XV. Flexible Repayment Options for Microfinance

A. Introduction

In 2006, Grameen Bank, a Bangladeshi microfinance organization, and its founder, Muhammad Yunus, jointly won the Nobel Peace Prize for spearheading the microfinance movement.[1] As of 2015, the microfinance industry had grown to include nearly 200 million clients and an aggregate $60–100 billion in credit outstanding.[2] The honeymoon phase of microfinance's recent history carried an optimistic tone for financial inclusion of the unbanked.[3] Yet, research suggests structural deficiencies of microcredit loans prevent debtors from receiving the full benefits of financial market participation.[4] In particular, research indicates that standard microcredit contracts fail to improve the lives of the borrowers in concrete ways.[5] To counteract this apparent problem, researchers advocate for flexible contracts uniquely tailored to individual borrowers as an alternative to rigid microcredit contracts of adhesion.[6] These flexible contracts, they

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[1] *Muhammad Yunus Biographical*, THE NOBEL PRIZE, https://www.nobelprize.org/prizes/peace/2006/yunus/biographical/ (last visited Oct. 6, 2019) ("Yunus established the Grameen Bank in Bangledesh in 1983, fueled by the belief that credit is a fundamental human right.").

[2] *Does Microfinance Still Hold Promise for Reaching the Poor*, WORLD BANK: NEWS (Mar. 30, 2015) [hereinafter *Microfinance Still Hold Promise*] https://www.worldbank.org/en/news/feature/2015/03/30/does-microfinance-still-hold-promise-for-reaching-the-poor (stating statistics from fifteen years after the inception of the idea of microfinance as a "poverty reduction tool").

[3] *See id*. ("With its focus on reaching the previously unbanked, microfinance was expected to bring about change at the household level, a market in developing countries that traditional financial institutions had failed to reach.").

[4] Navjot Sangwan, *Make Microfinance Great Again: A Shift Towards Flexibility*, DEVELOPING ECON. (Mar. 8, 2019), https://developingeconomics.org/2019/03/08/make-microfinance-great-again-a-shift-towards-flexibility/ (suggesting that the seemingly successful loan repayment statistics do not necessarily correlate to actual benefits to debtors).

[5] *Id.* (explaining that some customers skip meals or sell off valuable assets to meet the quick repayment dates).

[6] Giorgia Barboni & Parul Agarwal, *Knowing What's Good for You: Can a Repayment Flexibility Option in Microfinance Contracts Improve Payment Rates and Business Outcomes?* 30 (INT'L GROWTH CENT., Working Paper No. F-89219-INC-1, 2019), https://site.stanford.edu/sites/g/files/sbiybj8706/f/

suggest, may improve the lives of the borrowers without compounding default rates and correlated costs for creditors.[7] This article identifies common problems associated with standard microcredit. This article will then address how introducing flexibility may offset some of those common problems. Lastly, this article will identify some of the empirical and theoretical deficiencies of the research in the area of microfinance contract flexibility.

B. What Is Microfinance?

Microfinance is an umbrella term for a wide variety of small-scale financial services.[8] These services range from microsavings and microbanking to microinsurance and microcredit.[9] Microfinance institutions (MFIs) are the entities that provide these microfinance services, and their diversity rivals that of the services they offer.[10] What was once a separate industry has attracted participation from commercial banks, government entities, and non-profit organizations.[11]

Despite the wide breadth of activities that embrace the label "microfinance," they share a universal feature: each service is tailored to poor individuals.[12] This key feature suggests that poverty alleviation is the universal objective of all microfinance products.[13] However, this

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4988-barboni_jmp.pdf (concluding that offering flexible repayment schedules is beneficial to both borrowers and lenders).

[7] *Id*. at 2 (stating that the flexible contract "can be useful to microentrepeneurs living in developing countries").

[8] *See* Katherine Hunt, *The Law and Economics of Microfinance*, 33 J.L. & COM. 1, 9 (2014) (listing small-scale financial services such as "microsavings, microinsurance, and microbanking").

[9] *Id.* at 9 (explaining that the current research is focused on how microfinance can fit the needs of the poor).

[10] *See Microfinance Still Hold Promise*, *supra* note 2 ("Different types of microfinance institutions cater to different market segments.").

[11] *See id.* ("Different types of microfinance institutions cater to different market segments, with NGOs and non-bank financial institutions targeting the poorest and banks more focused on reaching the less poor, but more commercially viable, portion of the market.").

[12] Katherine Helen Mary Hunt, *Microfinance: Dreams and Reality*, 2013 DOVENSCHMIDT Q. 62, 63 (2013) (indicating that microfinance has most recently been explored with the goal of "providing financial services to the poor").

[13] *See Muhammad Yunus Biographical*, *supra* note 1 ("His objective was to help poor people escape from poverty by providing loans on terms suitable to

shared motivation does not constrain MFIs from having ancillary objectives.[14] Microfinance provides dignity to persons historically excluded from credit markets, allowing them an opportunity to participate as free and independent agents.[15] Microfinance is also a tool for achieving gender equality, as MFIs particularly target women who, historically, have been excluded from financial participation unlike their male counterparts.[16] Evidence shows that the overwhelming majority, well over 90%, of global microcredit is issued to women.[17] Additionally, microfinance is ultimately an economic activity, so these socially-based goals still require a degree of profitability and sustainability.[18]

C. Microcredit

1. The Typical Microloan

By their very definition, typical microloans are necessarily different than other loans because they adhere to a clientele that cannot

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them and by teaching them a few sound financial principles so they could help themselves.").

[14] Umakanth Varottil, *Microfinance and the Corporate Governance Conundrum*, 9 BERKELEY BUS. L.J. 242, 248 (2012) (discussing how many microfinance institutions' focus is shifted to profit-making, at the expense of their original social welfare goals).

[15] Rebecca Farrer, *Exploring the Human Rights Implications of Microfinance Initiatives*, 36 INT'L J. LEGAL INFO. 447, 451 (2008) (referencing United Nations Secretary General Kofi Annan's statement that "microfinance helps alleviate poverty").

[16] John Isaac, Expanding Women's Access to Financial Services, THE WORLD BANK (Feb. 26, 2014), https://www.worldbank.org/en/results/2013/04/01/banking-on-women-extending-womens-access-to-financial-services ("In addition, many women may have access to financial services in name only: A study in Pakistan showed that, although accounts might be opened in the name of a woman, the decision-making authority around the use of those funds often lies with a male relative.").

[17] *See* Sangwan, *supra* note 4 (explaining that, of the estimated 200 million clients of microfinance institutions, 32.5 million are in India and 90 percent of them are women).

[18] Hunt, *supra* note 12, at 65 (explaining that governments of developing countries should pass microfinance-friendly regulations because "self-sufficient MFIs are able to increase entrepreneurship and reduce poverty").

participate in the typical credit market.[19] Potential recipients of a microloan usually do not own any assets that can act as collateral.[20] In turn, these unsecured loans carry additional risk for creditors because a lack of collateral reduces the amount the creditor can hope to collect if the debtor were to default.[21] Creditors ultimately place the burden of these risks onto microcredit recipients in the form of higher interest rates.[22] Evidence from the late 2000s shows that the global median interest rate for an unsecured microloan was approximately 32%,[23] with interest rates generally falling between 32%–37%.[24]

Moreover, given the relatively small earning potential of a single microloan for a large commercial bank, a noticeable return is possible only by issuing a significant number of microloans.[25] This correlates to relatively high administration costs.[26] To remain a profitable and sustainable venture, MFIs can either raise expected returns—in the form of higher interest rates, as previously stated—or curb these administration costs.[27] This lowering of administration costs has shaped, in part, the traditional microcredit contract.[28]

One model which, in part, has tried to curb administration costs is the standard microlending scheme pioneered by Grameen

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[19] Hunt, *supra* note 8, at 30 (explaining that typical relationships between borrowers and financial institutions would have to "adjust greatly to account for microfinance borrowers and loans").

[20] *Id.* at 10 (stating that most microloan borrows lack signals of "loan worthiness," such as collateral or financial records).

[21] *Id.* at 16 (explaining how lending institutions assess the risk of providing a loan which contributes to determining the loan's interest rate).

[22] *Id.* at 23 ("The primary actions of MFIs and banks when granting loans is to adequately select a borrower who will repay the interest and loan principal and then monitor on-going repayments.").

[23] *Id.* ("Interest rates on microfinance loans have a global median of 32%.").

[24] *Id.* at 24 (explaining that this is much higher than interest rates charged to middle-and-upper class borrowers but cheaper than the "loanshark" interest rates).

[25] *Id.* at 23 (attributing the high interest rates to the need to engage in many small transactions to turn a profit).

[26] *Id.* ("[T]he high interest rates [are] attributable to the high proportional operating costs of providing a lot of small loans.").

[27] *Id.* at 24 (explaining that operating efficiency is not often prioritized).

[28] *See* Barboni & Agarwal, *supra* note 6, at 7 ("Individual loans are usually more expensive than group loans, are for larger amounts, and are targeted for business purposes.").

Bank.[29] One distinguishing feature of this microcredit model is a rigid and frequent repayment schedule.[30] These standard contracts often require borrowers to repay the microloan in weekly installments.[31] Some even require the first repayment to be made immediately after the microloan is issued.[32] At least two rationales seemingly justify this design.[33] First, lenders are apprehensive to lend to risky borrowers, and the weekly repayments due immediately upon receipt reduce the value lost to the lender in the case of default.[34] Second, examples of micro-credit borrowers have little to no experience in financial markets.[35] Thus, the rigid repayment schedule helps to instill fiscal discipline in the borrower, acclimating them to periodic cash outflows.[36]

2. *Problems with the Typical Microloan*

Critics of this standard microloan model argue that this weekly repayment structure prevents microloans from improving the lives of the borrowers.[37] For one, weekly repayments have a consider-

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[29] GRAMEEN BANK: BANK FOR THE POOR, http://www.grameen.com/introduction/ [https://perma.cc/3CKF-LERU] (last visited Nov. 7, 2019).

[30] Shayak Sarkar, Comment, *Repayment Frequency in the Law of Microfinance*, 31 YALE J. ON REG. 259, 261 (2014) ("The Grameen model also requires that installments be paid weekly, setting a periodicity standard for the field.").

[31] Barboni & Agarwal, *supra* note 6, at 2 (observing that many lenders find flexibility in repayment to be risky).

[32] *See* Sangwan, *supra* note 4 (explaining that some classic microcredit contracts have immediate repayment obligations).

[33] *See id.* (acknowledging that MFIs seek to "reduce defaults and instil [sic] fiscal discipline" in their clients).

[34] *Id.* (expressing that the immediate repayment is a contributing factor as to why microfinance fails to meet the needs of borrowers).

[35] Sanjay Jain & Ghazala Mansuri, *A Little at a Time: The Use of Regularly Scheduled Repayments in Microfinance Programs*, 72 J. DEV. ECON. 253, 254 (2002) (acknowledging that one common explanation behind the rigid repayment schedule is the need for "fiscal discipline" when dealing with inexperienced buyers).

[36] *Id.* (explaining fiscal discipline "gets borrowers used to the idea of making regular repayments").

[37] Rachael Meager, *Understanding the Average Impact of Microcredit*, MICROECONOMIC INSIGHTS (July 17, 2019), https://microeconomicinsights.org/understanding-the-average-impact-of-microcredit/ ("Perhaps part of the answer lies in the terms of the loans: they have to be repaid frequently, often

able amount of administrative costs, both for the lender and the borrower.[38] The time and effort to coordinate weekly payments between the parties has considerable transaction costs.[39] Thus, the weekly repayment schedule is counterproductive, replacing one source of administration costs with another.[40]

Even more costly, weekly repayments hinder the borrowers' ability to invest in long-term productive projects.[41] The repayment obligations initially reduce the number of potential recipients of the microloans.[42] The repayment schedule acts as a barrier for entry by disqualifying potential borrowers who, despite the long-term potential of their business, are unlikely to satisfy the rigid repayment obligations.[43] For those that do qualify, rather than deploy the proceeds from the microloan into profitable ventures, borrowers often leave the microloan liquid or even sell productive assets to meet their contractual deadlines.[44] Others elect to cover the payments by acquiring informal sources of credit.[45] Financially, this option can be more costly for the borrower than defaulting, as loan sharks in developing countries may charge as high as 300%.[46]

Yet, from the borrowers' perspective, these alternatives may appear reasonable compared to the social and financial consequences

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at weekly intervals, so borrowers cannot use much of their loan for risky business ventures which may only pay off in the longer term.").

[38] Jain & Mansuri, *supra* note 35, at 255 (examining numerous costs associated with the rigid, short-term repayments).

[39] *Id.* (describing, as an example, the difficulties of arranging weekly meetings between borrowers and collection groups).

[40] *See id.* ("Nevertheless, despite its costs, both in terms of transactions costs and in terms of the opportunity costs of restricting the choice of potentially profitable projects, the use of repayment schedules that require regular installments is widespread.").

[41] *Id.* ("Long-gestation projects, or even seasonal working capacity needs for agricultural production, are difficult to finance solely by loans for which repayments begin long before the returns from the project are realized.").

[42] *See id.* (For one, [rigid repayment structure] limits the types of projects that can be financed with microcredit loans.").

[43] *Id.* (describing how many potential borrowers have difficulty obtaining finance if their returns would be long term).

[44] Sangwan, *supra* note 4 ("Sometimes clients resort to selling productive assets in order to meet repayment deadines.").

[45] Jain & Mansuri, *supra* note 35, at 254 (indicating that many MFI borrowers "use informal loans to repay MFI debt").

[46] Hunt, *supra* note 8, at 24 n.148. ("The rate can be as high as 300%.").

of default. Because MFIs cannot collateralize most of their microloans, many microcredit models use social pressure as a threat to induce borrowers into repaying their loans.[47] For instance, the Grameen Bank model issues loans via solidarity groups of five people.[48] Under this model, bank managers will acclimate to a new location and familiarize themselves with the social climate.[49] The managers will then create solidarity groups of five prospective borrowers and issue loans to the two most eligible members of the group.[50] The three remaining members become eligible to receive their own loans only if the two initial recipients repay the principal and interest according to the terms of their contracts.[51] The negative incentive scheme created by this design lessens the lender's financial risk if a borrower defaults.[52] All loan recipients, in both standard and microfinance markets, already face the financial consequences of default, such as being barred from receiving future loans.[53] But under these circumstances, default for microloan recipients can add further harm in the form of verbal hostility, humiliation, and isolation from the surrounding social environment.[54] Faced

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[47] *See* Sangwan, *supra* note 4 (explaining that borrowers face "social sanctions" such as "humiliation, verbal hostility, harassment, shame and loss of face in their community").
[48] Sarkar, *supra* note 30, at 261 n.8 (explaining that the Grameen Bank uses "solidarity groups" so that they are all jointly liable for the repayment).
[49] GRAMEEN BANK: BANK FOR THE POOR, http://www.grameen.com/credit-lending-models/ [https://perma.cc/EFW6-LL6D] (last visited Nov. 7, 2019) ("The manager and workers start by visiting villages to familiarise themselves with the local milieu in which they will be operating and identify prospective clientele, as well as explain the purpose, functions, and mode of operation of the bank to the local population.").
[50] *Id.* ("Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan.").
[51] *Id*. ("Only if the first two borrowers repay the principal plus interest over a period of fifty weeks do other members of the group become eligible themselves for a loan.").
[52] *Id*. ("In this sense, collective responsibility of the group serves as collateral on the loan.").
[53] Sangwan, *supra* note 4 (stating that being barred from receiving loans is one of the many types of sanctions for default).
[54] *See* Rahul Kumar Sett, *Should Flexibility Matter?: A Poor Consumer's Perspective of Flexible Micro Loans*, 4 INDIAN INST. OF MGMT. KOZHIKODE SOC'Y & MGMT. REV. 166, 166–69 (2015) (discussing rigid repayment schedules impact on psychological wellbeing and motivation levels).

with these social consequences, a borrower may reasonably choose to skip a few meals in order to make a loan repayment.[55]

3. Flexible Microloans

Critics of the original microcredit model criticize its harshness towards the most financially-vulnerable cross-section of the global population.[56] As an alternative to rigid contracts, researchers suggest increasing the degree of flexibility in microfinance contracts.[57] While flexibility may take any number of forms, some prominent options include relaxed repayment frequency, grace-periods before the initial repayment is due, and contracts tailored to individual borrowers.[58] Each alternative has unique implications on the behavior of the recipient as well as the borrower's subsequent welfare.[59]

Relaxed repayment frequency directly targets a faulty assumption of the standard microfinance model; namely, that borrowers are naïve credit market participants that need to learn fiscal discipline.[60] For one, this desire to instill fiscal discipline should diminish for borrowers who have received consecutive loans, and who presumably have learned fiscal discipline by satisfying prior loans.[61] Yet, in practice, these borrowers continue receiving loans with high-frequency

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[55] *See* Sangwan, *supra* note 4 ("Poor borrowers also describe skipping meals . . . to avoid defaulting.").

[56] Farrer, *supra* note 15, at 457 (explaining that some criticized the harshness of the Grameen Bank while others expressed that the Grameen Bank treated clients like any other financial lender).

[57] Giorgia Barboni, *Repayment Flexibility in Microfinance Contracts: Theory and Experimental Evidence on Take Up and Selection*, 142 J. ECON. BEHAV. & ORG. 425, 426 (2017) ("[I]nnovating the repayment structure of microfinance contracts represents another potential channel through which micro and small enterprises' entry in credit markets, and their growth, could be promoted.").

[58] *Id.* (suggesting that these methods have recently been receiving attention).

[59] *See id.* (analyzing the implications of various flexible microfinance alternatives).

[60] Jain & Mansuri, *supra* note 35, at 254–55 (explaining that the assumption of the rigid repayment structure is based on the inexperience of the borrowers is "patently incorrect").

[61] *Id.* at 255 (explaining that the rigid repayment structure would "diminish over time" as the borrowers return for more loans).

repayment schedules.[62] Secondly, evidence shows that poor individuals participate regularly in informal credit markets.[63] In fact, some motivation for MFIs is to liberate poor individuals from informal credit markets and immerse them in formal alternatives.[64] Thus, MFIs assume the fact that microcredit recipients do not necessarily have any less fiscal discipline than typical credit market participants.[65]

Removing this faulty assumption about microfinance borrowers demonstrates how flexibility can have a prolific impact for individuals, at least in theory. Microentrepreneurs living in developing countries are likely to experience irregular cash flows.[66] By modifying repayment schedules to mirror the borrower's projected cash inflows, microcredit can decrease the borrower's cash flow volatility and smooth his or her consumption over time.[67] Monthly repayment schedules can similarly level borrowers' cash flow volatility.[68] Rather than experiencing cash outflows in rapid succession, the monthly schedule gives borrowers more time to manage short-term income shocks.[69] This smoother consumption correlates to a decrease in the amount of financial insecurity and stress that borrowers experience.[70]

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[62] *Id.* (suggesting that declining rigidity in repayment structure is "not the practice with microcredit programs").
[63] *Id.* (indicating that borrowers borrow extensively from the informal lending market).
[64] *Id.* at 254 (explaining that one of the motives of the Grameen Bank was to liberate "poor borrowers from the clutches of informal moneylenders").
[65] *Id.* at 254–55 ("This is a puzzling assertion, and can only be justified on the basis of the implicit assumption mentioned earlier—that, pre-MFI, borrowers had no experience of the credit market at all.").
[66] Barboni & Agarwal, *supra* note 6, at 2 (suggesting that microentrepreneurs in developing countries are likely to experience "irregular income streams" and "volatile cash flows").
[67] *Id.* (explaining that flexibility in repayment of microloans allows borrowers to "insure themselves against negative cash flow shocks").
[68] *See* Sett, *supra* note 54, at 167 (indicating that the shift from weekly payments to monthly payments reduced the financial stress on borrowers and "induced them to invest in larger income-generating enterprises").
[69] Erica Field, Rohini Pande, John Papp, & Y. Jeanette Park, *Repayment Flexibility Can Reduce Financial Stress: A Randomized Control Trial with Microfinance Clients in India*, 7 PLOS ONE 1, 1 (2012) (explaining that the weekly repayment periods "limits clients' ability to deal with short term shocks to household income").
[70] *Id.* at 1–2 (" . . . where alternative payment plans are possible, clients who face differentially stressful economic lives are likely to select into the repay-

From a cognitive psychology perspective, borrowers' stress peaks as repayment dates approach, so reducing the number of times this occurs should reduce the stress experienced in the interim.[71]

Delaying the initial repayment with a grace period is an alternative, or even supplemental, tactic that can improve the impact that microcredit has on its borrowers.[72] By requiring the debt to be serviced immediately after issuance, the standard microcredit contract stunts entrepreneurship among the poor.[73] Rather than encourage investing in higher-yield projects with longer gestation periods, prompt repayment obligations hamper entrepreneurial growth and encourage borrowers to leave the loan liquid.[74] Conversely, as exhibited in experimental trials, recipients of microloans with grace periods display greater risk-seeking behavior by: diversifying business products; by extending credit to, and accepting pre-orders from, customers; or purchasing illiquid investments.[75] This can lead to greater profits and capital accumulation in the long run.[76]

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ment schedule that best suits their needs."); *see also* Sett, *supra* note 54, at 166–67 (indicating that longer repayment periods reduced stress).

[71] *See* Sett, *supra* note 54, at 167 (explaining that repayments that are frequent increases financial stress).

[72] Barboni, *supra* note 57, at 426 (stressing that immediate repayments limit borrower's ability to invest long-term, but possibly more profitable, projects).

[73] Erica Field, Rohini Pande, John Papp, & Natalia Rigol, *Does the Classic Microfinance Model Discourage Entrepreneurship Among the Poor? Experimental Evidence from India*, 103 AM. ECON. REV. 2196, 2197 ("Survey data on loan use and long-run business profit showed that the introduction of a grace period led to a significant change in economic activity: Microenterprise investment was approximately 6.0 percent higher and the likelihood of starting a new business was more than twice as high among clients who received the grace period contract relative to those on the regular contract.").

[74] *Id.* at 2197–98 ("Thus, by limiting illiquid investment choices, the immediate repayment obligations of the classic microfinance lending model may simultaneously limit default *and* income growth.") (emphasis in original).

[75] *Id.* at 2197 (finding longer grace periods correlated with higher-risk taking behavior in clients).

[76] *Id.* at 2197–98 ("Thus, by limiting illiquid investment choices, the immediate repayment obligations of the classic microfinance lending model may simultaneously limit default *and* income growth.") (emphasis in original).

D. Implications of Increased Flexibility

1. Costs of Increased Flexibility

Theoretically, introducing flexibility for microloan borrowers should incentivize investments in profitable ventures.[77] However, in practice, this may not always be feasible. Even if borrowers have monthly repayment schedules, the added time between repayments is relatively worthless if the borrowers' capital is in the form of illiquid assets.[78] By sacrificing liquidity, borrowers sacrifice their ability to respond to and handle external shocks in the short run.[79] Given that the majority of microcredit recipients operate in volatile conditions with frequent external shocks, this lack of financial flexibility may contribute to higher default rates among borrowers who gamble on illiquid investments.[80] For example, in the short run, recipients of microloans with grace periods were three times more likely to default than recipients of a similar microloan without the grace period.[81] Thus, the introduction of flexibility could add to the overall costs for MFIs, and in turn, the interest rates borrowers face.[82]

Furthermore, as previously stipulated, microloans already carry some of the highest global interest rates in formal credit markets mostly to cover administrative costs.[83] However, that is true only for

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[77] *Id.* at 2197 ("Survey data on loan use and long-run business profit showed that the introduction of a grace period led to a significant change in economic activity: Microenterprise investment was approximately 6.0 percent higher and the likelihood of starting a new business was more than twice as high among clients who received the grace period contract relative to those on the regular contract.").

[78] *Id.* at 2203 ("Household ability to smooth shocks by liquidating assets is similarly limited.").

[79] *Id.* at 2197 (stating that illiquid assets add risk and risk drives up interest rates).

[80] Hunt, *supra* note 8, at 30 (explaining that lack of collateral leads to higher interest rates).

[81] Field et. al., *supra* note 73, at 2197 (finding increased risk-taking behavior in clients who received a grace period).

[82] *See id.* (attributing the greater risk-taking behavior to higher likelihood of default).

[83] Hunt, *supra* note 8, at 24 (suggesting that high interest rates are "attributable to the high proportional operating costs of providing a lot of small loans").

non-profit MFIs.[84] The interest rates that other MFIs charge are mostly attributable to generating high profits.[85] Historically, profit accumulation is a justifiable incentive scheme.[86] Investors, who could deploy their capital into a number of safe profitable investments, needed a reason to support the untested and risky industry of microfinance.[87] Microfinance pioneers, like Grameen Bank, needed to be self-sustaining, to show other potential investors that the business model was sound.[88] Now, however, the profit-seeking function of some MFIs stands in tension with the posited goal of poverty alleviation.[89] This dichotomy suggests that the remaining for-profit MFIs can endure more costs, such as those incurred from introducing flexible contracts, if they willingly forego additional profits.[90] This seems unlikely, as the for-profit nature of these institutions is essential to their very nature.

These two theoretical implications could impact the amount of microcredit actually issued. For lenders that are already risk-averse, MFIs may be even more particular when determining who qualifies for a microloan.[91] Greater selectivity criteria can exacerbate the problems microfinance faces with providing credit to the chronic poor.[92] Microcredit is already issued to the poor with the most potential to

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[84] Milford Bateman & Maren Duvendack, *Misunderstanding the Average Impact of Microcredit?*, DEV. ECON. (July 31, 2019), https://developingeconomics.org/2019/07/31/misunderstanding-the-average-impact-of-microcredit/ (asserting that the implementation of high interest rates in non-profit MFIs is to cover administration costs, as opposed to generating a profit).

[85] *Id.* (" . . . high interest rates are purposely deployed in order to generate high profits.").

[86] *See* Hunt, *supra* note 12, at 64 (exploring similar schemes that have developed around the world).

[87] *Id.* ("Initially, the bank was forced to be self-sustaining because donor and investor funds were difficult to establish in the unchartered waters in which microfinance was being formally established.")

[88] *Id.* (stating that Grameen Bank needed to be self-sustaining as donors and investors were reluctant to fund an untested type of lending institution).

[89] Bateman & Duvendack, *supra* note 84 ("[I]t is actually clear that in all but a handful of the remaining non-profit microcredit institutions, high interest rates are purposely deployed in order to generate high profits.").

[90] *See id.* (explaining that "microcredit meltdowns" are a result of reckless lending by fully knowledgeable CEOs and senior management).

[91] Hunt, *supra* note 8, at 22 (explaining many loan applicants have no evidence of "income, assets, or ability to prove they can repay the loan").

[92] Hunt, *supra* note 12, at 62 ("In addition to this, critics of microfinance generally comment on the mechanism not meeting the needs of the 'bottom of the pyramid' chronic poor and actually does not reduce poverty at all.").

repay the loan.[93] This leaves the "bottom of the pyramid" or poorest of the poor in isolation.[94] By offering flexibility in microloan contracts and thereby increasing the selectivity of potential recipients, MFIs may increase the number of persons in this isolated group at the bottom of the pyramid.

2. *Deficiency of Empirical Evidence*

Regardless of the actual and theoretical implications that introducing flexibility may have on the microfinance market, the mere suggestion itself has problems that need to be addressed before a comprehensive solution can be achieved. Despite being conducted under strict academic standards, experimental trials involve relatively small and homogenous samples.[95] For instance, each member of a sample of 800 borrowers from Uttar Pradesh, India had already "graduated" from the typical group model of lending and were seeking loans for business purposes.[96] Therefore, the results of this experiment say little about flexibility under the group model of lending in another part of the world.[97] In its most general terms, this criticism shows that, regardless of the actual results in any single study, the potential to generalize any broad conclusion from the results is effectively impossible.[98] What works for one demographic may not hold true for another demographic.

These studies also tend to ignore what flexibility may do for the typical microfinance borrower. Flexibility in microloans is

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[93] *See id.* (explaining that microloans are usually not issued to the chronic poor).
[94] *Id.* (explaining that microloans are usually not issued to the chronic poor).
[95] *See, e.g.*, Barboni & Agarwal, *supra* note 6, at 3 ("We test these predictions through a Randomized Controlled Trial set up in Uttar Pradesh, India and carried out in partnership with a local Microfinance Institution, Sonata Microfinance Ltd.").
[96] *Id.* ("These borrowers had just graduated from group loans and had approached Sonata for the first time for individual loans, which are larger in size than typical group loans and targeted for business purposes.").
[97] *See id.* (claiming that one objective of the study is "to provide guidance to Sonata).
[98] *See* Meager, *supra* note 37 ("Microcredit usually has zero effect for households with no previous business experience. While it has a large average effect for households with business experience, this effect is highly variable across settings and does not generalize.").

frequently studied in the context of business borrowers.[99] Yet microfinance borrowers that seek microloans for consumption purposes are constructively excluded from the results.[100] Again, what works for business-related microloans may not be generalizable for consumption-related microloans.[101] But regardless of failing to generalize, these studies ultimately fail to explain what introducing flexibility may do, at all, for a significant portion of microfinance borrowers. Much criticism of the standard microloan argues what borrowers theoretically could do if the microloan had more flexibility.[102] In theory, borrowers could invest in longer term projects and accept more risk.[103] But those theories assume that the borrower is in a position to invest the proceeds of the loan rather than use them for consumption purposes.[104] So even if flexibility could, in theory, financially improve the lives of borrowers, flexibility may be a moot point for borrowers who need only a short-term safety net for consumption purposes.

Finally, and perhaps most importantly, empirical studies about flexible microfinance fail to define essential terms. This concern speaks, not only to empirical research of microloans, but to the broader discourse of microfinance generally. Participants in the discussion, while using identical terms, may be talking about fundamentally different concepts.[105] For example, microfinance is any financial service targeted to poor individuals.[106] Yet, for regulatory purposes,

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[99] *See* Barboni & Agarwal, *supra* note 6, at 3 ("These borrowers had just graduated from group loans and had approached Sonata for the first time for individual loans, which are larger in size than typical group loans and targeted for business purposes.").

[100] Hunt, *supra* note 12, at 62 ("In contrast, the World Bank has found that most microfinance is used to meet basic needs (such as housing and food) rather than to generate income via investment activity.").

[101] *See* Barboni & Agarwal, *supra* note 6, at 3.

[102] *See supra* Section C.2.

[103] *See* Sangwan, *supra* note 4 (mentioning several studies that analyze the impact of flexibility in microloans).

[104] *See id.* (claiming that MFIs must "pay increased attention to their clients' needs, preferences, behaviours and well-being").

[105] GRAMEEN BANK: BANK FOR THE POOR, http://www.grameen.com/what-is-microcredit/ [https://perma.cc/VK3T-8M65] (last visited Nov. 7, 2019) ("In the process, the word ['microcredit'] has been imputed to mean everything to everybody.").

[106] Eugenia Macchiavello, *Microfinance Regulation and Supervision: A Multi-Faced Prism of Structures, Levels and Issues*, 9 N.Y.U. J.L. 125, 129 (2012)

different countries and firms may decide on a broader or narrower definition.[107] Hence, the scope and impact of microfinance products effectively turns on, for instance, the definition of "poor."[108] This failure to have a uniform language seems to have led to confusion and misunderstandings.[109] So when advocates call for added flexibility to microloans, they may be speaking about a specific form of credit, such as agricultural credit, rural credit, cooperative credit, consumer credit, or about a more general category.[110]

As previously stated, MFIs collectively are a multifaceted group of institutions.[111] They may categorically differ from each other based on size, geographic market, social concentration of their activities, centrality of the institution's decision-making, and operational and human resource risks.[112] The breadth of variability within the label "MFI" ultimately affects if and how the MFI is regulated, who or what does the regulation, the degree of interaction the MFI has with the ultimate borrower, and feasibility of administering flexible microloans.[113] Non-profits may have more incentive to incorporate

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("[M]icrofinance is any activity expanding financial access to low-income people . . .").

[107] *Id.* (". . . but many countries have chosen narrower definitions for regulatory purposes with references to, for example, a specific scope of activity or target clients.").

[108] Dean Karlan & Nathanael Goldberg, *Impact Evaluation for Microfinance*, 4 (The World Bank, Working Paper No. 42381, 2007), http://siteresources.worldbank.org/INTISPMA/Resources/383704-1146752240884/Doing_ie_series_07.pdf ("The focus on 'poor' clients is almost universal, with varying definitions of the word 'poor.'").

[109] GRAMEEN BANK, *supra* note 105 ("I think this is creating a lot of misunderstanding and confusion in the discussion about microcredit. We really don't know who is talking about what.").

[110] *Id.* ("No one now gets shocked if somebody uses the term "microcredit" to mean agricultural credit, or rural credit, or cooperative credit, or consumer credit, credit from the savings and loan associations, or from credit unions, or from money lenders.").

[111] Hunt, *supra* note 8, at 9 (describing microfinance as including, "microsaving, microinsurance, and microbanking").

[112] *See* Macchiavello, *supra* note 106, at 130 (listing the factors that characterize the business structure of MFIs).

[113] *See id.* ("Broadly speaking, microfinance is any activity expanding financial access to low-income people, but many countries have chosen narrower definitions for regulatory purposes with reference to, for example, a specific scope of activities or target clients.")

flexibility than for-profit ventures.[114] Even if flexibility undeniably improved the lives of borrowers, MFIs that operate for profit may incorporate flexibility in their microcredit contracts only if it increases their profit over typical microloans.[115] As a result, the findings of empirical research is worthless unless it is directed at the appropriate audience. And because microfinance does not yet have a clearly-defined audience with a central core of shared characteristics, the suggestion of introducing flexibility into microcredit contracts cannot be anything more than a suggestion.

E. Conclusion

The term "microfinance" carries an optimistic tone of financial inclusion as a basic human right.[116] Yet, achieving that outcome is difficult in practice. The original microcredit contract seemingly achieved this goal, giving access to credit to those who would not qualify for typical credit products.[117] However, these contracts sometimes fail to better the lives of borrowers due to the additional, non-pecuniary harms that these contracts create.[118] Flexibility may be able to curb some of these unintended consequences.[119] But until a larger data set, consisting of additional trials with diverse populations, arises, researchers cannot know the full extent to which flexibility may improve typical microcredit in a cohesive theory.

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[114] *See* Varottil, *supra* note 14, at 248 (explaining that for-profit MFI's focus on generation of gains for the company, treating "poor households as mere customers").
[115] *See id.* ("Although these institutions operate with the mission of achieving a 'double bottom line', [sic] social goals have been relegated to a subsidiary position while financial sustainability objectives dominate management decision-making.").
[116] *See supra* note 1 ("Yunus established the Grameen Bank in Bangledesh in 1983, fueled by the belief that credit is a fundamental human right.").
[117] *See* GRAMEEN BANK, *supra* note 29 ("GB provides credit to the poorest of the poo in rural Bangladesh.").
[118] *See* Sangwan, *supra* note 4 ("Despite the popularity of microfinance, a growing body of research suggests that access to microcredit programmes has a limited impact on clients' lives.").
[119] *See, e.g.*, Barboni, *supra* note 57.
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