Small and Medium Enterprise Financing and Mentoring Services in Emerging Markets in the Dominican Republic

Sector(s): Finance

Fieldwork: Ideas42

Location: Santo Domingo, Dominican Republic

Sample: 1,193 existing ADOPEM clients

Target group: Urban population

Outcome of interest: Profits/revenues

Intervention type: Financial literacy Training

AEA RCT registration number: AEARCTR-0001867

Data: Download from the AEA

Partner organization(s): Banco ADOPEM

A simplified financial training based on "rules of thumb" improved business practices and outcomes among microentrepreneurs in the Dominican Republic, while standard, fundamentals-based accounting training produced no significant effect.

Policy issue

Individuals and business owners have to make many financial decisions that are critical for their success and wellbeing. Yet in both developed and developing countries, research has shown that a large fraction of the population is unprepared to make these decisions. A good understanding of simple financial concepts can potentially lead to better business decisions and, ultimately, greater household welfare. The challenge is to determine not only whether training programs can improve financial practices and outcomes, but also how to teach financial literacy more effectively.

Researchers conducted a randomized evaluation to test the impact of financial training on both firm-level and individual outcomes.[1] The researchers also investigated how the content and complexity of training influence its effectiveness.

Specifically, the researchers tested two distinct types of financial training offered to existing clients of a microfinance institution in the Dominican Republic: (1) a standard approach, similar to what is currently in use by many large development organizations, which teaches the fundamentals of financial accounting; and (2) a simplified training based on financial rules of thumb.

Context of the evaluation

In the Dominican Republic, ADOPEM is a savings and credit bank which serves primarily low-income urban individuals and small businesses. They offer loans of US$70—US$1,400 to both individuals and groups, and also operate a training center with programs covering basic computing, entrepreneurship, and trade skills. Many clients operate small businesses with few or no employees, including enterprises such as general stores, beauty salons, and food services, which bring in an average of US$85 per week. Many ADOPEM clients have been found to have errors in their accounting books, and relatively few individuals kept their business and personal accounts separate.

An elderly man selling mangoes in the Dominican Republic.

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Details of the intervention

The researchers developed two alternative financial training programs in partnership with Dominican training experts and with ADOPEM, a savings and credit bank in the Dominican Republic that primarily serves low-income, urban individuals and small businesses.

1. *The accounting training* offered a traditional, principles-based course in basic accounting techniques. Topics covered included daily record-keeping of cash sales and expenses, aggregation of daily records into weekly and monthly reports, inventory management, accounts receivable and payable, calculating cash profits, and investment planning.
2. *The rule-of-thumb training* taught participants simple rules for financial decision making, including several strategies to separate business and personal accounts, how to estimate business profits by changes in business cash, paying oneself a fixed salary, and easy-to-implement tools for reconciling accounts when business and personal expenses have been mixed.

In the first part of the evaluation, a group of 1,193 existing ADOPEM clients who previously expressed interest in training were randomly assigned to three groups: 402 clients took part in the six-week accounting treatment, 404 in the five-week rules-of-thumb treatment, and the remaining 387 clients formed the comparison group, in which no additional training service was provided. Courses were offered once a week for three hours at a time. The first three classes were identical for the two training groups, focusing on general principles related to savings, consumption, and debt.

The second part of the evaluation examined the extent to which clients understood and implemented the trainings. A subset of clients in each of the previous treatment and comparison groups was randomly assigned to receive follow-up visits from trainers at their businesses. The purpose of the on-site visits was to reinforce the material taught in the courses and to ensure that individuals were capable of implementing their newly-acquired financial accounting skills in their businesses. The second evaluation sought to determine, in the event that either or both of the trainings did not impact business outcomes, whether it was because clients did not understand or could not implement the leanings, or because the program was ineffective even when the material was properly understood and implemented.

The evaluation was conducted between November 2006 and July 2008. All courses were taught by qualified local instructors who, in most cases, had university degrees and experience with adult education. The courses were heavily subsidized, with fees set at either US$6 or US$0, relative to a program cost of approximately US$21.

Results and policy lessons

Rule-of-thumb training improved business practices, while accounting training had little effect. Relative to the comparison group, individuals assigned to the rule-of-thumb treatment were 11 percentage points more likely to report separating business and personal accounts, 11 percentage points more likely to report keeping accounting records, and 6 percentage points more likely to report calculating revenues. Almost no significant effect was found on the participants of the accounting training.

Similarly, only the rule-of-thumb training produced a positive effect on business outcomes. Sales among the rule-of-thumb group saw a statistically significant and economically large increase during self-reported bad weeks, equivalent to an 18.5 percent increase with respect to the comparison group. Rule-of-thumb trainees also reported higher sales during average business weeks, while the accounting training trainees reported lower sales during average and bad business weeks, although these results were not statistically significant. These results suggest that following simple financial rules helped individuals to better recognize and manage negative shocks and counteract the effects of slow weeks.

Neither training program had an effect on finance-related outcomes such as a client's loan size, loan type, or likelihood of remaining as a borrower. Although those assigned to the rule-of-thumb training were 6 percentage points more likely to have savings, this result was only marginally significant.

Additional support offered through follow-up visits did not reinforce the positive effect of the rule-of-thumb training, nor did it lead to improvements in outcomes for clients in the accounting training. This suggests that while the rule-of-thumb training was simple enough to understand and put into practice without further help, the challenges of understanding or implementing the accounting training could not be resolved through the follow-up visit.

Researchers are planning a follow-up study to better understand the mechanisms behind the success of the rule-of-thumb training. This study will distinguish the importance of simplicity in itself versus the additional time the rule-of-thumb trainees were able to spend learning a specific subset of useful rules.

Financial skills can be effectively transmitted in a classroom setting. These results suggest that well-designed and -structured financial training programs can help micro entrepreneurs to learn and implement a set of business practices that are critical for their success.

In the context of financial training in the Dominican Republic, simpler was better. Any training program faces a tradeoff between the ease with which participants can grasp the material and thoroughness and depth of understanding.In the context of this evaluation, financial training based on simplified financial rules proved to be much more effective than the accounting-based trainings now offered by many development organizations. Training that focused on content that was easier to understand and implement helped many business owners to improve their business practices, even if no additional help was provided.

Appropriate financial training can produce significant gains in business outcomes for poor entrepreneurs. These results suggest that a lack of financial knowledge may be impeding the growth of small businesses in developing countries. A better understanding of simple financial rules and how to put them into practice might translate into more successful businesses. For example, they may allow business owners to adjust their effort in response to economic fluctuations or help them to manage inventory and products more effectively.

The success of simplification in financial training is consistent with similar evidence from different settings. Simplification has also proven its merits in the case of financial products, such as enrollment in retirement savings plans (Choi et al. 2009) and in applications for college student loans (Bettinger at al. 2009) in the US. These results suggest that in many different contexts, optimality may lie in the direction of simplification.

Drexler, Alejandro, Greg Fischer, and Antoinette S. Schoar. 2014. "Keeping it Simple: Financial Literacy and Rules of Thumb." American Economic Journal: Applied Economics 6(2): 1-31.

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1. ideas42 is a social science research and development laboratory that uses scientific insights to design innovative policies and products in partnership with the private and public sector