

# Microfinance Design

Sendhil Mullainathan

Harvard University

Based on joint work with  
Bindu Ananth, ICICI, CMFR

# Expanding the Scope of Microfinance

- Two potential bottlenecks
- Funding for MFIs
  - Others will talk about this
- Workable MFI models to increase scope of business
  - What I'll talk about today
  - Describe ideas that arise from seeing several MFIs at work

# Microfinance Model

- As with many ideas, most common spread of microfinance has been through imitation
- Proven models have been copied
- While this is effective, it comes at a cost
- Active experimentation with models is a public good
  - We all benefit from others' experiences.
- Today: suggest dimensions on which some experimentation would be helpful.

# Three Basic Features of Microfinance

- Clients facing volatile income streams
- High transaction costs per loan
- Clients potentially sitting on high productivity investments

# Important Design Features

- Payment Streams:
  - Payment flexibility
  - Payment frequency
  - Contract length
- Monitoring Technology
  - Group screening?
  - Reciprocal Altruism
- Productivity:
  - Productivity enhancement
  - Loan size and uses

# Some stories about payment streams

- The monsoon comes every year. For many, this indicates a drop in income.
- Many husbands get paid weekly on a particular day
- Women often buy buffaloes. Best “deal” may be buying a buffalo that is not yet milking.
- Cows experience dry periods during pregnancy
  - Dry periods
- Kirana stores and others use loans for working capital.

# Payment Stream Design Experiments

- Payment frequency:
  - Daily v. weekly v. monthly
- Should exact payment days (for weekly/monthly) match income receipt days?
- Should we customize contracts for predictable shocks?
  - Lower payments or non-payments during monsoon?
- Should we pre-build features for unpredictable shocks.
  - Savings like devices (voluntary prepayment?)
  - Preset “skip payments” where client has option to skip certain # of payments
- Should we customize payment stream to match use
  - Constant leverage loans for working capital
  - Lower upfront payments for buffaloes.
- Important insight:
  - All these matter if people are not able to budget/save effectively.

# Monitoring technology

- Group monitoring
  - How much do group meetings matter?
    - Expensive for clients and MFIs
    - Should it depend on group tenure?
  - Actual monitoring and screening largely left at group's discretion
    - Do we believe they are the best they can be at this?
    - Might simple interventions increase the efficacy of groups in doing this?
  - Are people good at choosing other group members?
    - Tension between friendship and enforcement?
- MFI monitoring
  - What is the utility of contact with MFI officers?
  - “Pay the debtor who is there”.
  - Importance of moral suasion
  - Are there ways to increase this feeling?

# Productivity

- Enhancing productivity
  - Dairy feed
  - Dairy vaccination
  - Goat rearing practices
  - Inventory management and procurement for kirana stores
- Increased productivity can:
  - Directly benefit clients
  - Could also increase scope of lending (or decrease?)
- Loan use
  - Should there be screening for loan use or at least activity of owner?
  - How do people get ideas in the first place?
- Health
  - Interventions to reduce incidence of basic diseases?

# Conclusion

- Active experimentation can be very helpful in moving MFIs forward.