Authors
Xavier Giné
World Bank

Pamela Jakiela
Williams College

Dean Karlan
Northwestern University

Jonathan Morduch
New York University

Microfinance Games

Xavier Giné, Pamela Jakiela, Dean Karlan & Jonathan Morduch

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Innovations for Poverty Action applies rigorous research techniques to develop and test solutions to real-world problems faced by the poor in developing countries.

NYU Wagner Graduate School
295 Lafayette Street, 2nd Floor
New York, NY 10012-9604

T: 212.998.7523
F: 212.995.4162
E: contact@financialaccess.org

www.financialaccess.org

Innovations for Poverty Action
85 Willow St, Building B, 2nd Floor
New Haven, CT 06511

T: 203.772.2216
F: 203.772.2428
E: contact@poverty-action.org

www.poverty-action.org

Microfinance Games

Microfinance banks use group-based lending contracts to strengthen borrowers' incentives for diligence, but the contracts are vulnerable to free-riding and collusion. We systematically unpack microfinance mechanisms through ten experimental games played in an experimental economics laboratory in urban Peru. Risk-taking broadly conforms to theoretical predictions, with dynamic incentives strongly reducing risk-taking even without group-based mechanisms. Group lending increases risk-taking, especially for risk-averse borrowers, but this is moderated when borrowers form their own groups. Group contracts benefit borrowers by creating implicit insurance against investment losses, but the costs are borne by other

borrowers, especially the most risk averse. Access the Briefing Note here.

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