The Impact of Flexible Credit for Entrepreneurs in Colombia

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Sector(s): Finance

Fieldwork: Innovations for Poverty Action (IPA)

Sample: 5,200 microenterprise owners

Target group: Entrepreneurs

Outcome of interest: Earnings and income

Intervention type: Credit

AEA RCT registration number: AEARCTR-0001123

Micro-loans are a promising means of promoting entrepreneurship, but conventional loan products are often unsuited to the needs of small businesses in developing countries. Offering microenterprise borrowers the ability to postpone loan payments when needed may encourage long-term investments in business expansion and help owners cope with financial hardship. Researchers partnered with Kiva in Colombia to examine the impact of a flexible credit product on microentrepreneurs' demand for loans, business investment, and resilience to unexpected events and emergencies.

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Hundreds of millions of people in the developing world operate their own business, and micro-loans are a means through which these microenterprises can expand.[1], However, evidence suggests that the loan products offered by most microfinance institutions (MFIs) are not suited to the needs of microenterprise clients.[2] Most micro-loans follow rigid repayment schedules beginning that begin immediately after loan disbursement, which are not conducive to long-term investments in business expansion. Moreover, the seasonal and unpredictable nature of micro-entrepreneurs' income makes it difficult for them to plan arousnd repayment deadlines. Flexible repayment schedules may alleviate both these problems. Researchers in Colombia are examining the impact of a flexible credit product with more flexible terms of repayment on entrepreneurs' loan takeup, business investment, and resilience to unexpected events and emergencies.

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This evaluation is being conducted in partnership with Kiva and Fundación Mario Santo Domingo (FMSD), Kiva's local field partner in northern Colombia . The study involves offering loans s taking place to small business owners across the Barranquilla, Cartagena, and Bogota metropolitan areas in norther Colombia. Participants are small business owners (the majority being one-person commercial enterprises) that were either contacted by FMSD's marketing campaign or approached during office visits and community events.

None of the participants had taken out a loan with FMSD before, but one third of those who eventually accepted the a loan offer through this evaluation had taken out another loan with another MFI in the past.

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Researchers are conducting a randomized evaluation to evaluate the impact of a flexible credit product on entrepreneurs' demand for loans, business investment, and resilience to unexpected events and emergencies. Unlike conventional loan products, recipients of these flexible loans have the option to pay only the interest portion of their debt and postpone the principal up to three times for every twelve months of maturity. They also can choose whether to pay this postponed amount as an additional installment or pay it before the initial loan period has concluded.

Participants were randomly offered the flexible credit product at one of two points: At the time of loan offer and after loan approval. Of the 14,000 potential borrowers approached during FMSD's initial door-to-door marketing campaigns in 2015 to 2017, 3,500 were offered a flexible loan instead of a conventional loan product. This group and the comparison group are being evaluated on their likelihood to apply for a loan after the offer, as well as their likelihood to accept the loan if approved.

Out of the participants who went on to apply and receive approval for a loan, 5,000 were selected for the second stage of the evaluation. Participants in the second stage were randomly assigned to one of three groups:

- 1,250 received both an initial offer of flexible credit and a subsequent contract.
- 1,875 received a standard loan offer but were extended flexible credit during the contract phase.
- The remaining 1,875 (a comparison group) received a standard offer and standard contract.

To measure demand for flexible credit products, researchers will measure the take-up of both credit products. To measure whether the flexible loan offer helps entrepreneurs invest more productively and cope with unexpected shocks to income, the research team will collect data on small business owners' Participants from the second stage are being evaluated on their investment decisions, business activity, likelihood of repayment, and resilience to financial emergencies.

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Study on-going; results forthcoming

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1. Innovations for Poverty Action. Small and Medium Enterprise Program - Five Years in Review: 2011-2016. Retrieved from http://www.poverty-action.org/sites/default/files/publications/SME-Program-Report-2011-2016.pdf

2. Field, E., Pande, R., Papp, J., & Rigol, N. (2013). Does the Classic Microfinance Model Discourage Entrepreneurship Among the Poor? Experimental Evidence from India. American Economic Review, 103(6), 2196-2226. doi:10.1257/aer.103.6.2196