

Microcredit and microsavings: Two sides of the same coin?

Summary

Do people want support with credit or support with savings? To find out, we ran a framed field experiment amongst women in rural Pakistan that tested directly between the demand for savings and the demand for credit. Inspired by the structure of ROSCAs (rotating savings and credit associations), credit and savings products were randomly offered to the same group of people. Contrary to predictions of standard models, we find high demand for both credit and savings products, with the same individual often accepting both a credit product and a savings product over three experiment waves.



Key findings

- Overall take-up of the product was very high (approximately 65% on average), with wide heterogeneity across individuals;
- The distinction between microlending and microsavings is largely illusory;
- Saving and borrowing amongst microfinance clients are used as substitutes, satisfying the demand for a regular schedule of deposits and also a lump-sum withdrawal.

Policy conclusions

First, microcredit programmes can have serious shortcomings, in particular the likelihood of charging high interest rates, a requirement for immediate repayments, and the risk of creating a debt spiral in customers. However, if microlending and microsavings share the same underlying demand, then the latter becomes a more attractive option for the poor. Second, results indicate that policy makers should support local savings institutions such as ROSCAs, that have evolved to meet local financial needs, and whose structure is easily understood in most developing countries.

Contact details: e: iig.enquiries@economics.ox.ac.uk t: +44-1865-271084

Overview

Researchers from the Lahore School of Economics, Milan Politecnico, Stanford University, and CSAE, University of Oxford, are taking part in a project to test whether microlending serves a microsavings objective. We use a 'lab experiment with field exposure' method: an experimental context in which choices are offered within a stylised context, but in which participants' outside shocks and outside financial pressures are allowed to influence their lives between experimental rounds. We take a simple repayment structure — loosely modeled on the idea of a ROSCA—and offer it as an individual microfinance product, repeating the exercise three times.

Project findings in more detail

This project introduces a new experimental design which is the first to allow a direct test between demand for microsavings and demand for microcredit. The project sample comprises female members of the National Rural Support Programme (NRSP) who are currently, or have in the past, been clients of microfinance products being offered by the NRSP. The experiment was conducted through four NRSP offices in the Sargodha district.

The project design generates new empirical results in which we find, for the first time, that the same respondent population has high demand for both microcredit and microsavings. Indeed, the same individuals often take up either contract within a couple of weeks. This design can easily be replicated in a wide variety of field contexts. Since it is based on the structure of a ROSCA, it is easily understood in most developing economies.

We find substantial evidence against the traditional model of demand for credit and saving services. We find that demand for our microfinance product is generally high, and sensitivity to interest rate and day of payment is statistically significant but not large. Results indicate that the same pool of respondents simultaneously holds demand both for microcredit and for microsavings. Our structural framework rationalizes the behaviour of 75% of the participants. Of these 'rationalized' participants, two thirds have high demand for lump-sum payments coupled with savings difficulties.

Together, the results imply that the distinction between microlending and microsavings is largely illusory. Rather, many people welcome microcredit and microsavings products for the same reason: that each provides a mechanism for regular deposits and a lump-sum payment.

Ongoing research

A scaled up version of this study is currently in the field, using six different contracts that differ by (i) the time of the payment and (ii) the interest rate. However, we use weekly, rather than daily repayments, taken over a period of six weeks. An extensive baseline and follow-up questionnaire has been designed to elicit more detailed information.

For more information

Two sides of the same rupee? Comparing demand for microcredit and microsavings in a framed field experiment in rural Pakistan, by Uzma Afzal, Giovanna d'Adda, Marcel Fafchamps, Simon Quinn and Farah Said. CSAE Working Paper 2014-32.

<http://www.csae.ox.ac.uk/workingpapers/wps-list.html>.

Information about the Researchers

Uzma Afzal is an Assistant Professor and Research Fellow at the Centre for Research in Economics and Business, Lahore School of Economics.

Giovanna d'Adda is a Researcher at the Department of Management, Economics and Industrial Organization, Milan Politecnico.

Marcel Fafchamps is a Satre Family Senior Fellow at the Freeman Spogli Institute, Stanford University and Senior Fellow at the Centre on Democracy, Development, and the Rule of Law.

Simon Quinn is an Associate Professor and Deputy Director of the Centre for the Study of African Economies, University of Oxford.

Farah Said is an Assistant Professor and Research Fellow at the Centre for Research in Economics and Business, Lahore School of Economics

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