Microfinance institutions (MFIs) have expanded rapidly in recent years. Microfinance proponents argue that access to MFI loans will allow poor households to start or expand businesses, smooth consumption in the face of job loss or illness, and reduce the rates of interest that they pay on their loans. While randomized designs have been used to explore the effect of microfinance product design\(^1\), and natural experiments used to examine the effect of the intensive margin of microfinance\(^2\), to date there have been few, if any, large-scale randomized trials with the potential to examine what happens when microfinance becomes available in a new market.

**Setting**

120 areas of Hyderabad, India’s fifth-largest city, were selected by Spandana, a large microfinance lender, as areas in which they were interested in opening branches. These areas were selected based on having residents who were desirable potential borrowers: poor, but not “the poorest of the poor.” Areas with high concentrations of construction workers were avoided because people who move frequently are not desirable microfinance clients.

In each area, a baseline survey was conducted in 2005. Households were randomly selected, conditional on having a woman between the ages of 18-55 in the household. Information was collected on household composition, education, employment, asset ownership, decision-making, expenditure, borrowing, saving, and any businesses currently operated by the household or stopped within the last year.

Sixteen areas were dropped from the study; of the remaining 104, Spandana began operating in 52, selected at random, in 2006-2007. A census of each area was undertaken in early 2007 to gauge loan takeup and establish a sampling frame for the followup study, which began in August 2007 and ended in April 2008. The followup survey in each area was conducted at least 12 months after Spandana began disbursing loans. The census revealed very low rates of MFI borrowing even in treatment areas, so the followup sample consisted of households whose characteristics suggested high propensity to borrow: households who had resided in the area for at least 3 years and containing at least one woman aged 18 to 55. Spandana borrowers identified in the census were oversampled. In general, baseline households were not purposely resurveyed in the followup, except for a sample of households who indicated they had loans at the baseline, with the goal of understanding the impact of an increase in credit availability for those households who were already borrowing (though not from MFIs).

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Baseline results

The average baseline household is a family of 5, with monthly expenditure of Rs 5,000. Only 6% of the households lived on under a dollar a day per member, but 47% lived on under 2 dollars per member per day. 67% of the households lived in a house they own, and 29% in a house they rented. 98% of the 7 to 11 year olds, and 84% of the 12 to 15 year olds were in school.

There was almost no MFI borrowing in the sample areas at baseline. However, 69% of the households had at least one outstanding loan. The average loan was Rs 20,000 (median Rs 10,000), and the average interest rate was 3.85% per month. Loans were taken from moneylenders (49%), family members (13%), friends or neighbors (28%). Commercial bank loans were very rare.

Although business investment was not commonly named as a motive for borrowing, 31% of households ran at least one small business at the baseline. However, these businesses were very small: only 10% had any employees, and typical assets employed were sewing machines, tables and chairs, balances and pushcarts; 20% of businesses had no assets whatsoever. Average profits were Rs 3,040 per month on average.

Baseline data revealed low use of consumption smoothing strategies other than borrowing: 34% of the households had a savings account, and only 26% had a life insurance policy. Almost none had any health insurance. 40% of the households reported spending Rs 500 or more on a health shock in the last year; 60% of the households who had a sick member had to borrow.

Followup questions

Preliminary results from the followup survey, to be presented at the conference, are shedding light on whether microfinance access has had any impact on household consumption, overall use of debt and other financial products, business activity, or risk coping:

- do households use MFI borrowing when it becomes available?
- does the presence of Spandana affect the interest rates households pay, or the amount that they borrow?
- is there an impact on the level or composition of household expenditure?
- is there an impact on other risk-smoothing strategies, such as insurance policies or gifts and loans from families and friends?
- does MFI access affect the number, scale or profitability of businesses?
- (how) does the impact of microfinance access vary with household characteristics, and can this tell us anything about the channels through which microfinance matters?