A Typology of Criteria used By Microfinance Institutions to Evaluate Potential Microentrepreneurs

Project description

The dreams of many microentrepreneurs, or owners of microenterprises comprising of five or fewer employees, have never been fully aided by the existing microfinance institutions (MFIs). Microfinance is the business of providing “loans, savings, and other basic financial services to the poor,” (Consultative Group to Assist the Poor [CGAP], 2011). About 90 percent of the world’s population lack access to financial services (Vincent, 2004). Thus, many microentrepreneurs turn to MFIs for financial services to start their microenterprises in hopes of being successful enough to be a critical part of their economies (Mead & Liedholm, 1998). However, many microentrepreneurs are unable to develop comprehensive business plans; thus, the MFIs fail to fully understand the scope of their business, which often result in their applications being rejected and their failure to secure loans. According to a source, “studies have indicated that as high as 90 percent of micro businesses were not registered nor had a business plan, while more than 70 percent did not have audited financial records” (“Collateral, Perceived Risk are Major Challenges for Micro Businesses”, 2013).

Although extensive research has been conducted on the relationship between MFIs and microentrepreneurs, the chasm between these two parties is significant in merit. This has been identified as an unexplored area of research because although microfinance emerged as a solution to a lack of capital for those living in poverty in developing countries, many microentrepreneurs find MFI loans difficult to secure (Freedman, 2000). Often, microentrepreneurs’ alternative to microfinance is informal loans from those in the community that usually come with high interest rates (Bruton, Khavul, Siegel, & Wright, 2015).

A substantial portion of microentrepreneurs fails to understand the standards enforced by MFI’s for loans because of poor education and knowledge constraints. Though supplementary knowledge services are provided by most of MFIs for their borrowers (Chakrabarty & Bass, 2013), the applicants must first become a borrower in order to receive these services. To shed light on this gap in understanding, this research explores the various practices MFIs use to evaluate microentrepreneurs for loans beyond their collateral and credit history—both of which are minimal and thus have limited influence on the MFIs’ lending decisions.

The significant chasm between loaning and lending of microentrepreneurs and MFIs could be resolved with my research. My research (1) identifies the micro credit models and standards of MFIs and (2) groups them in a database, which allows me to assess each MFI in terms of the standards associated with evaluating and lending to microentrepreneurs. From this I will (3) develop a typology that summarizes how MFIs evaluate microentrepreneurs. My research is twofold; one, it identifies and assesses MFI loan standards; and two, it develops a standards typology of MFI evaluation of microentrepreneurs.

My research plan includes a primary data collection on the selected MFIs from the Microfinance Information Exchange (MIX), a nonprofit private organization that promotes information sharing and transparency for the microfinance industry on financial and social performance (MIX Market, 2010). I will use both financial data and annual survey data on MFIs provided by the MIX to create a database and group MFIs. The secondary data collection will be conducted through open-ended telephone interviews (approx. 15 minutes each call) and email interviews (if they cannot meet over the phone) with up to 40 MFIs to identify what the MFIs use to evaluate potential lendees. Overall, I will provide a detailed typology based on the identified standards adopted by MFIs for lending micro loans. My study will work toward delivering substantial results from the combination of realistic data from the MIX and the additional insights gained through the telephone and email interviews and also the public information available in peer-reviewed articles to lend credence to my research.
The GRACA funds will allow me to cover the research costs incurred over the summer 2016.

**Product of funded project and contribution to graduate studies**

The outcome of this funded project will be twofold: 1) creating a database of MFI lending criteria, and 2) developing a typology, a way of describing groups of respondents displaying different clusters of behaviors, attitudes or views of the world (“Typology”, n.d.), based on themes derived from the database. I plan on presenting these research findings at the Student Research and Creative Activity Fair (SRCAF), in a CBA Brown Bag session among faculty and other graduate students, and also consider to submit my research paper to an entrepreneurship-related conferences/symposia, such as the United States Association for Small Business and Entrepreneurship (USASBE) ([http://www.usasbe.org/](http://www.usasbe.org/)) and the Sustainability, Ethics, and Entrepreneurship (SEE) conference ([http://seeconf.org/](http://seeconf.org/)).

This research will enhance and enrich my experience in the areas of entrepreneurship. My work as a Graduate Assistant for the Center for Innovation, Entrepreneurship and Franchising since 2014 has enabled me to think entrepreneurially and personal experiences in securing loans has influenced me to direct my research in the specified area. Since this research will allow me to get a detailed understanding of MFIs and their relationships with microentrepreneurs, I can apply my hands-on experience in entrepreneurship to establish a microconsulting organization for microentrepreneurs after my graduate studies. This would be a beginning of my entrepreneurial journey. As an international student from a developing country, I see potential in this study, and I am positive this will make me a better entrepreneur and understand the field of microfinance.

This is just one facet of research for a potential future business, and I am hopeful to further continue this research toward identifying the deficiencies in skills of the microentrepreneurs in securing loans.

I have taken this project in my own capacity and anticipate the tangible outcomes in the specified time period.

**Contribution to the field**

MFI loans are “crucial for millions of low-income people who depend on it to finance their business activities. Together, microenterprises constitute more than 90 percent of all businesses in Latin America and employ over half of the labor force and produce approximately 20 percent of the region’s GDP” (Jansson, Rosales, & Westley, 2004). Given this, in terms of both output and employment, any increase in financial flow to this field will have a prominent impact on poverty levels and the national economy as a whole (Jansson et al., 2004). Microentrepreneurs’ failure to secure micro loans is at an alarming rate (“Collateral, Perceived Risk are Major Challenges for Micro Businesses,” 2013). Insights as to the criteria that preclude microentrepreneurs in securing loans could be brought to light with this research. The specified standards typology could help microentrepreneurs secure loans. In addition, my research represents a starting point for my own entrepreneurial journey, as discussed above.

I will write up this research for the academic community, which includes the UNO community through SRCAF and Clinton Global Initiative University (CGIU) ([https://www.clintonfoundation.org/clinton-global-initiative/meetings/cgi-university](https://www.clintonfoundation.org/clinton-global-initiative/meetings/cgi-university)); CBA community through Brown Bag sessions; and academic entrepreneurship community through the USASBE and/or SEE conferences. In this way, my research could be accessible to all levels of communities, and my findings will provide an understanding of the MFIs loan approval criteria. Also, I’m opening a gateway for new research for future researchers in the areas of microfinance and entrepreneurship. Due to certain limitations in my research (lack of randomization due to small sample size and budget and time constraints), I hope the primary research I conduct will provide
guidelines for future researchers to further continue with even more extensive research in this area. Certainly, I would want to revisit and learn recent developments at a later date.

**Project timeline**

<table>
<thead>
<tr>
<th>Month</th>
<th>Task Description</th>
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<tbody>
<tr>
<td>January</td>
<td>Submit GRACA for review</td>
</tr>
<tr>
<td>April – May</td>
<td>Literature review and topic research</td>
</tr>
<tr>
<td>June – August</td>
<td>Data Collection</td>
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<tr>
<td>September</td>
<td>Complete Database</td>
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<tr>
<td>October</td>
<td>Develop typology</td>
</tr>
<tr>
<td>Spring 2017</td>
<td>Present at ORCA Fair</td>
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</tbody>
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**Role of Student**

- ✓ Research Microfinance institutions
- ✓ Writing Literature review
- ✓ Collect Data from MIX on Microfinance institutions
- ✓ Arrange appointments for telephone/email interviews
- ✓ Create a database of MFIs with the assessments
- ✓ Develop typology to suggest the recommendations
- ✓ Create a presentation for dissemination

**Role of Mentor**

- ✓ Advising
- ✓ Overseeing data collection
- ✓ Supervising database creation
- ✓ Mentoring with interpretation of data for typology development
References


**Budget justification**

<table>
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<tr>
<th>Expense</th>
<th>Description</th>
<th>Budget</th>
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<tbody>
<tr>
<td>Microfinance Information Exchange student account subscription</td>
<td>Subscribe to the MIX information to collect data on MFIs to create database</td>
<td>$50</td>
</tr>
<tr>
<td>International Calls</td>
<td>Call charges to conduct telephone interviews with MFIs internationally</td>
<td>$70</td>
</tr>
<tr>
<td>Interview Transcriptions</td>
<td>For transcription of the telephone interviews</td>
<td>$130</td>
</tr>
<tr>
<td>Summer Salary</td>
<td>I will use the summer salary to cover my living expenses which I earn working as a graduate assistant (Based on my current hourly pay)</td>
<td>Approx. $15 \times 316 \text{ hr} = $4740</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$4990</strong></td>
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GRACA Advisor Letter of Support for Anjani Danthuluri

January 15, 2016

To the GRACA Committee:

It is my pleasure to write this letter of support for the GRACA application for Ms. Anjani Danthuluri. Ms. Danthuluri is currently enrolled in the MBA/MIS MS degree program in the College of Business Administration and serves as the Graduate Assistant for the Center for Innovation, Entrepreneurship, and Franchising (CIEF) in the College of Business Administration. Ms. Danthuluri is very interested in entrepreneurship, and has worked alongside the CIEF faculty members to help plan and promote several entrepreneurship-related events across campus including the Big Idea Pitch Contest (http://www.unomaha.edu/college-of-business-administration/center-for-innovation-entrepreneurship-franchising/events-and-opportunities/bigidea.php), the Maverick Business Plan Competition (http://mavbusplan.unomaha.edu/), the Midwest Entrepreneurship Conference (http://mwecomaha.com/), and UNO’s inaugural Entrepreneurship Week (http://www.unomaha.edu/college-of-business-administration/center-for-innovation-entrepreneurship-franchising/events-and-opportunities/entrepreneurship-week.php). Ms. Danthaluri’s keen interest in entrepreneurship paired with her high level of involvement in entrepreneurship-related activities demonstrate her keen interest in understanding more about entrepreneurship, which positions her well to take on a new task in her graduate studies—leading her own entrepreneurship research project.

As an international student, Ms. Danthuluri adopts a global perspective to entrepreneurship, and specifically seeks to understand how people with ideas secure financing so that they can become entrepreneurs. Although she is generally interested in this topic, for this GRACA, she narrows her research question to understand it in the context of microfinance. That is, she seeks to investigate how individuals in emerging economies become “microentrepreneurs” (i.e., start a business that employees only themselves or a few other individuals) through securing microfinance loans.

Ms. Danthaluri will use a combination of primary (interview) data and secondary (publicly-available) data to collect information on the criteria and requirements that microfinance institutions use to evaluate the entrepreneurial potential of individuals living in emerging economies that want to become entrepreneurs. The outcome of her research is twofold. First, she will build a database of microfinance institution criteria and requirements. Second, she will develop a standards typology of microfinance institution lending.

Although her GRACA research “ends” here, she plans to continue researching this topic by understanding, given the standards that microfinance institutions use for lending, what potential microentrepreneurs can do to secure lending from microfinance institutions. Thus, this project represents a first step in a larger research area that she hopes to continue working on. Given her entrepreneurial spirit, she has discussed developing her own microconsulting organization after graduation that would provide potential microentrepreneurs this guidance to help them secure microfinance loans.
I believe Ms. Danthuluri will be successful in pursuing this project. Her curiosity and passion for entrepreneurship, paired with her educational experiences and background, will help her to conduct the research outlined in the GRACA proposal. I will serve as Ms. Danthuluri’s advisor for this project. Although Ms. Danthuluri will lead the project and work independently, my knowledge of microfinance allows me to provide her with context and guidance regarding the appropriate data sources and interpretations of the data. I look forward to mentoring Ms. Danthuluri’s on this research journey as she grows in her research skills and knowledge in a subject she is passionate about.

Sincerely,

Erin Bass, PhD
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Department of Marketing & Management
College of Business Administration
University of Nebraska Omaha
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