3 (b)

**Model Description**

The researchers developed a diffusion model to capture the diffusion process of participation in a microfinance program at household level.

The structure of the diffusion model can be explained as follows:

1. A set initial leaders (injection points) are informed of the microfinance program. These leaders are generally pre-school teachers, shop keepers and saving self-help group leaders.
2. Leaders get to decide if they wish to participate
3. In each period households that have been informed pass the information independently to each of their neighbors with probability (q) that varies depending on a household participation status. (Participant qp or non-participant qn)
4. Newly informed households can then decide whether to take part depending on their characteristics and previous participation decisions of their neighbors who passed the information to that household.
5. The model repeats the same procedures and terminates after a certain periods of information passing.

The model allows information to be transmitted even by nonparticipants. People who are informed but not eligible or have no intention to participate can still pass the information around and the effect of those non-participants is examined in the study. The baseline model is the simple information model which incorporates only information transmission. Another more enriched model, information model with endorsement effect, incorporates peer influence. The model accounts for the endorsement effect by allowing households’ decisions to participate to depend on what their neighbors have done.

**Model Estimation**

Two diffusion models are estimated in the study: a baseline information model which considers only information passing and an information model with endorsement effect which evaluates peer influence. The models are estimated structurally with the use of Method of Simulated Moments (MSM).

* It starts by considering key moments:

1. The share of leaders who participate microfinance
2. The share of households who participate with no participating neighbors
3. The share of households who participate that are in the neighborhood of a participating leader
4. The share of households who participate that are in the neighborhood of a non-participating leader
5. Covariance of fraction of households participating in the program with the share of their neighbors that participate.
6. Covariance of fraction of households participating in the program with the share of their second-degree neighbors that participate.

* Simulate the information diffusion process with the use of various selected parameters. The parameters chosen aim to best match the key moments predicted by the model with actual moments observed in the village.
* Parameters are estimated by minimizing a criterion function consisting the difference between moments observed in the data and those predicted by the model for each village.
* Several robustness checks are performed on the modelling results such as re-estimating the model with a different set of moments and a different participating variable.

The modelling results suggest that information effects are far more significant than peer influence. Individual’s decision to participate is not significantly affected by peer influence and hence no additional endorsement effects beyond information passing. Participants in the microfinance program are approximately five times more likely to pass the information to their friends than nonparticipants. Both forms of information transmission are important. The model replicates well the actual observed pattern of information transmission in these villages. There is no significant correlation between network characteristics and the eventual participation of the program.