Funding microfinance under asymmetric information

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Abstract

We consider a model where poverty minimizing donors fund microfinance lenders that are heterogeneous in cost. Under asymmetric information, the donors face a choice whether to issue grants or to change the lenders for funds. While charging for funds leads to higher interest rates, a higher rate can induce separation by squeezing the higher cost lenders. Whether separation is good or aggregate poverty reduction or not depends on the quantity of supply of funds. When the supply is small, grants are best, but when the supply is large enough, it is better that lenders pay for external funding.

JEL classification

012, 016, 021

Keywords

Microfinance; Poverty; Screening

Figures and tables from this article:

Fig. 1. Total poverty reduction.

Fig. 2. Parameters such that Equation (15) holds.