to microcredit has important effects on household expenditure patterns and the creation and expansion of businesses, but no effect on health, education, women’s decision-making, or average monthly expenditure overall, at least in the short term. It is possible that impacts on education, health, or women’s empowerment would emerge after a longer time, when the investment impacts (may) have translated into higher total expenditure for more households. However, at least in the short-term, microcredit does not appear to be a recipe for changing education, health, or women’s decision-making.

Policy Issue

Microcredit is one of the most visible innovations in anti-poverty policy in the last half-century, and in three decades it has grown dramatically. Now with more than 150 million borrowers, microcredit has undoubtedly been successful in bringing formal financial services to the poor. Many believe it has done much more and, by putting money into the hands of poor families (and often women), it has the potential to increase investments in health and education and empower women. Skeptics, however, see microcredit organizations as extremely similar to the old fashioned money-lenders, making their profits based on the inability of the poor to resist the temptation of a new loan. They point to the large number of very small businesses created, with few maturing into larger businesses, and worry that they compete against each other. Until recently there has been very little rigorous evidence to help arbitrate between these very different viewpoints.

Evaluation Context

Over one third of Hyderabad’s population resides in slums and other poor settlements, where there is extremely low access to formal financial services. At the time of the baseline survey, there were almost no microfinance institutions (MFIs) lending in the sample area, yet 69% of the households had at least one outstanding loan. Loans were taken from moneylenders (49%), family members (13%), or friends and neighbors (28%). Commercial bank loans were very rare.

Launched in 1998, Spandana is one of the largest and fastest growing microfinance organizations in India, with 1.2 million active borrowers in 2008. Spandana offers traditional microfinance loans, in
which self-formed groups of six to ten women are given loans. A “center” is comprised of 25-45 groups, and to join an individual must (i) be female, (ii) aged 18 to 59, (iii) residing in the same area for at least one year, (iv) have valid identification and residential proof, and (v) at least 80% of women in a group must own their home.

Details of the Intervention

This project investigates a randomized impact evaluation on the introduction of microcredit in a new market. Spandana selected 120 areas in Hyderabad as places in which they were interested in opening branches, based on those communities having no pre-existing microfinance presence, and having residents who were desirable potential borrowers. Sixteen communities were subsequently dropped from the sample because they were found to have large numbers of migrant workers, who are less desirable as loan candidates. Fifty-two areas were randomly selected for the opening of an MFI branch immediately, while another 52 served as the comparison communities.

Spandana introduced their financial products into the treatment villages at the beginning of the study in 2005. Data was collected on income, consumption, borrowing, and investment practices in a random sample of eligible households in both treatment and comparison areas. The typical loan was approximately Rs. 10,000 (US$250).

Results and Policy Lessons

Loan Take-Up and Use: Twenty-seven percent of eligible households took up loans from Spandana or another MFI by the time of the endline survey. Spandana does not insist that loans be used for business purposes, however 30% of Spandana borrowers reported they used their loans for starting a new business, and 22% to buy stock for existing businesses. Additionally, 30% of loans were reportedly used to repay an existing loan, 15% to buy a durable good for household use, and 15% to smooth household consumption.

New Businesses and Business Profits: Seven percent of households in treatment areas reported operating a business which was opened in the past year, compared to 5.3% in comparison areas. Existing business owners did not see a change in profits with the new competition.

Expenditure: Expenditure patterns were very different for different groups. Those with an existing business bought more durable goods for their home and business (i.e. they invested). Those most likely to start a new business cut back sharply on temptation goods (tobacco, eating out, etc) and invested more. Those least likely to start a business consumed more non-durable goods. A switch from temptation goods to investment in the first two groups is encouraging and may lead to higher consumption in the future, though it is too early to tell. The increased consumption of the third group may come from paying off higher interest loans, which means that the households have more money to spend. But it could also mean that the households simply spent the loans on non-investment goods, and have fallen further into debt. Again, this short-term study cannot tell.

Education, Health and Female Empowerment: No evidence was found to suggest that microcredit empowers women or improves health or educational outcomes. Women in treatment areas were no
more likely to be make decisions about household spending, investment, savings, or education. Households in treatment areas spent no more on medical care and sanitation than do comparison households, and were no less likely to report a child being sick. Among households with school-aged children, households in treatment areas are also no more likely to have children in school- although school going rates were already high in the treatment and comparison groups.

**Sources**