
Schumpeter
Business and management

Microcredit **Put to the test**

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ONCE illustrated with pictures of happy village women engaged in lending circles, and celebrated as an ideal charitable activity that helps people earn their way out of poverty, in recent years microcredit has become increasingly controversial. Critics have argued that giving poor people a small affordable loan is not in fact an effective way to help them escape from poverty. And the growth in loan volume has been driven lately by a bunch of for-profit microlenders who their critics say have motives that are anything but charitable.



The most successful of these for-profit lenders is a case in point. After Banco Compartamos, a Mexican microcredit bank, had an initial public offering of its shares in 2007, it was publicly chastised by Muhammad Yunus, who had won the Nobel Peace Prize for his role in developing the non-profit microcredit industry. "Their priorities are screwed up," Mr Yunus said in an interview. Compartamos made its profit by charging its poor customers annual interest rates on their loans of around 100%. "Microcredit was created to fight the money lender, not to become the money lender," noted Mr Yunus.

Compartamos, whose founders believe they are helping the poor, responded to these criticisms by inviting three economists, Dean Karlan, Manuela Angelucci and Jonathan Zinman, to examine the evidence. They devised two randomised control tests to find out the impact of Compartamos's lending practices. The results were published on May 14th.

A first study looked at whether Compartamos really needs to charge 100% a year. The bank

argued that this rate was necessary to cover costs and make enough profit to stay in business over the long run. The study found that demand for microcredit is more price elastic than had been thought. Cut the annual interest rate by 10 percentage points and more people will take out a loan whilst existing borrowers will increase the size of their loans. The effect of this extra demand equalled the cost of lowering the interest rate, so by cutting rates Compartamos could earn just as much profit while providing better service to more people. Apparently, it is now considering doing so.

The second study examined what happened over the three years after Compartamos began lending to groups of between 12 and 50 women in the state of Sonora, just south of the border with Arizona. It found that borrowers were able to grow their businesses faster and managed their financial risks better (in particular by avoiding having to sell assets on the cheap to get through tough times). They were also less likely to feel depressed, and more likely to trust others.

The study found no clear evidence that microcredit helped people escape poverty by raising their income, however. But it also did not find any evidence that taking out a loan with an interest rate of 100% a year actually made borrowers worse off on average (although women who had not borrowed before lost ground on average, a finding that has prompted Compartamos to offer first time borrowers financial education). Either three years is too short a period to measure the poverty easing effects of microcredit, or it is a much less powerful anti-poverty tool than some of its boosters have claimed.

Perhaps the clearest impact of microlending in the study was its impact on the power of women in the home. Female borrowers gained control over a significantly larger number of household decisions. What did their husbands think of this? The study reports that these more empowered female borrowers did not experience any increase in domestic conflict. Overall, then, the studies show that microcredit, even the for-profit kind, typically benefits borrowers in a variety of ways, even if it does not lift them immediately out of poverty.