Introduction to MICROFINANCE

Todd A. Watkins

Lehigh University, USA



NEW JERSEY • LONDON • SINGAPORE • BEIJING • SHANGHAI • HONG KONG • TAIPEI • CHENNAI • TOKYO

CONTENTS

List of Co-Authors	v
List of Figures	xiii
List of Tables	xvii
List of Boxes	xix
Chapter 1. An Introduction to Microfinance	. 1
1.1. Microfinance Begins	2
1.2. Microfinance Defined	2 5
Can the Poor Really Use Financial Services?	5
 Microcredit: The Roots of Microfinance 	8
 Group Lending 	10
 Savings and Beyond 	13
1.3. Microfinance as an Industry	18
How Big Is Microfinance and Who Uses It?	18
• Who Provides Microfinance?	19
 Commercialization: Does It Undermine Social 	
Missions?	21
 Outreach 	23
 Key Players and Intermediaries 	25
 Microfinance Institutions and Networks 	25
MFI Funders and Service Providers	28
Chapter 2. Daily Financial Lives of the Poor	35
2.1. The Portfolios of the Poor	36
One Poor Family's Financial Story	36
Meet Khadeja and Hamid	37
 Finance without Money 	40

 The Need for Financial Services 	43
 Ensuring Daily Consumption 	44
 Emergencies and Other Big Ticket Expenses 	47
2.2. Informal Mechanisms of Savings, Lending, and Insurance	52
 Saving Up 	53
 Saving Down 	54
 Saving Through 	55
 The Demand for Microfinance 	60
2.3. Patterns of Global Poverty	63
Where and How Poor Are the Poor?	63
 Wealth Distribution and Income Inequality 	66
Chapter 3. Barriers to Financial Services for the Poor	75
3.1. Patterns of Access to Financial Services	76
3.2. Two Worlds: Formal Finance and Informal Markets	82
 Banking Business Models vs. the Informal Sector 	82
 Dead Capital and the Informal Economy 	82
• The Primacy of Flow Transactions	88
Information Asymmetries and Agency Problems	89
Adverse Selection	91
 Moral Hazard 	94
Limited Liability	96
3.3. Behavioral Barriers	98
 Social and Cultural Norms 	99
 Psychological Tendencies 	100
Self-Control	101
Mental Accounting	103
 Misestimating Risk 	104
3.4. Problems of Costs and Risks	107
 Transaction and Opportunity Costs 	107
 Last Mile Problem and Complementary Infrastructure 	110
 Challenges of On-Demand Access 	111
 Managing Risks 	114
 Subsidized Credit 	116
Chapter 4. Informal Finance	125
4.1. Savings Clubs	126
 ROSCAs: Rotating Savings and Credit Associations 	127

Basic ROSCAs	128
Other Forms of ROSCAs	130
 Motivations for Joining ROSCAs 	132
ASCAs: Accumulated Savings and Credit As	ssociations 135
 Non-Time-Bound ASCAs 	138
• Flexibility and Issues with ASCAs	140
4.2. Savings Handlers and Credit Providers	144
 External Managers 	144
 Deposit Collectors 	146
 Informal Moneylenders 	149
How Much Do Moneylenders Charge and V	Why? 153
 Credit under Contract 	156
Chapter 5. Microlending	165
5.1. Group Lending	166
 Group Lending Approaches 	167
 Classic "Grameen-Style" Group Lending 	168
 Solidarity Group Approach 	173
 Village Banking 	174
 Village Savings and Loan Associations 	177
 Self-Help Groups 	177
5.2. Group Lending as a Tool to Overcome Market	:
Failures	180
 Social Implications and Moral Hazard 	180
 Gender and Group Lending 	183
 Implications for Forming Groups 	184
Strangers vs. Community and Friends: What	t
Works?	186
5.3. Limitations of Group Lending	188
The Inflexibility of Group Lending	188
 Opportunity Costs 	190
Free Riding	192
 Joint Liability's Double Edge 	192
 Collusion Risk 	196
5.4. Individual Lending	198
 Individual vs. Group Lending from the MFI 	
Perspective	199

Individual vs. Group Lending from the Client's	
Perspective	204
 Graduation 	205
Chapter 6. Beyond Microcredit	211
6.1. The Emerging Array of Microfinance Services	212
6.2. Microsavings	214
Why Do the Poor Need to Save?	214
 Types of Microsavings Services 	215
 Compulsory Savings 	215
 Voluntary Savings 	217
 Commitment Savings 	221
The Benefits of Savings Mobilization	223
 Benefits to the Individual 	224
• Benefits for the MFI	226
 External Challenges to Savings Mobilization 	227
6.3. Microinsurance	233
Why Microinsurance?	233
How Widespread Is Microinsurance?	235
Who Provides Microinsurance?	238
 Potential Market Failures and Microinsurance 	239
Adverse Selection	240
 Moral Hazard and Limited Liability 	240
• Fraud	241
Covariate Risk	241
 Technical Challenges in Microinsurance 	242
 Loan Protection Insurance 	243
 Life Microinsurance 	244
 Savings-Linked Microinsurance 	245
 Health Microinsurance 	249
 What's Covered? Balancing Costs and Demand 	250
 Adverse Selection and Health Insurance 	253
 Why Isn't Health Microinsurance More 	
Widespread?	254
 Agricultural Index Microinsurance 	255

Chapter 7. Gender Issues in Microfinance	263
7.1. The Focus on Women	264
 Regional Patterns 	265
 Commercialization and Gender 	266
7.2. Why the Focus on Women? The Demand Side	271
 Why Might Women Demand Microfinance More 	
Than Men?	271
Wage Gaps and Informal Economy Financial Patterns	273
7.3. The Supply Side: Why Do MFIs Prefer Women?	277
Are Women Better for Business?	277
The Family Impact Motive	281
The Empowerment Motive	285
 Might Microfinance Dis-empower Women? 	292
Chapter 8. The Evolution of Commercial Microfinance	305
8.1. Profitability, Transformation and Scale	307
 Demonstrating MFI Profitability 	307
Transformation of Non-Profits into Regulated Banks	311
 The Distortion Potential of Subsidies 	314
Achieving Scale and Mass Outreach	314
 Efficiency and Pricing Incentives in Competitive Markets 	319
How Much Does Microcredit Cost?	321
8.2. The Ecosystem of Intermediaries	327
International Financial Institutions and Investment Funds	327
Information Providers and Other Professional Services	333
8.3. Accessing International Capital Markets	336
 Public Equity 	337
 Commercial Debt 	342
8.4. The Social Mission Debate	348
Chapter 9. Measuring the Impact of Microfinance	365
9.1. Challenges to Measuring Impact—Part I	369
Correlation vs. Causation: What's the Difference?	370
Selection Bias Explains Some Correlations	371
 Establishing the Counterfactual to Determine Causation 	374

9.2. Meth	odology of Impact Assessments	378
■ Mo	odel of the Causal Impact Chain	378
 Lev 	rels of Analysis	378
 Spe 	ecification of Types of Impact to Assess	381
 Gat 	thering Information: Qualitative vs. Quantitative	
Stu	dies	382
 Rar 	ndomized Control Trials	383
9.3. Challe	enges to Measuring Impact—Part II	388
 Trac 	deoff between Depth and Breadth	388
■ Pro	blems with Mathematical Models	390
9.4. Evider	nce of Impact	393
 Evid 	dence on the Impact of Microcredit	394
• E	Experimental Evidence	396
• E	vidence from Quasi-Experiments	400
 Evic 	dence on the Impact of Microsavings	404
• T	he Poor Want Formal Ways to Save	405
• C	Commitment Savings vs. Basic Savings Accounts	406
 Mic 	crofinance's Macroeconomic Effects Remain Unknown	411
References		417
Index		431