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An Impact Analysis of Microfinance in Bosnia and Herzegovina

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Summary. — This paper applies the financing constraints approach to study whether microfinance institutions improved access to credit for microenterprises in Bosnia and Herzegovina. According to this approach, microenterprises with improved access to credit rely less on internal funds for their investments. Thus, we compare investment sensitivity to internal funds of microenterprises in municipalities with significant presence of MFIs to that of microenterprises in municipalities with no (or limited) presence of MFIs using Living Standards Measurement Survey and MFI branch location data. Results indicate that MFIs alleviated microbusinesses' financing constraints. This approach is applicable to evaluating microfinance impact in other countries.

Key words — microfinance, impact study, microfinance institutions, financing constraints, Eastern Europe, Bosnia and Herzegovina

1. INTRODUCTION

Worldwide, microfinance institutions (MFIs) expand the frontier of finance by providing loans and other financial services to underserved populations. Microfinance is important in Bosnia and Herzegovina (BiH) because estimates for 2001 show that the number of people employed in MFI-supported microenterprises is comparable to the 72,000 workers on wait-lists for jobs (Dunn & Tvrtkovic, 2003). [1] Among post-communist countries, Bosnia has the most dynamic microfinance sector and analysis of its both successes and setbacks could help microfinance donors and policy makers in other post-transition countries develop adequate policies to promote microfinance.

This paper studies whether the microfinance sector in BiH improved access to credit for the entrepreneurial poor. [2] Previous studies focus mainly on evaluating the impact of a single MFI, usually on the request of donors who want to know whether to discontinue support for a specific MFI (Zohir & Matin, 2004). This paper focuses instead on the impact of all microfinance institutions operating in the local credit market. Industry-wide focus is important because competition may affect the impact of an individual MFI. For example, lack of impact could be the result of too much competition that leads to client over-indebtedness, where clients take too much debt and borrow from one lender simply to repay another. On the other hand, the lending criteria of a single MFI may address the needs of a specific target population but may not be flexible enough to include many viable microentrepreneurs.

The impact of microfinance on the target population can be measured in social and in economic terms. [3] While the choice of impact variables reflects what school of thought or "shism" the authors belong to, a recent survey of the literature makes the case for evaluating both aspects (Armendariz de Aghion & Morduch, 2005; Morduch, 2000). In Bosnia, the impact on entrepreneurs' finances has been underemphasized because in the post-war environment, the social impact was of main interest (Matul & Tsilikounas, 2004). According to the

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financial sector development "shism," MFIs should lend to entrepreneurs who already have the skills and the markets but lack credit (Conning, 1999). Post-war Bosnia had educated but impoverished population with limited access to credit, which affected entrepreneurs' ability to sustain microbusinesses. This study contributes to the literature by studying whether MFIs collectively serving a local market improved credit access of the entrepreneurial poor.

The approach used in this paper avoids methodological challenges typical to impact assessment studies where MFI clients serve as a treatment group and non-clients who satisfy the lending criteria of a particular lender serve as a control group (Dunn, 2005). Such design has self-selection and, in panel data, attrition issues typical for social sciences where controlled experiments are not possible. In the case of self-selection bias, for example, achievements attributed to microfinance may simply be attributes of the most talented microentrepreneurs who self-select to apply and consequently receive microloans. These issues could be addressed in some programs where design and implementation yield quasi-experimental data such as in Coleman (1999), and Pitt and Khandker (1998). Since quasi-experimental data are not always available, exploring alternative methods remains important.

This paper evaluates the impact of microfinance by applying the financing constraints approach according to which improvement in access to credit resulting from availability of microfinance is reflected in the sensitivity of microbusinesses' investment to availability of internal funds. Specifically, the paper compares the sensitivity of investment to internal funds of microentrepreneurs in municipalities with significant presence of MFIs to that of microentrepreneurs operating in municipalities with no or only limited MFI presence using a randomly selected sample of municipalities and entrepreneurs from the Living Standards Measurement Survey (LSMS) series of the World Bank, conducted by the Agency for Statistics of Bosnia and Herzegovina, the Federal Office of Statistics and the Republika Srpska Institute of Statistics in 2001. The sample includes not only clients and comparable non-clients but also microbusinesses that may not qualify for a loan by the criteria of one or more MFIs. Data about municipalities covered by MFIs are obtained from the Bosnian Local Initiative Project (LIP), MFIs reports, and the Mapping Survey by the Microfinance Center for Central and Eastern Europe and Newly Independent States (Microfinance Center for CEE & NIS). Controlling for enterprise-specific and region-specific characteristics, we find that investment in microenterprises in municipalities where MFIs' presence is limited is more constrained, and depends to a larger extent on the availability of internal funds than investment in microenterprises from municipalities with strong presence of MFIs.

2. OVERVIEW OF THE MICROFINANCE SECTOR IN BOSNIA

Microfinance initiatives targeting disadvantaged populations in BiH started operations soon after the 1995 Dayton Peace Agreement was signed. According to some estimates, in the 1990s, the international community supported as many as 70 projects with some element of microfinance activity (Goranja, 1999). However, the microfinance sector developed mainly due to a unified strategy implemented by a Local Initiative Project (LIP) funded by the World Bank through the Local Initiatives Departments in the Federation of Bosnia and Herzegovina and Republika Srpska. LIP identified and trained about 25 organizations of which 17 potentially viable programs received funding and the most viable received further support through 2001 (Berryman & Pytkowska, 2003). Another important objective of the LIP was the creation of an appropriate legal framework for microfinance. This helped many MFIs become more integrated in the financial sector. Some MFIs were successful in obtaining commercial loans from local banks, while others transformed into financial companies which also improved their access to funds as well as their ability to provide more financial services.

By 2001, microfinance programs disbursed over 20,000 microloans but served a market different form that of banks since the loans offered by MFIs were much smaller. For example, in 2000, banks offered loans starting at 25,000KM while MFIs' loans started at 1,000KM (Berryman & Pytkowska, 2003). [4] The lending technologies employed by Bosnian MFIs were also culturally appropriate, adjusted to serve the unique clientele. Poverty in BiH differed from poverty in Africa and Asia, as the new poor were highly educated and usually with good physical assets base. The potential microentrepreneurs were people who before the war might have had sophisticated private businesses but were dis-