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TEACHING ENTREPRENEURSHIP: EXPERIMENTS TO IMPROVE MICROFINANCE

by **Dean Karlan** dean.karlan@yale.edu *and* **Jonathan Zinman** jzinman@dartmouth.edu,
with **Martin Valdivia**

Untapped market

DESPITE THE EXPANSION of microfinance worldwide, many potential clients remain unserved, even in regions saturated with microfinance institutions (MFIs). If MFIs have not adequately developed methods of serving those who remain outside the system, whether through more flexible products, pricing, or marketing, this might be due in part to the dizzying variation in the type of products, services and processes employed by MFIs. To date, not enough is known about the exact advantages and disadvantages to both the institution and client of alternative designs.

Research can help policymakers and donors search for—and test the efficacy of—innovations that will allow MFIs to maximize social welfare while maintaining acceptable returns for the institutions themselves. In this brief, we describe an evaluation that Innovations for Poverty Action conducted with the MFI FINCA-Peru, in which we tested the impact on both clients and institution of offering entrepreneurial training to microfinance clients. We employed randomized control trials to ensure that the results were free of the bias one would find if an evaluation merely compared outcomes of those who chose a credit-only program to those who chose a credit-with-education program. The study yields important results of interest to practitioners and policymakers. Most importantly, perhaps, it demonstrates that randomized evaluations can be practical for MFIs to implement, and less risky than alternative processes for innovation and evaluation.

Experimenting for innovation

Randomized control trials can help practitioners and policymakers build evidence on program designs that best allow MFIs to reach an untapped market profitably. By using randomized evaluations, researchers can measure the impact of these innovations on lender profits, as well as on client borrowing, revenues and social outcomes.

Armed with knowledge about which innovations are shown to have positive impacts—and why—lenders can choose to replicate the practice on a larger scale. In this way, MFIs can refine their business practices so as to improve their portfolios while the poor gain greater access to credit.

It is also important to measure why interventions won't work. Small pilot tests allow for experiment and innovation at low cost, and the even greater cost of launching a product that would be bound to fail is avoided. Randomized evaluations can be used at the launch of an innovation to determine whether the new product or policy works for both the institution and the client, and allow for modifications to be made before offering the innovation at scale. The knowledge produced by this methodology results in a public good from which other institutions can benefit.

BASIS researchers have implemented or are currently implementing experiments in consumer, microenterprise and agricultural credit and savings markets in Brazil, India, Kenya, Mexico, the Philippines, South Africa, and the United States. In South Africa, for example, we used a randomized field experiment to test the poor's sensitivity to interest rates. We found that borrowers were slightly sensitive to price drops, but highly sensitive to increases from the lender's normal rates and highly sensitive to increases in loan terms. We also found that costless marketing techniques, such as the visual presentation of the loan offer on the marketing brochure, or the placement of a photograph on the brochure, could have effects as large as that of dropping the interest rate down to zero!

In the Philippines, we are measuring the impact of microcredit by implementing a credit scoring system for lenders and then randomizing which marginally creditworthy clients are approved for a loan. By comparing clients who are assigned to receive credit to those we assigned to the control group, we can make a clean estimate of impact.

Can entreprenuership be taught?

Many development practitioners pursue strategies to teach adults (typically women) entrepreneurial skills. These programs are strikingly heterogeneous, and little is known about their impact on economic outcomes for the poor.

The goal of interventions such as business training should be not only to improve business outcomes and welfare for clients but also to improve institutional outcomes for the MFI. It is important to be able to identify the potential positive and negative outcomes for both client and institution. Stronger business results may lead to a demand for more services, and clients may be less likely to default if they are satisfied—either due to higher cash flow or a stronger feeling of reciprocity. If valued by the clients, training could generate more client loyalty, which in turn could increase client retention and repayment. However, there could be a negative effect on client retention too, since training increases the length of the regular meetings by thirty to sixty minutes.

FINCA-Peru offers "village banking" for poor, female microentrepreneurs in Lima and Ayacucho. Through market research, FINCA-Peru learned that its clients wanted more education in business skills, and the MFI wanted to implement such a program with the aim to increase the income earned by its clients. There was concern, however, whether the program would yield benefits and be a good investment and transition for the organization to make.

We worked with FINCA-Peru to evaluate the marginal impact of adding entrepreneurship training to their microfinance program. This study implemented a randomized control trial to compare outcomes between those who receive financial services only and those who receive business training as well as financial services.

The goal of the program was to teach entrepreneurial skills that lead to improved basic business practices, such as how to use profits, where to sell, the use of credit sales, and the goods and services produced. These improvements should lead to more sales, more workers, and could eventually provide the skills and knowledge perhaps needed to join the formal sector.

We evaluated the effectiveness of integrating this business training with microfinance services by using a randomized control trial in which over 4,000 clients from pre-existing lending groups were assigned randomly to treatment and control groups. Clients were assigned either to a *mandatory* treatment group, which received training as part of their mandatory weekly bank meetings, a *voluntary* treatment group, where clients were allowed to leave meetings after the loan payment was made and before the training began, or a control group, which received no additional services beyond the credit and savings program. The randomization was stratified by credit officer, hence each credit officer had the same proportion of treatment and control groups.

We divided the analysis into four categories:

1) institutional outcomes,

2) business skills and practices,

3) business outcomes,

4) household outcomes, including empowerment in decision-making and child labor.

Institutional outcomes. The strongest results were in institutional outcomes, with repayment among treatment groups three percentage points higher and client retention five percentage points higher than among control groups. We infer from the latter result that clients place high value on the training they receive, causing them to remain with the program.

Yet, treatment clients did often cite the extended length of weekly meetings as a factor in dropping out of the program.

The analysis shows that business training helps the MFI retain clients, and making training entirely voluntary would strengthen this outcome since dropout rates are significantly higher for the mandatory treatment group than for the voluntary treatment group. Voluntary training would avoid the problem of losing some clients who are bothered by the fact that training lengthens the meetings.

However, our findings also show that improvement in repayment rates and client retention are strongest for clients who expressed the *least* interest in business training prior to the program. This has strong implications for the appropriate method for introducing business training to a program or market. Since the impact is highest on those who indicate the lowest demand for the service, charging a fee for the business training may attract the exact wrong set of clients needed in order to maximize impact.

The improvement of clients' business outcomes (discussed below) might also help explain the increase in client retention for the treatment group. Because a client's business improves, she is better able to repay the loan, therefore remaining a client.

Overall, the improvement in defaults and the better client retention as a result of the training have strong implications for the profitability of the institution.

Business skills and practices. Training participants demonstrated greater business knowledge in the follow-up survey. This greater knowledge translated into better business practices, though only in limited areas. Training increased the likelihood that individuals reinvested profits in their businesses and maintained sales and withdrawal records for their businesses.

Individuals were asked to identify changes or innovations they made to their businesses over the prior year, and those in the treatment group were five percentage points more likely to report having made changes or innovations. In contrast to the finding above regarding repayment and client retention, training impact on business skills and practices was observed mostly on clients who had expressed a high degree of interest in receiving training.

Business outcomes. Significantly, we find an increase in business revenue. Last month's sales increased by 16% relative to the control group. Even the worst month in the prior year increased by 28% relative to the control group, hence providing evidence that the business training provided important income smoothing for the clients. Since much of microfinance is thought to address risk and vulnerability, not just income growth, this is a particularly striking finding that supports that motivation for microenterprise services.

Household outcomes. We divided household outcomes into two categories: empowerment in decision-making and child labor. The former can be seen through improved business success that empowers female microentrepreneurs with respect to their husbands/partners in business and family decisions by giving them more control of their finances. We detected no impact on household decisions such as how to use the MFI loan and savings, whether to take money or products from the business, or family size. Also, those trained were no more likely to keep track of household bills or separate their money from that of their husband or partner.

Regarding child labor, since children in the household are often involved in the family enterprise in settings such as these, any change to the household enterprise may have important effects on child labor and education. If the training increases business income, then this would lead to an expected decrease in child labor and increase in schooling as wealth increases. Furthermore, an indirect effect may occur in which the education motivates the mother to invest more in schooling for her children.

Although the overall effect was not significant for both boys and girls, we did find a positive treatment effect on the number of hours girls dedicate on average to school and schoolwork. We do not see a corresponding shift downward in hours spent working in the enterprise or housework, which indicates that girls spent less time in leisure.

This also implies that the training had its effect not through changing the marginal product of labor in the enterprise, nor through an income effect, but instead perhaps through increasing the mother's preference for education for their daughters. We also found that, for more-educated mothers, training reduces the number of hours the children spend working in the enterprise, but the corresponding increase in education is not significant statistically.

B A S I S
Briefs

Authors

Dean Karlan
Yale University, USA

Jonathan Zinman
Dartmouth College, USA

Martin Valdivia
Grupo de Análisis para el Desarrollo, Peru

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BASIS CRSP
Comments encouraged:
Department of Agricultural and Applied Economics, University of Wisconsin, Madison, WI 53706 USA
basis-me@facstaff.wisc.edu
tel: +608-262-5538
fax: +608-262-4376
http://www.basis.wisc.edu

Seeking mutual benefits

As indicated, many innovations are being tried in order to improve lending in the microfinance sector. It is important that innovations be tested on a small scale first in order to find the best approaches that benefit both clients and institutions.

Our study testing the impacts of business training shows clear welfare implications for clients. Clients appeared more satisfied with the organization (as evidenced by lower dropout rates), demonstrated better business practices and knowledge, and, most importantly, generated higher and smoother business revenues.

From the institutional perspective, the intervention succeeded and was a profitable undertaking. While the education program carries a monetary cost for the MFI, this is offset by increased client retention and repayment rates. The fixed cost of managing a village bank is high, but the variable cost of each individual client is quite low. The improved client retention rate of 16%, and the lower enforcement costs due to the higher repayment rate, generate more profits than the marginal cost of providing the training.

Given the importance of human capital to our thinking about growth and development, it is imperative that we answer the fundamental questions of whether entrepreneurship can be taught, and whether business training leads to improved business outcomes. In our experiment, the answer was that we *can* teach individuals to engage in certain good business practices, and that this leads to observed improvements in business revenue and reduced variance in income.

Further experimentation can determine how generalizable these results are, and whether it is possible to generate these results in a shorter time period (for example, by focusing on the most relevant portions of the training). Further experimentation also can help to answer questions about optimal implementation, such as whether credit officers or specialized employees (or firms) should deliver the training.

Related reading

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