Impact of Non-Bank Micro-Lending*

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Non-Technical Summary

Microfinance is the non-standard provision of a broad range of financial services such as collateral free loans, saving deposits, insurance, remittances, leasing and money transfers to low-income households that are used to support family business or productive activities. Despite the wide recognition of microfinance since its birth in the 1970s, it is still astonishing that there is little reliable evidence on its positive impact. The first major obstacle is a lack of reliable data, while the second stems from flaws in robust methodology (Armendáriz and Morduch, 2010). Moreover, an "evaluation gap" has emerged because governments, donors and other industry stakeholders do not demand or produce enough impact evaluations and because those that are conducted are often methodologically constrained. This calls for advanced techniques of microfinance program evaluation and broader country evidence.

Recent changes in microfinance landscape are characterised by client over indebtedness and MFI failure in India (in 2010), Bosnia and Herzegovina (in 2009) and Bolivia (in 1999) due to commercialization and signal that canonical microfinance models do not work. Critics around microcredits suggest that job creation that boost economic growth and hence reduces poverty is better done by larger enterprises defined as small and medium enterprises (SMEs) (Karnani 2007). The original model of Mohamed Yunus assumed that small, informal microenterprises supported by microloans can be unlimitedly absorbed by weak local economies of developing countries. However, judging from general equilibrium effects, microfinance model caused fallacy of composition as job and income displacement costs increased dramatically. Being tiny, unskilled, informal start-ups, these microenterprises eventually did not have enough capacity to scale-up, diversify and innovate, leading to an unproductive underdeveloped economy and creating negative externalities to existing productive businesses (Bateman, 2011). The strategy of development economics is to focus on middle level, growth-oriented SMEs, the so-called missing layer. These models have been already proven to be successful in European countries such as Italy, Germany and Scandinavia where growth oriented, productive microenterprises integrated promptly into supply chains, innovated and scaled-up with the support of state, trade unions and larger corporations (Bateman, 2011). In this regard we contribute to a general body of microfinance and development finance literature testing the viability of the mid-level, growth oriented SME lending model as opposed to the donor reliant, canonical microfinance model.

The contribution of the paper is therefore two-fold:

First, we propose a novel methodological approach for impact assessment which is based on a combination of propensity score matching and retrospective data collection when no panel data is available or when an experimental solution is not viable. The primary motivation for using a retrospective approach vis-à-vis experimental intervention is based on the fact that accurately measuring program impact has historically been logistically difficult, time consuming, and costly. Many institutions would like to evaluate the effectiveness of their programs ex-post to implementation, which creates problems with the establishment of baseline surveys, control groups, and other means of identification. To address these issues, we extend a one-shot cross-sectional survey with retrospective questions to capture respondents' pre- and in-treatment experiences on changes in discrete, memorable "fundamental events" in their history. Based on collected data, a dynamic panel is re-constructed, allowing for inference on how changes in fundamental events are affected by microfinance participation. In other words, a dynamic retrospective panel setting enables us to go beyond finding simple differences in people's lives with and without microfinance - which is generally found very marginal[2] – but rather to focus on a much more informative agenda of answering who is being served by microfinance and how it is working.

[2]"Event recap: Microfinance impact studies – necessary but not sufficient?" Financial Access Initiative panel chaired by J. Morduch, D. Roodman, Ch. Dunford and J. Rasch. Retrieved from http://financialaccess.org/node/3529

Second, we quantify the impact of microfinance on business and welfare improvement in case of Uzbekistan. Being the first evidence from the Central Asia region, the research takes the advantage of a unique development path of microfinance in the country thus enabling us to assess the viability of emerging commercial SME lending model as opposed to a traditional group lending microfinance model whose efficiency has been criticized and revisited vastly. In Uzbekistan, a conventional microfinance model was introduced in 1998, but later it evolved differently encountering exogenous shocks on the supply side driven by changes in the legal base and termination of external donor support to the market. These changes provoked the emergence of two types of non-bank microfinance institutions: microcredit organizations (MCOs) operating similar to traditional form microfinance model though without external donor support and credit unions (CUs) corresponding to commercial SME finance models. Therefore in addition to the evidence of the impact of microcredits in this paper we also contrast the two models for microcredit provision. The general research question is therefore whether commercial SME microlending is sustainable and generates the same impact which will potentially question the validity of donor intervention.

Our results find the support for market segmentation and a particular niche hold by two types of non-bank MFIs. As such, MCOs serve the lower end segment of the population thus confirming the social objectives. CUs serve higher profile consumers though no impact is detected on business profit indicators. This implies that lending mechanism matters. We also observe the substitution on the market between formal (i.e. non-bank MFIs) and informal (i.e. relative, friends, connections) source of lending which confirms the theory of missing markets (Tirole 2006; Holmstrom and Tirole 1997).

The impact of microcredits on entrepreneurship activity suggests a positive and significant impact on business profit and income for MCO lending. For credit unions there is a significant effect on business employment but not on business income or profit. This finding confirm the current debate over effective job creation, which is claimed to be better done by larger enterprises such as SMEs and their potential for poverty reduction through employing low-skilled workers which is claimed to be channeled by credit unions (Karnani 2007).

The welfare part of the impact is explored through number of channels including total expenses, break-down spending on various aspects of household life, income, household and business assets. Overall the results indicate different patterns and hence heterogeneous impact of microfinance participation on welfare changes of households. We find that borrowing from non-bank MFIs is associated with a positive and significant change in expenses on health and education, total household income and consumer durables. In contrast there is a negative and significant impact on total household expenses, expenses associated with housing and social events as well as on the level of business assets. All of this evidence suggests that borrowing from non-bank microfinance institutions leads to changes in spending patterns of households. There is also evidence of intra-household resource re-allocation and hence substitution effect between welfare expenditures and family business enterprises.

Finally, our obtained results on business and welfare impact are in line with the findings of prominent experimental studies on microfinance impact assessment (Banerjee et al, 2009, Karlan and Zinman, 2010b) and the evidence on disciplining effect of microcredits (Bauer, Chytilová, Morduch, 2011). We demonstrate that impact assessment studies can be done retrospectively preserving accuracy of recall. Our findings are consistent with the ones obtained using experimental interventions and therefore are argued to be robust for selection issues.