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Financing Businesses in Africa

The Role of Microfinance

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Abstract

This paper evaluates how microfinance performed in providing business financing in 27 Sub-Saharan African countries. It uses data from the 2009 and 2010 Gallup World Poll, a nationally-representative survey of at least 1,000 individuals per country, conducted in up to 157 countries per year. The data, supported by rigorous statistical evidence in related literature on the use of microcredit around the world, demonstrate

that economic gains from microcredit have been more modest than what was once believed. On the other hand, the analysis suggests that the poor save in order to start new businesses and that the introduction of formal products for small savings can be a key financial innovation. The authors also analyze the challenges the poor face in setting money aside to save, and discuss what policymakers can do to promote savings.

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Financing Businesses in Africa: The Role of Microfinance

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1. Introduction

The law of diminishing marginal productivity dictates that scarce resources earn a high return. Why, then, does capital not flow to the poor, its most productive users? This has been attributed in part to the failure of credit markets. The argument goes that the poor have so little to offer by way of collateral, and borrow such small amounts, that it is too risky and too expensive to lend to them. The ramification is that they get caught in a credit-based poverty trap, wherein they are unable to undertake profitable investments due to credit constraints and, hence, remain poor. The great promise of microcredit – making joint-liability loans to small groups of poor people possessing no collateral, enabling them to make productive investments – was to be the magic bullet against poverty. Yet, a mere five years after the Nobel Peace Prize was awarded to Muhammad Yunus and the Grameen Bank, claims about microcredit's transformative power are being debated.

Supporters of microcredit still maintain that it is capable of raising incomes and consumption, empowering women, fostering a feeling of community and establishing creditworthiness and financial self-sufficiency. However, nay-sayers contend that it can lead to over-indebtedness resulting in perpetual poverty and crowds out other anti-poverty interventions. In order to understand the stakes involved in this debate, consider this: as of December 2009, of the \$21.3 billion in cross-border funds committed to microcredit, \$14.6 billion (68.5 percent) came from aid agencies and development institutions as grants or as highly subsidized debt (El-Zaghbi, Gähweiler and Lauer, 2011). In the absence of hard evidence definitively supporting the wealth-creation role of microcredit, it is questionable whether it makes sense to channel so much money into it, at the cost of other, competing anti-poverty investments.

Different strands of the literature have examined the varied claims about the positive impacts of microcredit, but the evidence continues to be mixed. While most studies find that access to microcredit enables households to better smooth and enhance consumption, the picture around other claims remains murky.

We evaluate microcredit in its purported income-enhancing role – Do small loans enable the poor to make productive investments? In this context, we document the low use of microcredit for business purposes in Sub-Saharan Africa (SSA).. We discuss the potential reasons behind this low usage, and examine how SSA fits in with the patterns and predictions of the academic evidence on microcredit. We also evaluate a new avatar of microfinance – microsavings. We review the literature on savings as well as the evidence from the ground to show how savings might be positioned to yield the gains that were expected from credit. Finally, we discuss the behavioral and institutional challenges that the poor face in saving money and the policy prescriptions for overcoming these challenges.

The paper proceeds as follows: in Section 2 we review the related literature and motive for empirical analysis; Sections 3 and 4 discuss financial inclusion data from SSA, in the context of the microcredit and microsavings movements, respectively; Section 5 concludes.

2. Review of the Literature on Microfinance and Returns to Capital

Rigorous experimental evidence establishing a causal link (or lack thereof) between access to microcredit and growth of microenterprises is hard to come by. Selection bias prevents direct comparisons between those who borrow from microfinance institutions (MFIs) and those who do not. Similarly, the lack of a counterfactual makes it impossible to gauge how the borrowers would have fared in the absence of credit. The first quasi-experimental study in this

area is Pitt and Khandker (1998), who utilize Grameen's loan eligibility threshold of 0.5 acres of land as a discontinuity in a maximum likelihood model. While their paper focuses on consumption-related outcomes (which are large and positive, especially for women), they also look at labor supply, including self-employment hours. This effect is found to be marginally positive for women but negative for men. Since the same study finds substantial consumption gains, this might suggest that micro-credit makes people substitute away from productive work and towards leisure. That said, the findings from this paper, have been challenged by Morduch (1999), who shows that the eligibility threshold was not strictly enforced, invalidating the identifying assumption.

The first truly experimental evidence on this subject comes from Banerjee et al. (2009) who worked with an MFI called Spandana based in Hyderabad, India. Their experiment entails a random roll-out of MFI branches in half of 104 selected slums, with the remaining half being the control group. They find that 15-18 months after lending begins, there is a positive, albeit insignificant, difference between the profitability of existing businesses in treatment and control areas. Importantly, the rate of creation of new businesses is significantly higher with 32 percent more businesses created in treatment areas. The most interesting aspect is the heterogeneity in the treatment effect across households. Households with differential propensities to become business owners display differential rates of substitution between durable and non-durable consumption: those with an existing business increased investment without cutting back on current consumption; those with a high propensity to become business owners increased investment spending and decreased current consumption – an artifact of the high fixed cost of starting a business; those with a low propensity simply increased current consumption with no accompanying effects on durable consumption spending. A key takeaway here is that, contrary to

what was believed, providing access to credit to all will not make an entrepreneur out of everybody.

A closely related study is by Crépon et al. (2011) in rural Morocco. This intervention involved randomly offering microcredit to one out of two villages in 81 matched pairs. They find that providing access to microcredit did not lead to new business creation, only to an expansion in the scale of existing businesses. Households with no existing business at baseline merely increased consumption once they got access to credit. This again reminds us that credit, by itself, cannot spawn entrepreneurs. Like Pitt and Khandker (1998), they also find that treated households decreased their wage employment and increased their consumption of leisure, offsetting the income gains realized from the scale expansion of existing businesses. If this finding has external validity, it not only casts a shadow on the income generating potential of microcredit, but also raises longer term questions about the borrowers' ability to repay their loans and/or the possibility of chronic indebtedness.

Kaboski and Townsend (2011) also utilize village level differentials in access to credit, albeit through an entirely different channel. They study the impact of the Thai Million Baht Village Fund program, under which the government of Thailand provided a million baht to each of the country's 80,000 villages to start a rural bank. The exogenous variation stems from the fact that all villages got the same amount, irrespective of their population. As a result, there was a huge variation in the per capita expansion of credit across villages. The authors construct a structural model and use a panel of 960 households from 64 villages for estimation. They find significant increases in consumption, but no impact on average investment. Similar to the preceding two papers, this one also finds heterogeneous effects, with a small subset of households choosing to increase its investment spending. However, this increase is more than

offset by a larger subset of households that substitute towards present consumption as borrowing becomes cheap.

Karlan and Zinman (2010a, b) measure the impact of microfinance at the individual level by studying marginal loan applicants to a Manila-based urban lender that uses a credit scoring algorithm for its lending decisions. This study only targets existing microentrepreneurs (this was a qualification requirement, and the mean number of businesses held by applicant households is 1.15), so the impact on new business creation cannot be analyzed. For existing businesses, surprisingly, the findings suggest a scale contraction after getting access to microcredit. The operative channel for this seems to be the shedding of unproductive workers, but the reasons for this aren't really clear. Business profits increase for male entrepreneurs, but decline for female entrepreneurs, the target constituency of most MFIs.

The desultory evidence from these studies can be a little disconcerting after having heard poignant stories of the destitute finding freedom from poverty through microcredit. Indeed, anecdotes about the positive impact of microcredit abound in the popular press. However, it is useful to temper our expectations with the fact that isolated success stories do nothing to educate us about how something performs on average. This is equally true on the flip side: individual tales of microcredit's spectacular failure, leaving in its wake entire villages of debt-ridden farmers, who en-masse chose to default, do not address its overall performance. This is why the current body of work on microcredit, with its few but rigorous experimental studies that take into account both gainers and losers, as well as the sizeable majority who are neither, provides us with the only reliable evidence on its efficacy.

In fact, the lesson from the current literature bears repeating: large doses of microcredit might not be useful for creating new businesses, on average, due to borrower heterogeneity. This

is not to say that its consumption-smoothing and risk-coping functions are not valuable in themselves. In fact, Collins et al. (2009) document that just to meet these needs, the poor juggle complex financial transactions on a daily basis. However, it is possible to achieve these benefits through other innovations like micro-savings (discussed later in the paper) and micro-insurance, which displace other pro-poor interventions to a much smaller degree.

The bigger puzzle here is that of existing businesses. Evidence has been inconclusive as to whether microcredit fosters investment in incumbent firms. This is surprising, given that limited access to finance is frequently stated as a stumbling block to business growth by entrepreneurs in developing countries; for example, 30.9 percent of firm owners in the World Bank Enterprise Survey list access to finance as a major constraint to growth.¹ Using regulatory changes in the Indian banking sector as a natural experiment, Banerjee and Duflo (2008) also find evidence that medium-sized enterprises are stymied by credit constraints. Both of these studies include large and medium sized firms, and this handicap is even more pronounced for small firms. In fact, Beck, Demirgüç-Kunt and Maksimovic (2007) find that financing constraints impede growth by 10 percent for small firms, as against 6 percent for large firms. Worse, Sabarwal and Terrell (2009) find evidence from Latin America consistent with the fact that when women own small or medium enterprises, they are less likely than men to receive formal credit when they apply for it.

Why, then, do small firms not borrow from MFIs? One possible factor driving low usage could be that returns to capital in microenterprises are low and therefore it does not make sense for their owners to borrow money to invest in them. However, multiple pieces of evidence allow us to negate this possibility.

¹ The complete World Bank Enterprise Survey dataset is available at: <http://www.enterprisesurveys.org>.

The first evidence comes from the literature on returns to capital in developing countries. Udry and Anagol (2006) estimate 150 to 250 percent annual returns to pineapple cultivation (more capital-intensive than the traditional crops) in Ghana. Duflo, Kremer and Robinson (2011) also find very high returns (ranging between 52 percent and 85 percent, annualized) to the relatively low capital-intensive task of applying fertilizer to the maize crop in rural Kenya. Returns are similarly high for non-agricultural microenterprises. In a randomized control trial (RCT) involving a subset of microenterprises in Sri Lanka, de Mel, McKenzie and Woodruff (2008) find the average return on capital to be as high as 4 percent per month; high returns to capital are similarly found among a group of microenterprises in Ghana (Fafchamp et al., 2011). In a very similar intervention in Mexico, McKenzie and Woodruff (2008) find this return to be in the range of 20-33 percent per month.

The fact that business-owners do utilize other sources of money to meet their borrowing needs (money lenders, friends and family, etc.) attests to the fact that they are not unwilling to borrow. We examine this phenomenon more closely in the context of Sub-Saharan Africa (SSA) in the following section. We also evaluate financial access in SSA more broadly, in order to gain better insight into business-related financing.

3. Microcredit in Sub-Saharan Africa

3.1 Gallup World Poll Database

The micro-level data that we analyze in this paper come from the 2009 and 2010 waves of the Gallup World Poll.² The Gallup World Poll is a nationally representative survey comprising annually up to 150,000 individuals from up to 157 countries. The core Gallup World Poll questionnaire includes detailed demographic, employment, and income information, as well

² For additional information, see: <https://worldview.gallup.com>.

as self-reported perceptions, such as of personal “wellbeing”, government, politics, and religion. The 2009 round of the poll added several new questions in SSA in order to measure financial inclusion. The measurement was done along the following three dimensions: use of bank accounts, credit allocation and risk mitigation. We utilize this data for SSA countries in our evaluation of the role of microfinance in business-creation. We report data averaged by country over 2009 and 2010 since some countries only have data available for one of the two years and while other have data for both years.

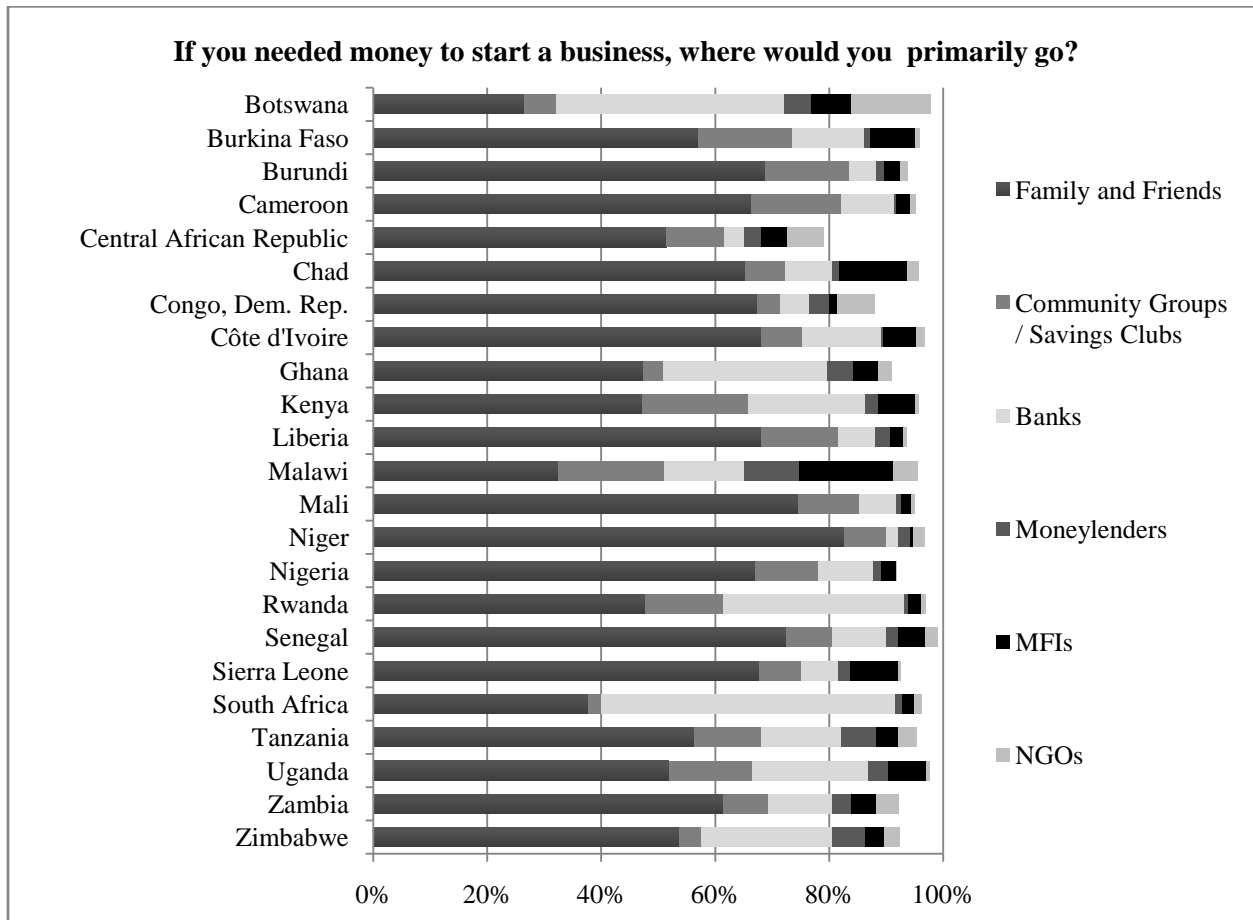
3.2 Evidence on Microfinance Usage and Awareness

In the previous section, we briefly examined the current literature on microcredit and its role in creating and expanding businesses. Since most studies show less than expected utilization of microcredit, it is useful to first look at perceptions and uses of various sources of financing. The Gallup World Poll asks what sources of financing individuals would consider using to start a new business. The data show that 42.3 percent of all responders in SSA state family as the primary source of funds for potential business needs (Figure 1). Community savings groups (also known as ROSCAs – Rotating Savings and Credit Associations), through which groups of people save money together, are a popular mode of savings in parts of Africa and are cited as a source of funds by about 10 percent of those surveyed. Importantly, commercial banks are reported by about 20 percent of responders (though not all respondents necessarily have the collateral and/or credit history to access formal bank financing).

Notably, in none of the Sub-Saharan countries surveyed, does the proportion of people willing to borrow from MFIs exceed 17 percent, and the mean for all SSA countries is a meager 4.3 percent. Not all of this difference between the borrowing rates from community networks and

MFI is attributable to informal insurance and risk-sharing mechanisms, as 16 percent cite commercial banks as their potential go-to source for business funds.

Figure 1: Sources of Start-up Financing, by Country (average 2009-10)



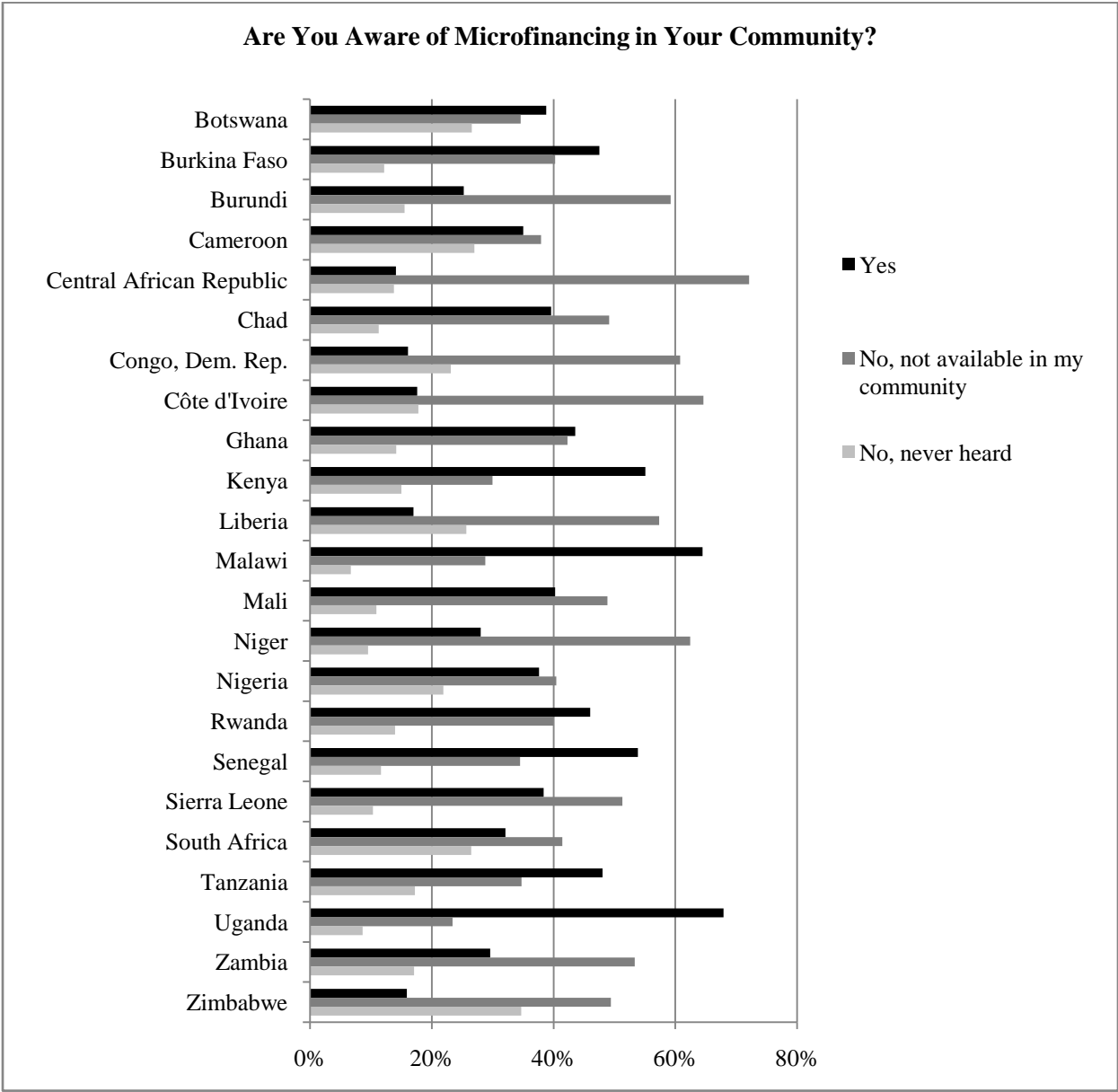
Source: Gallup World Poll 2009 and 2010.

It would be quite natural to wonder at this point as to why this distinction is important. After all, shouldn't the source of a loan be immaterial as long as the poor have someone to borrow from when the need arises? However, the literature draws a clear advantage of access to formal lending institutions for a number of reasons. For instance, Collins et al. (2009) observed that microcredit is far more reliable, in terms of both availability and price, than one's informal

network. Closely related to this is the fact that relatives and friends may not have much to lend if there has been an adverse shock that has affected everybody contemporaneously. Another issue that a microentrepreneur who leverages his informal network for business funds might face is that of reciprocity – having to lend money to someone else during their time of need might starve the lender’s business of much needed funds. This risk of having to lend to family and friends is well documented. For instance, Baland, Guirkinger and Mali (2007) present evidence from Cameroon, where a large number of individuals borrow money (and pay interest on it) from credit cooperatives for no other reason other than to appear poor in order to avoid having to lend to family and friends.

The potential benefit from promoting access to formal lending institutions is high in SSA since there are a substantial number of small and micro enterprises. According to calculations from Schneider (2002), the informal economy accounted for 43.2 percent of GNP for SSA in 1999-2000 and 81 percent of those employed in the informal economy in SSA (excluding South Africa) are self employed (ILO, 2002). Add to this the fact that women, either by choice or by necessity, work disproportionately more in the informal sector – according to the World Bank Development Report (2004), the proportion of the female non-agricultural labor force that works in the informal sector is more than 95 percent in Benin, Chad and Mali, and more than 80 percent in Guinea and Kenya. These are the very people who run corner grocery stores and small tailoring shops – the small entrepreneurs, especially women, that microfinance set out to target. Since less than 3 percent of them borrow from MFIs today (CGAP and MIX, 2010), it is imperative for development practitioners and policy-makers to understand the reasons behind these low levels of adoption.

Figure 2: Awareness of Microfinance, by Country (average 2009-10)



Source: Gallup World Poll 2009 and 2010.

The Gallup data illuminates potential reasons for the low take-up of microfinance (Figure 2). Asked if they are aware of any institutions in their community that help people obtain small business loans, 16.2 percent of the respondents stated that they had never heard of such institutions. An additional 46.2 percent stated that such institutions are not available in their

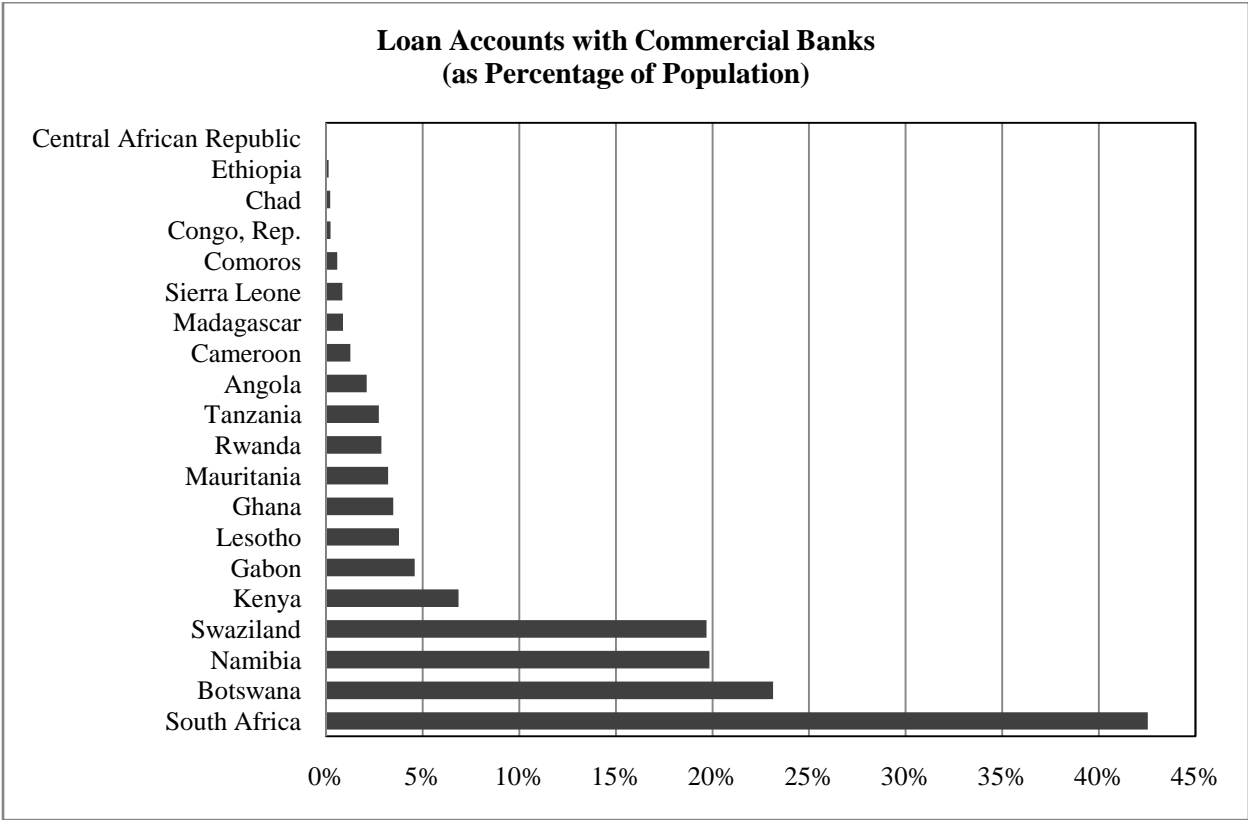
community. Certainly, a percentage of those reporting that microcredit was unavailable in their community might also simply be unaware of its presence, given that some form of MFIs had reached 85 percent of all depositors and borrowers in SSA by 2009 (CGAP and MIX, 2011). When taken together, these numbers point to exceedingly low levels of awareness.

Sparse evidence from the literature also points towards awareness as part of the problem. In an intervention aimed at urban microenterprises in Sri Lanka, de Mel, McKenzie and Woodruff (2011) find that providing more information about the loan product on offer by a regional development bank doubled the proportion of firms receiving a loan. There are a couple of things worth bearing in mind about this intervention: first, the information session was combined with a decrease in the bureaucratic requirements for the loan, so the impact of information alone cannot be isolated. More importantly, the intervention entailed providing more details about the loan to clients who already knew about its availability. The SSA problem, on the other hand, centers on low awareness about the existence of MFIs and the availability of microloans as such. However, as suggested by Beck et al. (2011) financial literacy programs for households and enterprises might be able to address some of the nonfinancial constraints to borrowing, particularly in rural areas.

Another fundamental challenge that might be keeping MFIs from making deep inroads into SSA, is that borrowing from formal financial institutions, in general, is very low (Figure 3). These numbers are based on supply-side data collected by the International Monetary Fund (IMF) directly from Central Banks around the world on the number of loan accounts. SSA shows very low loan penetration; for example, the number of loan accounts normalized by population is less than 10 percent, with the exception of a number of countries in Southern Africa. However, there is a great degree of country-level heterogeneity in this borrowing rate – the numbers range

from less than 1 percent for the Central African Republic to over 40 percent for South Africa (Ardic, Heiman and Mylenko, 2011). An important caveat is that these data are supply-side indicators of financial usage and therefore do not correct for double-counting (e.g. one individual with multiple loans). Therefore, these numbers represent an upper bound on borrowing rates in these countries, and actual borrowing rates are likely even lower.

Figure 3: Borrowing Behaviour, by Country (average 2008-09)



Source: IMF-IFS Statistics, 2011.

It is striking how these borrowing rates vary by per capita GDP: South Africa, Botswana, Namibia, and Swaziland, the four countries with the highest borrowing penetration, are also among the 10 richest countries in Africa, as measured by GDP (WB-WDI, 2011).

Similarly, the Central African Republic and Ethiopia, countries that find themselves at the bottom of the borrowing rate rankings, are also among the 10 with the lowest per capita GDP in all of Africa. However, caution is required in interpreting this relationship, as the same factors that drive gains in income could be leading to an increase in borrowing rates. For example, one such factor might be local institutions. For instance, Mauro (1995) has shown that corruption has a pernicious effect on economic growth by lowering investment. In fact, corruption is an endemic problem in SSA. The “Corruption Perceptions Index” published by Transparency International has consistently ranked SSA as one of the most corrupt regions in the world and in 2010, 16 of the world’s 30 most corrupt nations were in SSA.³ The region also ranks dismally in the World Bank’s Doing Business index⁴, which rates countries based on how conducive their regulatory environment is to starting and operating a local firm. The rating incorporates several parameters like ease of registering property, getting credit and enforcing contracts. A low ranking in this index is indicative of weak institutions. It is highly likely that corruption could be one of the driving forces behind the low per capita GDP as well as the low borrowing rates in this region.

Although it is difficult to glean any other causes behind low usage of formal financial services from the Gallup survey, another potential candidate is “trust.” The trust explanation is closely related to the problem of corrupt institutions that we just discussed. There are two ways in which trust, or social capital, can have an impact on the adoption of microfinance. Under the first mechanism, which is specific to microcredit, people are less likely to borrow under joint liability if there is low level of trust within their community. Cassar and Wydick (2010) provide laboratory evidence indicative of support for this hypothesis. They find a positive correlation

³ Complete data is available at: http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results.

⁴ Complete data is available at: <http://doingbusiness.org>.

between contribution rates and trust levels in a cross-country group lending experiment. However, the prevalence of ROSCAs in SSA suggests high levels of intra-community trust (Ardener and Burman, 1995), refuting this explanation.

The other “trust-channel” is the positive relationship between social capital and financial development in general. Guiso, Sapienza and Zingales (2004) were the first to document this phenomenon for Italy by showing that individuals hailing from high social capital areas are more likely to use checks and to have access to institutional credit. They also show that the causality is particularly strong in regions with low levels of education and weak judicial enforcement. This correlation is also highlighted by Calderon, Chong and Galindo (2002), who compiled cross-country evidence showing that a one standard deviation improvement in the trust indicators brings about an expansion in the financial market of a country that is equal in magnitude to 19 percent of GDP.

The prevalence of ROSCAs suggests that a level of individual trustiness exists in SSA, which suggests that this channel might be operating through trust in institutions. We have already discussed that the region is fraught with corruption. Banks have also not remained untainted by this systemic malaise. The banking sector in 32 SSA countries faced mild to severe crises related to solvency and non-performing assets in the late 1980s and 1990s (Caprio and Klingbiel, 2003). In several instances, the crisis was so crippling that a substantial proportion of the country’s GDP was lost, and several banks had to be shut down. Here’s a sampling of the extent of the losses, expressed as a percentage of the GDP of the country in question for the year of the respective crisis: Benin – 17 percent, Cote d’Ivoire – 25 percent, Mauritiana – 15 percent, Senegal – 17 percent, Tanzania – 10 percent (Caprio and Klingbiel, 2003).

Beck, Demirgüç-Kunt and Levine (2000) and Beck and Demirgüç-Kunt (2009) have also documented the extremely poor financial health of the SSA banking sector. It is also important to remember that in SSA, while the banking sector has come a long way, collective memory has not. Dupas et al. (2011) find that risk of embezzlement and unreliability of the bank are stated as reasons for low usage of savings accounts in a recent study based in Western Kenya. This may explain part of the reason why people still prefer to borrow and lend within their small circle of family and friends.

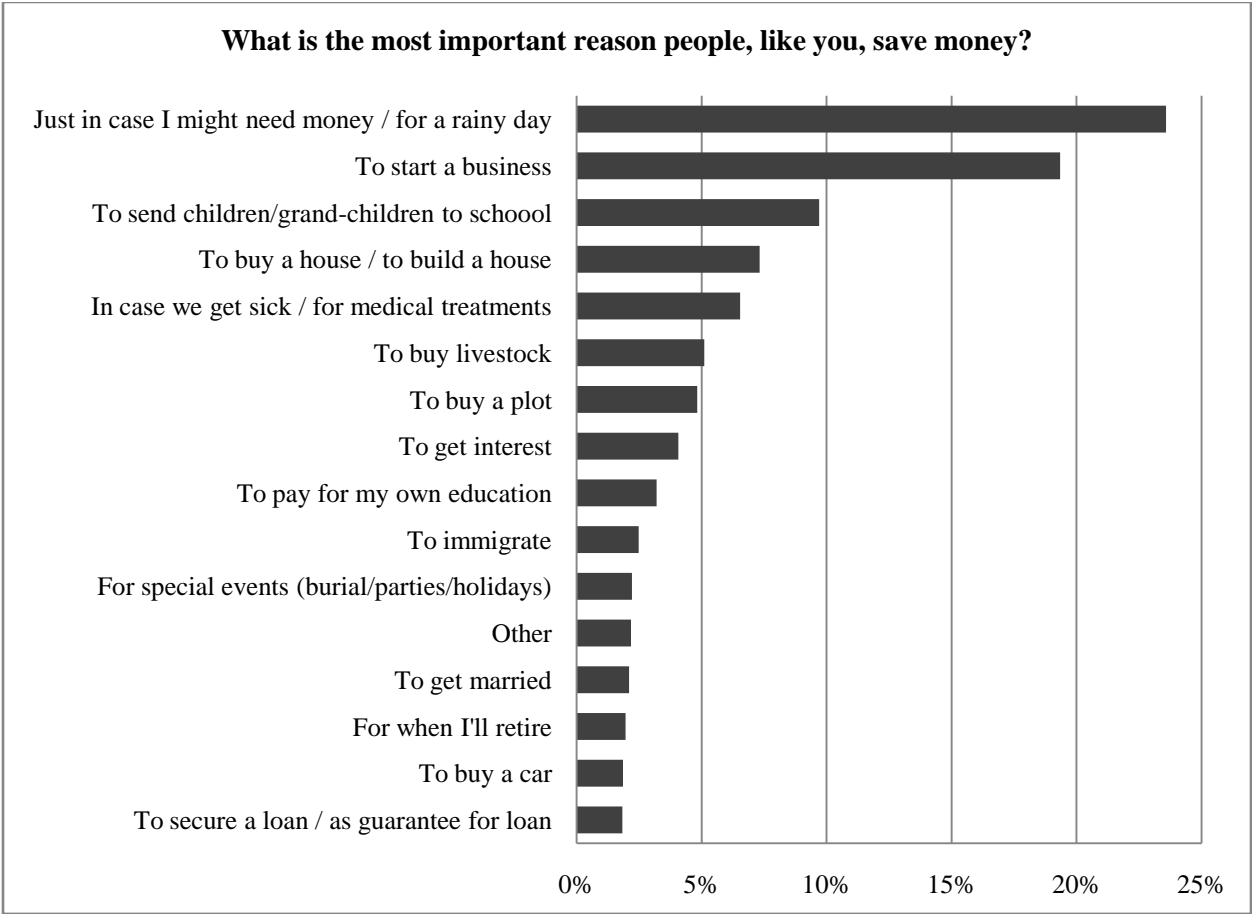
How much of the meager adoption rates are explained by the factors which we have explored above is still an open question. To some degree, this is not an SSA-specific problem since in their Hyderabad-based study Banerjee et al. (2009) also find that the introduction of an MFI to a new area leads to an increase of merely 8.3 percent in the probability of receiving a loan from a MFI. However, to the extent that trust and awareness are significant explanatory factors, it would be realistic to expect that as the presence of MFIs becomes older in the region, both of those problems might become less severe. Even in the Hyderabad study, the impacts were analyzed just 15-18 months from roll-out, and newness could certainly be driving part of the low adoption.

4. Savings in Sub-Saharan Africa

Meanwhile, as inconclusive evidence around credit's potential has continued to trickle in, the focus of microfinance practitioners has become much broader to include other financial services like microinsurance, micropensions, and especially microsavings. The epiphany that unleashed the shift toward microsavings is this: if the poor can borrow their way out of poverty, they can equally well save their way out of it. Having a nest egg should be as effective as a loan

in relaxing credit constraints. In fact, findings from the Gallup survey confirm this reasoning (Figure 4). Asked about the most important reason why people save money, 29 percent provide a precautionary motive behind their most important reason to save, stating saving for either “a rainy day” or “in case we get sick”. The second most important reason that people report saving is “to start a business” (almost 20%). These numbers suggest that almost half of the people surveyed are actually using savings for purposes that credit was either supposed to, or is billed to, serve. What is more, enabling savings neither creates the burden of debt, nor the resource diversion that credit does.

Figure 4: Reasons for Saving (average 2009-10 over SSA countries)



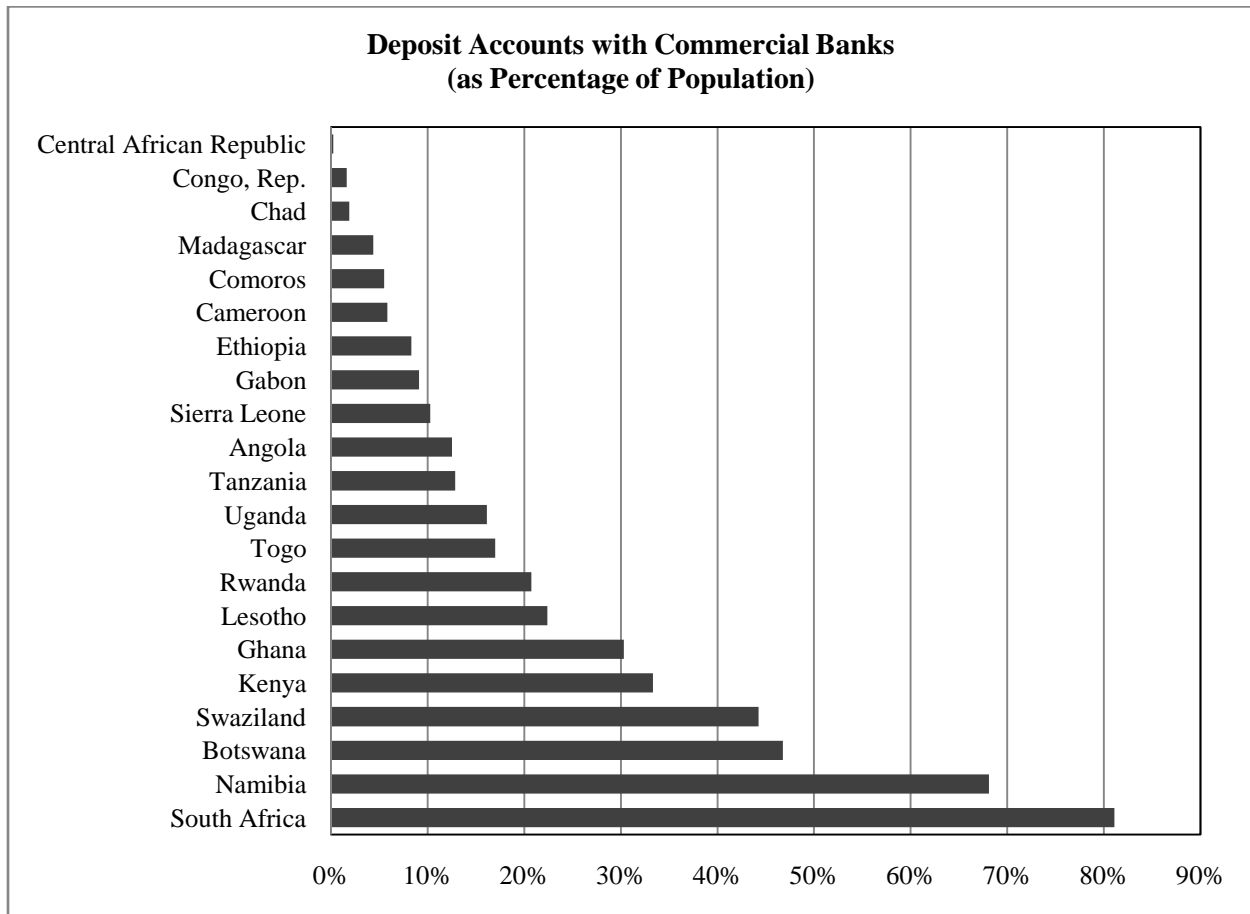
Source: Gallup World Poll 2009 and 2010.

However, before this willingness to save can be harnessed towards actual gains on the ground, we need to better understand the challenges that the poor might face in setting money aside as savings. Banerjee and Duflo (2007) have documented that a huge proportion of the poor still lack access to formal banking services. Chaia et al. (2009) estimate that 80 percent of the entire adult population in SSA was unbanked at the beginning of the 2000s. Expectedly, the penetration numbers are much worse for those living below the poverty line: Gaul (2011) calculates the absolute difference between the population living below the poverty line and the population with access to financial services, and finds that the numbers are as high as 80 million for Nigeria and 48 million for Congo. While this is a somewhat crude and imprecise way to measure financial inclusion, it does underline the fact that a vast majority of the very poor continue to be bypassed by financial institutions. Data from IMF statistics also reflects this lack of access to financial services. The number of deposit accounts as a percentage of population is a meager 19 percent on average (excluding South Africa) (Figure 5). Again, the caveat applies that these are supply-side data that do not control for multiple and dormant accounts and actual formal bank penetration is likely much lower.

The lack of access to formal financial institutions drives the poor to save in sub-optimal ways. For instance, the widely prevalent practice of saving through Rotating Savings and Credit Associations (ROSCAs) in Africa comes with a significant risk of the ROSCA itself collapsing before all the members have ‘won’ the draw. Similarly, in an RCT based in rural Kenya, Dupas and Robinson (2011a) offered savings accounts to 163 microentrepreneurs. These accounts provided no interest and entailed a withdrawal fee, which effectively means that they had a negative interest rate. They find that 53 percent of those who were offered this account chose to save through it, implying that they could not access a better way to channel their savings.

Importantly, the negative return on the accounts isn't merely an experimental gimmick. Besley (1995) documents that moneylenders in Western Africa have been successfully charging significant withdrawal fees on deposits.

Figure 5: Deposit Accounts, by Country (average 2008-09)



Source: IMF-IFS Statistics, 2011.

The challenges presented by a lack of financial access get compounded for people who have present-biased preferences and, lacking any formal vehicles to save, just choose to consume it. However, in an RCT based in the Philippines, Ashraf, Karlan and Yin (2006) find that when offered savings accounts that require commitment, people with such preferences are more likely to sign up. Furthermore, Dupas and Robinson (2011b) find that providing informal savings

mechanisms (like a lockbox) to the poor increases their investment towards preventive health, suggesting that they were making suboptimal health choices in the absence of access to a savings vehicle. This suggests that in addition to financial access, provision of the right kind of savings technologies is also imperative in enabling savings.

In addition, even if the poor do manage to save at home on their own, they face the risk of the money being appropriated by others, like their spouse, friends or members of the extended family. This is a non-trivial risk and Jakiela and Ozier (2011) provide experimental evidence from Kenya demonstrating that participants were willing to forego expected earnings in order to conceal the size of their initial endowment so that they could avoid sharing it with those in their network. Interestingly, Brune et al. (2011) find that commitment savings accounts can also provide protection from such appropriation by minimizing access to the funds that have already been banked.

For anybody who has followed the arc along which microcredit evolved, it is natural to wonder if the evidence from the ground for microsavings supports what seems like a very promising theory on paper. So far, we have only one good quality RCT on the impact of microsavings, and the evidence from that is promising. In the Dupas and Robinson (2011a) experiment that has been mentioned earlier, we find that those who were offered accounts save more and show a significant increase in business investment and even in personal consumption expenditures. It shouldn't be excessive to conjecture here that the increase in consumption was a result of increased profits, which in turn came about due to the increase in investment. Further, the study finds a decrease in average poverty, something that RCTs of microcredit have failed to demonstrate unambiguously.

There also exists a small body of studies that looks at the impact of expanding access to banking services in general, i.e. both savings as well as credit products. Burgess and Pande (2005) and Bruhn and Love (2009) find evidence in India and Mexico, respectively, that providing access to banking to low-income clients leads to an increase in new business creation (Mexico) and to a reduction in poverty (India and Mexico). Since credit alone has not been shown to have discernible effects on either of these outcomes, it might be possible to surmise from here that at least some of these effects stemmed from having access to dependable savings technologies.

4.1 *How to Enable Savings?*

The looming policy question is about how we can make savings technologies accessible to the poor. Various developing countries are experimenting with novel schemes to facilitate savings. In some cases, these are being driven by the state, like in India, where the Central Bank directed all commercial banks in late 2005 to provide ‘no frills’ bank accounts to the poor. These accounts can be opened and operated with miniscule to no money, making it easier for the poor to save. By 2008, more than 15 million interest-paying no-frills accounts had been opened (Thyagarajan and Venkatesan, 2008). In other cases, the microsavings movement has completely bypassed the state’s institutional set-up, utilizing the private sector instead. The Philippines and Kenya are great examples for that. In fact, the M-PESA service in Kenya (through which people can transfer, deposit and withdraw money using their cell phones) has become such a runaway success since it was first launched in 2007, that it now covers 70 percent of Kenyan households and processes more transactions domestically than Western Union does globally (Kendall, 2010; Mas and Radcliffe, 2010). As of today, there are more than 10 million M-PESA subscribers in

the country, while only 4 million hold bank accounts (Microfinancefocus, 2011). These numbers underscore the unprecedented degree of financial inclusion that has been heralded by M-PESA and the reason why it is being hailed as a model to be emulated in developing countries. Other models are being tried out in other parts of the world: Brazil, Mexico and India, for example, are experimenting with banking correspondents, i.e. non-bank agents such as retail stores or post offices with whom people can make their banking transactions (McKinsey & Company, 2010; Reserve Bank of India, 2006).

While these initiatives for expanding financial access are a step in the right direction, they may still prove entirely ineffectual in the face of the trust problems that we discussed earlier in the paper: if people are unwilling to borrow from untrustworthy institutions, they are likely even less willing to entrust them with their own money. As also mentioned earlier, this problem has already surfaced in one RCT, where people did not use free savings accounts because they did not trust the bank (Dupas et al., 2011). Furthermore, we might expect this issue to be particularly acute in SSA, which lags behind the rest of the world in providing deposit insurance (Demirgüç-Kunt, Karacaovali and Laeven, 2005). In response, the Grameen Foundation has called for an institution, either a local or an international non-profit organization or a consortium of MFIs, to provide this insurance in order to win depositor confidence (Counts and Meriweather, 2008).

In the meantime, as formal savings institutions continue to evolve, it would be useful for policy-makers and aid-agencies to remember that even informal (and inexpensive) mechanisms like lockboxes have proved to be highly effective in promoting savings (Dupas and Robinson, 2011b; Kristoff, 2009).

5. Conclusion

This paper has reviewed evidence from the literature and individual-level surveys in order to develop a better informed perspective on the pros and cons of microfinance for setting up and expanding businesses. The verdict seems to be that while microcredit is primarily useful as a consumption-smoothing and risk-management tool, microsavings potentially has a greater role to play in wealth creation. Further, neither savings nor credit would be able to do much by way of anything in an environment that does not inspire public confidence. The world's poor desperately need financial innovations that help them save, borrow and lend and an environment that helps them do so securely.

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