

Center for International Development

at Harvard University



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Empowerment Lab

When Adam Smith wrote "The Wealth of Nations" in 1776, the richest country in the world was four times richer than the poorest country. Today, the United States is more than 60 times richer than Malawi or Sierra Leone. Inequality between countries has been on the rise for the past 200 years, creating disparities in income and the things that go with it-like health, education, quality of life, and people's ability to control their own destinies.

Much of this divergence can be explained by changes in technology, as people find new and better ways to do old things or engage in new activities altogether. As income levels have grown farther apart, these innovations have become less and less useful for those who are left behind. Washing machines, TV and refrigerators have little value for those without running water and electricity; e-commerce and on-line banking are of little value for those without access to the internet or the banking system.

Raising the living standard of people in developing countries requires more than just replicating what works somewhere else - it demands innovations designed with context in mind. Beyond simply looking to the developing world for new consumers, truly successful innovations will provide tools that allow people to access markets and the possibilities that go with them. Financial markets are one of these key markets, since they allow people to survive lean times, take risks, and build new ventures. To further global research on this subject, the Center for International Development, with support from the MPower Foundation, has launched the Empowerment Lab at CID which promotes innovations that extend the reach of markets in developing countries.

In partnership with the world's leading policy makers, business leaders, and development experts, the Empowerment Lab engages in research and activities to understand what limits the reach of markets and what interventions might enable us to overcome those obstacles. By systematically examining what works and what doesn't, the Empowerment Lab identifies innovations that enable individuals and communities to take control and improve their own lives.

Research and Grant Opportunities

As part of its initiatives, the Empowerment Lab offers three types of grants on topics related to the core interests of the Empowerment Lab: (i) Faculty Research Project Grants, (ii) Faculty Seed Capital Grants, and (iii) Student Research Project Grants.

Events

The First Annual Global Empowerment Meeting will be held September 22-23, 2008 at Harvard University, Cambridge, MA. This invitation-only event will convene the world's leading policy makers, business leaders, and development experts focused on extending the reach of markets, particularly financial markets, to the economically disenfranchised. This event brings together innovators who are doing cutting edge work in the field, including researchers from Harvard and MIT, entrepreneurs in technology and finance, leaders of banks and financial institutions, and policy makers.

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Entrepreneurial Finance Lab

The missing middle

Emerging and developing economies have a large number of micro-firms and some large firms, but far fewer Small and Medium Enterprises (SMEs) compared to developed economies. Despite evidence of high returns, these firms face critical problems in accessing finance, as existing lending models - microcredit, banks, and VCs - have been unable to reach them. Microcredit may reach micro-enterprises, but such firms rarely graduate to SMEs. The microcredit model falls short when larger and riskier investments are needed and cash flows are not immediate. Banks have the liquidity, but face too high a transaction cost to evaluate small businesses and must rely on collateral. VCs are willing to incur large screening costs, but only for the few SMEs that can generate extremely high returns and viable exit options. In other words, current models are better at matching money to money (collateralized lending) or money to no money (microcredit) rather than money to profitable business ideas.

Banks in rich countries penetrated the missing middle in part by evaluating the entrepreneur's own abilities and trustworthiness instead of focusing on the particular business, much like VCs do. They could do this cheaply and accurately using individual credit histories. But what does one do in developing countries where such deep credit histories are not as widespread? Is there another way to evaluate an entrepreneur's own abilities and trustworthiness in a low-cost, automated, and reliable way?

A new approach: psychometric screening

Advances in psychometric testing can provide ways to measure a potential borrower's entrepreneurial ability and honesty directly with low transaction costs and few information requirements. A battery of field-validated tests for personality, psychological and sociological traits, cognitive abilities, and honesty could provide direct measures of an entrepreneur's ability and integrity. These tests can be automated, do not require a credit history, and are resistant to manipulation. And when combined with the right financial contracts, they could represent a breakthrough in profitable lending to the missing middle. We have developed a prototype and tested it against a detailed and expensive due diligence process in a South African financial institution, and the early results are quite promising. With start-up support from Google.org, we have established the Entrepreneurial Finance Lab at Harvard University to develop and disseminate this and other technologies to unlock the potential of the missing middle.

The way forward

The Entrepreneurial Finance Lab is seeking partners in the finance industry, primarily commercial banks, as well as VCs and NGOs with large sets of clients. The Lab will further refine the screening tool, and these partners will administer it to a sample of their clients. The predictive power of the test will be compared to the clients' actual business performance, giving a clear indication of the screening tool's accuracy. Armed with these results, the psychometric screening tool can be added on to the partner's existing methods to improve accuracy and reduce costs in existing segments, and will allow them to move down-market to profitable firms in the 'missing middle'. As compensation for their participation in the development and testing of this tool, partners will be provided with rights to the technology.

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