Brief 1

The World Bank - Pakistan Poverty Alleviation Fund

Research Partnerships on Participatory Development

UNDERSTANDING THE CONSTRAINTS TO ENTREPRENEURSHIP IN RURAL PAKISTAN

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Context

In this brief we report on a study that asks the following question: What are the barriers to entrepreneurship among microfinance clients in rural Pakistan? We posit that the main barriers are credit constraints and managerial capacity constraints.

The Experiment

The National Rural Support Program (NRSP) with the help of PPAF offered microfinance clients in rural Pakistan an eight day business training course designed by ECI and access to a loan lottery where eligible clients could borrow up to 4 times the average loan size. The experiment therefore alleviates each of the two potential barriers in turn.

Training was randomly offered to half of 747 groups of borrowers from 5 different branches in three districts. Training sessions were held from February to May 2007 and focused on business planning, marketing and financial management. From November 2007 to June 2008 a lottery was introduced that allowed eligible members to apply for a loan of up to Rs. 1 lakh. Loan requests were subject to the usual screening and amounts approved above the usual limit of Rs 30,000 were forwarded to headquarters, where the result of the lottery was maintained. Lottery winners could borrow the approved amount, while those who lost the lottery could borrow up to their maximum loan size which depended on the number of loans they had previously repaid successfully.

Results

We find that offering business training leads to increased business knowledge, better business practices (but not business sales) and increases in household expenditures, group cohesion and general outlook on life. These effects are mainly concentrated among male clients, however. Among men, business training also leads to lower business failure.

One reason for the increase in household income but not business sales or profits is that there may be households without businesses who also benefit from business training, particularly those engaged in self-employment activities. Indeed, this is what we find: gains from business training are concentrated among self-employed households.

Unlike men, women increase business knowledge but show no improvements in any other outcomes, particularly income and assets, and business practices and operations. One plausible explanation for these gender differences is rooted in the norms about the role of women as care givers and other social norms that limit their participation in the labor force. In our data, while most men are active in the labor force, 71 percent of females report staying at home without a primary occupation. In addition, the same social and cultural norms that restrict female labor supply also affect their mobility outside the home. This explains why women are primarily engaged in home based manufacture.

But even if female labor supply is limited, the intervention could have improved the performance of their businesses if they were inefficiently run. After all, better decisions about production and marketing, etc may not require additional time. However, 40 percent of business women report that their (male) spouses are responsible for most of their business decisions, suggesting that female businesses show no improvement because women have little decision-making control. Indeed, business creation increases in households of women offered business training and assigned to be winners of the lottery, but the woman is not directly involved in the new business suggesting that their spouses or other household members use the proceeds of the loan to start the business.

Business training also increased the number of larger loans issued, but being assigned a winner of the lottery has on average little effect on the clients, perhaps because the limit on the current loan size already meets the demands of most borrowers. Among male borrowers, lottery winners tend to borrow larger amounts, perhaps not surprisingly.

More importantly, we also find that business training improved the pool of borrowers. In particular, men offered business training with a higher probability of default were *less* likely to borrow during and after the lottery. This result is remarkable because it suggests that training led to better financial decision-making (i.e. requesting a loan).

Policy Implications

From these results we conclude that offering business training and larger loans were beneficial to the lender because they led to increased neither lending without a rise in default nor an increase in the workload of credit officers.

For clients, business training led to more positive impacts, especially among men, than relaxing credit constraints, perhaps because in the context we study, micro finance clients are not constrained.

Most entrepreneurs in the study would be classified as “subsistence” entrepreneurs, that is, individuals that own the business to survive and perhaps provide employment to family members. Indeed, most of the businesses in the study have no hired employees and most business owners have low levels of literacy. Yes, they do account for a large share of the population and so business training can serve as an effective poverty alleviation tool as it improves business management and financial decision-making.

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