ASSESSING THE IMPACT OF INNOVATION GRANTS
IN FINANCIAL SERVICES

An Appetite for Credit

A Study of Product Innovation by Pro Mujer Peru

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MICROFINANCE OPPORTUNITIES

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ABOUT THE PROJECT

The *Assessing the Impact of Innovation Grants in Financial Services* project, undertaken by the IRIS Center at the University of Maryland at College Park and its partner Microfinance Opportunities, is assessing the impact of grants provided by the Bill and Melinda Gates Foundation (BMGF) to six microfinance organizations for the development of innovations in financial services. The research endeavors to examine the impact of these innovations in terms of poverty alleviation, sustainability, and scalability. The aim is to identify the most promising products, services, and delivery systems in current microfinance. The approach taken by the Impact Assessment project gives novel emphasis to issues such as access to financial services and the role of the regulatory environment.

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REPORT SERIES

This report is part of a series that will be generated by the *Assessing the Impact of Innovation Grants in Financial Services* project. The reports are disseminated to a broad audience including microfinance institutions and practitioners, donors, commercial and private-sector partners, policymakers, and researchers.

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ABSTRACT

This investigation concerned use of the Premium loan, Pro Mujer Peru's (PMP) largest credit ever offered. The most common motivation for seeking the Premium loan was that clients simply wanted more capital for their businesses. In nearly every case, clients realized their plans for the loan, which is to say, nearly all the funds went directly into business investment. But the Premium loan was just part of broad credit and cash-management strategies among these clients. In total over the past year, they had taken out 5-6 separate loans averaging over $5,000 between them, with the Premium loans comprising just 30 percent of the total. The dominant pattern of business investment was loan patching. The Premium loan was taken up simultaneously or in sequence with other credits, both at PMP and other institutions, and applied toward the same purpose of business investment. Many people reported increased profits, compared with years past, as a result of the capital boost from the Premium loan. The Premium loan also enabled some clients to respond to opportunities to upgrade their businesses and to strengthen vertical and horizontal relationships in the value chain. All clients were engaged in obligatory savings connected to the Premium loan, which was noted as a pleasing feature. These clients like to be forced to save, but also wanted reasonable access to those savings when they needed them, which PMP's policies provided. Few had or wanted conventional voluntary savings accounts. These initial observations on savings inspired a follow-up investigation in June 2009, which combined MIS analysis with additional interviews to challenge some of the conventional wisdom on limited value of obligatory savings. Key takeaways from the study included this rethinking of mandatory savings and complication of the notion of "graduation" – i.e. many clients "graduated" from PMP in the conventional sense (i.e. sought bigger loans with competitors), but retained their smaller group loans for intangible reasons such as loyalty and friendship.

OTHER NOTES

All photos included here were taken by the author in November 2008.

An exchange rate of 3 soles/USD was used in this report

In instances when the report refers to individuals, names and identifying information have been altered.

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ABBREVIATIONS

BMGF	The Bill & Melinda Gates Foundation
FSA	Overall project name (Financial Service Assessment, or *Assessing the Impact of Innovation Grants in Financial Services*)
FSP	Financial Service Provider
INEI	Instituto Nacional de Estadística e Informática (Peru's National Statistics Office)
MFI	Microfinance Institution
MFO	Microfinance Opportunities
NGO	Non-governmental Organization
PMP	Pro Mujer Peru

EXECUTIVE SUMMARY

This study is part of the *Assessing the Impact of Innovation Grants in Financial Services* project, undertaken by the IRIS Center at the University of Maryland and its partner Microfinance Opportunities. The goal is to assess the impact of grants provided by the Bill and Melinda Gates Foundation (BMGF) to microfinance organizations for the development of innovations in financial services.

The purpose of this investigation is to examine how Pro Mujer Peru's (PMP) clients have used and continue to use BMGF-funded credit innovations. More specifically, the investigation concerns one innovation, the Premium loan, PMP's largest loan ever offered, with a longer term, less frequent payments, and lower interest rate than PMP's Regular loan product. The loan is targeted at (and limited to) PMP's longer-term, more successful borrowers—a bigger loan to meet the needs of bigger borrowers.

The study was based on a series of individual interviews with current Premium clients in the southern Peruvian cities of Puno and Tacna. In our sample, we found on average a group of middle-aged women with less than a complete secondary education. They tended to stand out from their peers, at least compared to other PMP clients, in terms of the scale and relative success of their businesses. We found very little indication that these women had been born into advantage.

Their most common motivation for seeking the Premium loan was that they simply wanted more capital for their businesses, and the Premium became a new vehicle for doing that. Many cited the loan's longer term and slightly lower interest rates as reasons for preferring it over other PMP products, but the difference was not such that they discontinued their use of the other products. They also favored the obligatory savings policy, which compelled them to save somewhat more than they were saving with just the Regular loan.

In nearly every case, these clients realized their plans for the loan, which is to say, nearly all of the funds went directly into business investment. Most clients (about 2/3) reported some kind of economic shock in the past year, but they were able to use other resources—ongoing earnings, savings, or other credit in some cases—to compensate for these shocks (only 5 percent of the initial sample applied Premium funds to a shock, as compared to over 50 percent that applied ongoing earnings to a shock). Almost no one employed Premium funds for household expenses (though other enterprise loans were diverted for household use on occasion).

The Premium loan was just one part of their broad credit and cash-management strategies. On average, Premium clients had taken out 5-6 separate loans over the past year. There were varying degrees of overlap in these loans. The average total credit over the year was just over $5,000 in Puno and just over $5,400 in Tacna. Premium loans taken up by clients in the past year comprise, on average, less than one-third of their total credit obtained. The Premium loan combined with all other PMP credits comprised 56 percent of total borrowing in Puno and 68 percent in Tacna.

Sometimes the Premium loan provided a boost that significantly raised the scale of a client's business or propelled the client into a new business. Sometimes the Premium loan was one new element in an ongoing business plan that did not depend on any one particular loan. There was no evidence the Premium loan changed clients attitudes regarding business expansions or upgrades. For some, the loan was a new way to realize expansion plans, but generally those plans pre-dated the loan (using credit to follow opportunity, rather than vice versa). Moreover, many clients had made investments/upgrades as big or bigger using other credit in the past.

At the same time, the Premium loan had a clear net effect on the total amount of capital in circulation among these clients. As noted above, the Premium represented about 30 percent of the total credit taken out by clients over the past year, but most evidence suggested that this was 30 percent of *additional* credit, rather than credit substituted for other loans sought in the past. Nearly all clients sustained their pre-Premium borrowing habits at PMP, which is to say, they sought out all available Regular and Seasonal loan as they added the Premium to the mix. Likewise, there was little indication that taking the Premium loan made them any less inclined to borrow from other institutions.

The dominant pattern of business investment was loan patching. The Premium loan was taken up simultaneously or in sequence with other credit and applied toward the same purpose of business investment. One might describe the pattern as one of "maxing out" PMP resources, meaning most clients took out nearly every possible loan from PMP over the course of the year, usually including the Premium, Regular, and Seasonal loans. Also, over 80 percent had taken up a loan with a competing institution that overlapped with the Premium loan.

About half of respondents reported increased profits, compared with years past as a result of taking the Premium. This finding is consistent with the prevailing attitude among clients that increased profits hinge on increased capital for investment; the Premium loan was a new source of capital and hence a new basis for profit this year, as compared with past years.

All clients were engaged in obligatory savings connected to the Premium loan, which generally meant that their overall savings levels were increasing (the sums saved with the Premium were on top of ongoing obligatory savings with the Regular loan and, in some cases, competitors' group loans). Beyond PMP, only about one-third of respondents had voluntary savings accounts, and only about 20 percent had voluntary savings accounts with formal financial institutions (the rest saved at home).

This savings increase was noted by many as a pleasing feature of the Premium loan, who saw it a productive way to amass resources over time. The obligatory nature of it, coupled with PMP's relatively liberal policy on withdrawals, was seen as critical. Simply put, these clients like to be forced to save, but also wanted reasonable access to those savings when they needed them. One can speculate that voluntary savings is difficult for this group, who may face a variety of familial and societal pressures that undermine their capacity to save voluntarily.

The initial observations on savings inspired a follow-up investigation in June 2009, which combined MIS analysis with more tightly-focused additional interviews. We found that about ¾ of Premium borrowers in the sample supported the obligatory savings policy, most often for one or both of two reasons: 1) they liked being forced to save; and 2) many distrusted commercial banks. The study also found that 80 percent of the Premium client base overall was leaving more than necessary in these accounts, as compared with 56 percent Regular loan borrowers (average surplus for Premium borrowing was around $60, with subpopulations at considerably higher levels). Once withdrawn, uses ranged from entertainment funds to longer-term business investments.

At the same time, the follow-up visit showed that the utility of these accounts was undercut by the potential for involuntary appropriation by PMP when payment problems develop in the loan groups. Such approppropriation is part of PMP's group loan methodology that lay mostly dormant until recently, when Peru's economy weakened in 2009.

The change in the economy and implications of this policy were striking in the follow-up visit, as compared to the initial visit. Initially, about 20 percent of the sample mentioned "recession" in some form, but defaults in Premium groups were virtually non-existent. Upon return in June 2009, about half of the sample reported drops in business revenue ranging from 20 to 50 percent. Relatedly, 55 percent of the sample reported serious economic problems within their loan groups, with defaults occurring or imminent. In these scenarios, some substantial savers we interviewed had seen their savings evaporated or frozen to cover others' defaults.

The Premium loan, in combination with other borrowing, enabled some clients to respond to opportunities to upgrade their businesses and to strengthen vertical and horizontal relationships in the value chain. In the initial sample, 30 percent of Premium clients reported upgrades of this sort. In some cases, there were reports of new links, e.g. access to new wholesalers and/or new buyers, created by the infusion of new funds including the Premium loan.

Questioning extended to gender dynamics and whether any changes in the role of women in the household could be correlated with the appearance of the Premium loan. None could be reasonably linked to the loan. The lack of transformative effect reflects the fact that most of these women have access to a wide matrix of credit, where the Premium represents a significant but not landmark component.

The study answered some questions about these clients, while opening others. Key takeaways include:

1) *Mandatory savings* - These clients are viewing mandatory savings in an unconventional way, bolstered by the relatively liberal withdrawal policies of PMP. The savings has transformed into a usable resource in several different ways, both short- and long-term. It is an interesting counterpoint to the increasing calls for the encouragement of voluntary savings products. At the same time, confidence is undercut when the funds are appropriated to cover loan defaults; MFIs like PMP face a difficult choice between encouraging savings or sustaining their current group-loan methodologies.
2) *Rethinking "graduation"* – A common concern among MFIs is that their best clients will become so successful that they leave to seek larger loans with commercial competitors—in a word, "graduating." This study complicates the notion of "graduation" because many clients in fact "graduated" in the conventional sense (i.e. sought bigger loans with competitors), but they retained the smaller loans at the same time.
3) *Valuing the intangibles* – Many Premium clients are continuing to borrow from PMP when they can and do borrow much larger loans (with better terms) from competitors. Their motivation is mostly the friendships and social capital of their long-term loan groups at PMP. The case clearly shows that clients operate with multiple drivers of choice in their borrowing.
4) *Loan patching and risk-aversion* – Would these clients be better-served if PMP raised its tolerance for risk and were willing to deliver $5,000 in a single loan? Would institutions like PMP benefit financially? There are arguments to be made on both sides of the issue, and these clients provide prime substance for the debate.
5) *A complicated view of transaction costs* – Lowering transaction costs is a central concern of the present microfinance industry. Yet we must acknowledge that transaction costs seem to have no decisive influence on the borrowing patterns of some clients, who take big bank loans but still maintain their (smaller) group loans for the social capital. Again, the case demonstrates clearly that there are multiple and overlapping drivers of choice in borrowing patterns.

These components, in turn, will be joined with the other elements of the overall impact study. Our goal will be to combine different methods and different moments in time to deliver a composite portrait of how and why conditions change. The expectation is that the results will contribute significantly to the learning agenda of BMGF and the field of microfinance in general.

I. INTRODUCTION

"AN APPETITE FOR CREDIT"

Microfinance Opportunities specializes in delivering insights on clients' financial strategies and behavior, to help strengthen the base of knowledge on which the microfinance industry rests. Generally, we aim to apply this understanding of clients and their motivations toward "improving" microfinance services, in the sense of demonstrating to service-providers what works for clients and why. At the same time, our findings contribute to impact studies, adding implications toward "proving" the impact of formal financial services. The present investigation is no exception in this regard—an "improving" study with "proving" implications.

Generically termed the Product Use study, this investigation centers on one particular service-provider, Pro Mujer Peru (PMP), a division of an international microfinance network that has helped pioneer the village-banking model (see Westley, 2004). More specifically, the investigation concerns one PMP service innovation, the Premium loan. The Premium is PMP's largest loan ever offered, with a longer term, less frequent payments, and lower interest rate than PMP's Regular loan product. Like PMP's Regular loan, the Premium loan comes with a mandatory savings requirement.

The Premium loan represents a broadening of PMP's village-banking model in the sense of diversifying its product array, away from the traditional focus on smaller loans with short terms and frequent payments (cf. Nelson, et al. 1996). PMP offers the loan selectively within its historically-female client base, requiring clients to have completed a minimum of three years or eight loan cycles. Generally, PMP targets its relatively successful microentrepreneurs with the loan—again, a departure from traditional village banking's "deep outreach" and aim to serve the "extreme poor" (Churchill, et al., 2002, pp. 1-2). In the field of larger microloans, the Premium is distinguished as a sizeable, group-based loan offered to successful women, as opposed to the more typical approach of individual loans appropriated by men.

The prescriptive value of this study applies to PMP but does not end with it. Here some comments on research design are warranted. As the name suggests, the study focuses on the oft-overlooked area of loan use. The panel studies that predominate in microfinance impact research (see overview in Goldberg, 2005) tend to begin with service provision and leapfrog directly to outreach or impact, only inferring the processes in between that give rise to such results. The major exceptions are the panel studies that mix methods, pairing substantial qualitative research and detail with their quantitative investigations (see, e.g., Dunn and Arbuckle, 2001).

This study represents the qualitative portion of such a mixed-methods approach. The study delivers a richness of detail that stands apart from and complements quantitative methodology, in this case represented by the outreach study of our research partner, the IRIS Center at the University of Maryland. Moreover, the Product Use study delivers precisely the "in-between," the use of the funds, or the period between service provision and outcomes. In doing so, we pose the critical how and why questions that dig deep into client motivations and behavior.

Clearly, microfinance practitioners know their clients, but most lack the resources and opportunity to pose such probing questions about the use of their loan funds. In this way, our findings can help reshape service and product design, having tangible effects on the operational side ("improving"). At the same time, the findings help reorient the understanding of anticipated impact, for the larger impact study of which this study is part ("proving").

The subject of the study, PMP's Premium clients, is also quite noteworthy and raises an abundance of questions with both "improving" and "proving" implications. The clients interviewed for this study were indeed as PMP envisioned them—therelatively successful "good payers." With the outreach data provided by our research partner the IRIS Center, we have independent confirmation that Premium clients are relatively affluent in basic socioeconomic terms, at least compared to non-Premium borrowers at PMP.

We do not know for certain where our respondents began, but all indications are that their success was self-made. In other words, at this point in their lives as businesswomen and debtors, these clients were not precarious survivalist borrowers, whose welfare has tended to consume the attention of donors and high-profile microfinance innovators. By the scale of their businesses, the Premium borrowers fall short of the so-called "Missing Middle" (cf. Ody and de Ferranti, 2007), but at least some appear to be moving in that direction.

The microfinance industry has long recognized that loaned cash is fungible, and that enterprise loans are widely diverted for household use, especially when clients confront economic shocks. In fact, some experts have suggested that this manner of shock-absorption and/or large lump-sum provision may be the primary value of microfinance (cf. Sebstad and Cohen, 2001; Rutherford, 2000). In this respect, the Premium clients may represent something of on outlier. Unlike poorer borrowers, which is to say the more typical microcredit clients, these clients made fairly sharp distinctions between household and business finances. They rarely diverted the Premium loan, ostensibly a business loan, from productive to household purposes.

In addition, these clients borrowed quite aggressively across the board. Most were traders, vendors, or store-owners, and the prevailing business sense was that more inventory equaled more profit. Consequently, the Premium loan comprised just a fraction of their total borrowing. Most juggled multiple loans from PMP and its competitors, both in sequence and overlapping. All told, these clients displayed an intense appetite for loans, which they devoured by pouring into their businesses (only occasionally diverting enterprise loans other than the Premium for non-productive purposes).

A close look at these use patterns helps challenge some conventional wisdom of the microfinance industry. These clients are relatively “successful” in the sense of taking out and paying back quite a few loans, and in the sense of absolute poverty confirmed by the IRIS study. In many ways, we are dealing with a group that might be the “poster children” of microfinance, the achievement stories to appear in an MFI’s promotional materials. The overarching question then becomes, how does “success” shape use? And what common assumptions about loan use might be reshaped by this client group?

An example of an area where the effects of “success” manifest are attitudes toward savings. This study concerns a loan product, not savings per se—as an unregulated financial institution, PMP is not permitted by Peruvian law to capture savings on its own. However, like most village-banking products, the Premium loan comes with an obligatory savings policy that entails collecting sums from clients, both at the start of the loan and during the term, and depositing those funds, via a partnership with a regulated bank or savings and loan.

What we found in the Premium client group, initially, was a very particular enthusiasm for this obligatory savings. Clients liked knowing that the sums would build over time and that they would be available for withdrawal at varying points if circumstances required it. Per PMP policy, at the end of each loan, these clients could withdraw a portion of those savings at set levels and not disrupt their borrowing cycles. Moreover, unlike survivalist borrowers, these clients recognized that in tight circumstances they could even withdraw all of their accumulated savings, with plans to restore them for a later cycle, thereby resuming loans with PMP. The reason they were capable of this was that they had multiple sources of cash and credit. As a third option, clients could forgo the regular withdrawals and let the savings build over several cycles, for more liquidity and greater lump-sum availability over time. Between these options, clients saw considerable risk-management and even “nest egg” potential in the obligatory savings.

In other words, for these clients, the meaning of mandatory savings had changed, from “the price of borrowing” (Rutherford, 2005, p. 22) to something useful and accessible in needful situations, such as emergency or economic shock. If they chose to do so, the savings could be retained over time as a risk-management resource as these women aged toward retirement (most Premium clients were mature, and some senior). Again, this kind of risk-management role is precisely what some leading scholars have posited as the core value of microfinance (e.g. Sebstad and Cohen, 2001), yet in mandatory savings the value comes in an unlikely and unheralded form. The rule one might distill out is that the more economically stable the client, the more flexible and useful obligatory savings becomes. We note that these findings run counter to some critiques of the village-banking model, which have characterized forced savings as a hindrance to the proliferation of credit and have called for less of it (e.g. Westley, 2004). If anything, this client group wanted *more* obligatory savings.

The findings on savings were intriguing enough to warrant a short-follow-up visit in June 2009, in which a smaller sample of clients were interviewed with a new series of probes about savings behavior. These interviews helped flesh out and reinforce many of the initial findings, and added MIS data from PMP to address broad quantitative questions about savings propensities in the client base. At the same time, the visit underscored a complication to the potential of obligatory savings as a useful financial resource—that is, when economic conditions engender widespread defaults, the savings become vulnerable as part of the group guarantee. The investigation found a markedly weakened economy in Peru in June 2009.

Similarly, this group helps reshape the idea of "graduation." PMP's move to create and offer the Premium loan can be seen as part of a trend among MFIs "to offer new loan products for bank members whose growing business needs can no longer be satisfied by the terms of the existing village bank services" (Nelson, et al., 1996, p. 27). Underlying this trend is the possibility that some clients will leave their original MFIs behind to seek larger loans with the commercial competitors—in a word, "graduate" to another institution. The Premium is an example of larger, more appealing loan intended to raise the ceiling at the original MFI and retain at least some portion of the total credit of these "good payers," who tend to be cheaper to serve and beneficial to the MFI's overall portfolio.

This study complicates the notion of "graduation" because many of the clients in fact "graduated" in the conventional sense (i.e. sought bigger loans with competitors), but they retained the smaller loans with PMP and other lenders at the same time. Their most common stated reason: the social capital of their loan groups (cf. Mosley and Verschoor, 2005; Woolcock, 1998), which they missed with individual loans. (Some borrowers also had difficulty meeting the collateral requirements for larger individual loans.) These findings challenge conventional wisdom (or perhaps teleology) on a second level—that successful borrowers evolve and eventually want to replace their small group loans with large individual loans. For this group, it was not a question of group loan *or* individual loans. Many wanted a mix—group loans *and* individual loans—and they achieved this mix, reaping the perceived value of each.

By virtue of its cumulative debt load, this client group also raises the specter of overindebtedness and compels us to consider any bearing it may have on this case. The subject of overindebtedness is widely discussed in today's microfinance, though we find a remarkable lack of consensus on its definition (Richard Rosenberg, personal communication, 2008). Much of the more definitive work focuses on debt levels in developed nations (e.g. European Commission, 2008; Kempson, 2002), which present variables (e.g. mortgages, multiple high-limit credit cards) that limit relevance to cases like Premium clients in Peru.

Nevertheless, Premium clients present some interesting challenges for the examination of overindebtedness. The average debt load of this group is high—certainly high enough to give an outside observer pause in some cases. In addition, some borrowing habits noted in the interviews, such as extensive regular and cyclical use of money-lenders, seem especially problematic.

Yet in November 2008, nearly all clients seemed to be doing just fine in terms of maintaining their businesses, supporting their households, and making their loan payments. In many ways, these findings seemed a testament to a group's skill in conceiving and capitalizing on complex cash-management strategies. Employing some of the more sensible and relevant definitions of overindebtedness (e.g. Richard Rosenberg, personal communication, 2008), this group appeared NOT overindebted, since their business and household obligations were being met, and their lives were not worsening as a result of the credit. Indeed, even sizeable economic shocks seemed to be absorbed by most in this group with relative ease.

But the questions abound. To what extent has the high debt level defined their "success"? To what extent has it hindered it? How much debt is too much? Moreover, the economic "health" of this client group is called into question by the results of the follow-up visit in June 2009. We found a significantly weakened economy at that time, and waves of defaults that seemed to be upending many Premium loan groups. It appeared that the economic downturn had exposed real vulnerability associated with carrying these debt levels.

The following report will elaborate on the significance of these and other findings related to the behavior and motivations of this client group, in advancement of this "improving" and "proving" effort for the microfinance industry.

OUTLINE OF REPORT

Chapter II provides an overview of the overall project and the place of the Product Use study within it. Chapter III provides background on the subject matter and research design. It also includes summary statistics on the socioeconomic profile of the interviewees. Chapter IV proceeds into the major trends and issues that emerged in the research. It begins with a summary overview on those findings, before delving more deeply into a group of issues the project set out to explore. Chapter V continues with summary findings and discussion of key questions, both addressed and opened by the study. Chapter VI concludes with proposed lessons for the microfinance industry.

In addition, Chapters III and IV close with case studies intended to flesh out the portrait of Premium clients. (NOTE: in all cases, details have been altered to conceal the identity of respondents.)

II. PROJECT OVERVIEW

PROJECT BACKGROUND

This study is part of the *Assessing the Impact of Innovation Grants in Financial Services* project (also known as Financial Services Assessment; hereafter FSA), undertaken by the IRIS Center at the University of Maryland and its partner MFO. The goal is to assess the impact of grants provided by the Bill and Melinda Gates Foundation (BMGF) to microfinance organizations for the development of innovations in financial services. The impact of microfinance on clients and their households remains an issue of core interest and inquiry within the microfinance industry, among service providers and donors alike. The project is part of BMGF's longstanding impact investigation.

The approach adopted in this project is mixed-methods, and the project endeavors to examine the impact of these innovations in terms of poverty alleviation, sustainability, and scalability. The aim is to identify the most promising products, services, and delivery systems in current microfinance. The approach taken by FSA uniquely emphasizes issues such as access to financial services and the role of the regulatory environment. The division of labor is largely IRIS on the quantitative research and MFO on the qualitative research.

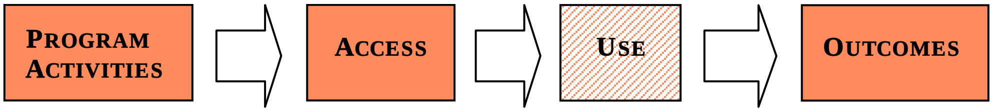
PURPOSE OF THE PRODUCT USE STUDY

The purpose of the Product Use study is to focus on BMGF-funded credit innovations of Pro Mujer Peru (PMP) and examine how clients have used and continue to use those innovations. We aim to examine both the motivations and behaviors surrounding use. The study comprises the middle link of the project's causal chain, which was conceived as a way to explain the pathway to impact (see Figure 1).

As part of a larger impact study, the underlying idea of the Product Use study is that understanding use will help investigators better define anticipated impact. In other words, *we must understand how and where loan funds are applied in order to shape our expectations about effects on clients' lives.*

The study posits the PMP's Premium loan as a recently-introduced resource among a variety of resources clients have at their disposal and investigated both the uses of the loan and the factors mediating that use (in the convention of livelihoods analysis, cf. Ellis, 2000). We examined client decision-making regarding the use of the loan funds (e.g. capital investment, offsetting of shocks), how use developed over time, and the clients' reasons for use patterns. Investigators probed for information on profits or losses tied to the loans, and their implications vis-à-vis growth and vulnerability at both the household and enterprise levels.

FIGURE 1 – PROJECT CAUSAL MODEL



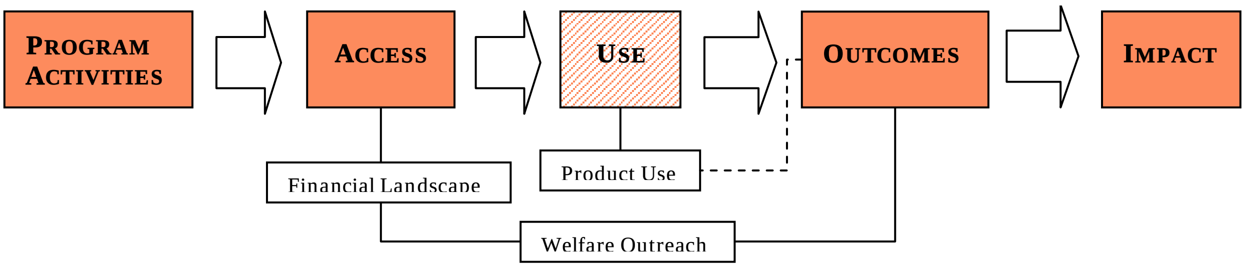
THE PRODUCT USE STUDY'S PLACE IN THE FSA STUDY

The Product Use study presented here is but one piece, specifically focused on use, in a complex assessment picture that will take shape through the overall FSA. The research in Peru also includes a quantitative Welfare Outreach study, comparing absolute poverty of incoming Premium clients against incoming Regular clients, and a qualitative Financial Landscape study, examining the context and value proposition of the PMP credit innovations. This configuration of studies in Peru reflects FSA's broad strategy of combining different methods and different moments in time to deliver a composite portrait of how and why conditions change.

The investigation in Peru began in the fall of 2007 with the Financial Landscape study (Ferguson, 2008). The purpose of that study was to investigate the issue of *access*, meaning what financial services are available in the areas of the innovations and whether potential clients, particularly those with low incomes, make effective use of those services. In sum, that study found a highly competitive and crowded credit market in the urban areas where the Premium loan is being offered. Though introduced as an innovation for PMP in its potential to serve the larger-scale needs of relatively successful microentrepreneurs, the size and major attributes of the loan (e.g. term, payment frequency, interest rate) are mostly matched or improved upon by a range of products offered by competitors. The study found that the product's value proposition for clients lies primarily in its potential to serve a relatively successful (for its context) client segment that feels loyalty to PMP and wishes to remain with the organization as their credit needs grow (as opposed to "graduating" from PMP and seeking larger loans with competitors). A second area of value was the product's potential to serve a niche market of relatively successful microentrepreneurs who prefer group loans over individual loans; nearly all of the larger loans offered by competitors were individual.

The Product Use study also was implemented in coordination with the Welfare Outreach study, a quantitative survey examining the depth of outreach (i.e. level of absolute poverty) of clients who receive the innovations. The first phase of the Welfare Outreach study, which focused on the Premium product, has been completed, and the findings suggested several key points that informed the Product Use study. The study employed IRIS's poverty assessment tool with 420 new clients who took regular PMP products and 235 new clients who took the Premium loan in the cities of Tacna, Juliaca, and Puno. The results indicated that while 8.1 percent of the sampled regular PMP clients are estimated to live below the $2 a day poverty line (in PPP terms), the results were 1.28 percent for the Premium clients. Hence the evidence strongly suggested that Premium clients are less likely to be poor compared to regular clients—an expected finding given the nature of the product and PMP's stated intent.

FIGURE 2 - CAUSAL MODEL WITH RESEARCH COMPONENTS



The Product Use offers an important complement to both studies. In the case of the Financial Landscape, the Product Use study presented the opportunity to test the key conclusions of that study about these credit markets and the Premium's value within them. We asked clients directly about their criteria in choosing the Premium over comparable products at PMP's competitors. We probed as to the nature and extent of client loyalty and its role in decision-making, and investigated the relative importance and value of the group loan structure. We also examined the relationship between the Premium and the multitude of competing products. Are clients taking out other larger loans simultaneously with the Premium? Are they substituting the Premium for other existing loans? To what end?

Similarly, the Product Use study probed the implications of the Welfare Outreach findings. Given that the relative poverty of this client segment is low for its context, what role is the loan playing in the lives of these entrepreneurs? Is it meeting a need that was unmet by competing products? Is it making a real difference in clients' lives at both the household and enterprise level? Does the use of the loan have "trickle-down" effects, such that new opportunities (e.g. jobs) are created for more impoverished Peruvians? On a broader level, what does relative "success" mean in terms of day-to-day household and business management? (Many of these issues clearly cross over from "Use" into "Outcomes," hence the dashed line connecting with Outcomes in Figure 2.)

The Product Use study provides critical details on the ground-level implications of the products in the intervening phase between access and outcomes, thereby adding detail and color to the emergent picture of impact. It works in conjunction with the other components as shown graphically in Figure 2. The reader will note that the Peru phase of FSA extends to outcomes but not conventional impact.

FIGURE 3 - A PREMIUM CLIENT WITH HER MOTO-TAXIS AND CHILDREN IN PUNO

III. SUBJECT OVERVIEW AND RESEARCH DESIGN

COUNTRY OVERVIEW: PERU

Peru is a country of just under 500,000 square miles, occupying the central west coast of South America. Geographically it consists of three major regions: the coastal desert; a mountainous spine through the center of the country, formed by the Andes; and the tropical Amazonian lowland zone on the eastern side of the Andes. Two of those three regions were featured in this project, with Tacna situated in the coastal desert and Puno perched high amid the Andes mountain range.

The country's population was estimated at just over 27 million in 2005 (INEI, 2005). Though the country's economic base remains in agriculture and livestock, the last half-century has been marked by high rates of urban migration and subsequent urban growth. The capital city of Lima alone now contains close to one-third of the county's total population.

In a global context, the country ranks toward the middle of the poverty scale—number 87 out of 177 countries on the Human Development Index (UNDP, 2007). Internal social indicators paint a somewhat direr picture. Peru's office of national statistics (el Instituto Nacional de Estadístico e Informático, or INEI) calculates domestic poverty rates based on varying levels of minimum income in the cities and rural areas of each of the three major regions described above (desert coast, sierra, and tropical lowlands). By their 2006 estimates, 45 percent of the country lived below the poverty line, and 16 percent lived in extreme poverty (INEI 2006). For a sense of what this means in international terms, Table 1 presents income figures derived from international poverty standards for the areas of the country covered by the research:

TABLE 1 - PERU'S POVERTY THRESHOLDS IN USD, 2007

	POVERTY LINE, DAILY INCOME PER PERSON (PPP)	EXTREME POVERTY LINE, DAILY INCOME PER PERSON (PPP)
Puno	$1.44	$0.72
Tacna	$1.44	$0.72

Source: http://www.povertytools.org/Links/Calculating_PPP_Conversion.pdf

PRO MUJER PERU

PMP is part of a U.S.-based women's development and microfinance network with a stated mission "to provide Latin America's poorest women with the means to build livelihoods for themselves and futures for their families through microfinance, business training, and healthcare support" (Pro Mujer 2007). The organization operates in five Latin American nations: Mexico, Nicaragua, Bolivia, Argentina, and Peru.

The Peruvian institution was founded in 1999. Headquartered in Puno and mainly serving districts in southern Peru, PMP is a credit-led organization that offers a range of loan products to its traditional client base of resource-poor women. Historically PMP's loans have adhered to a village-banking model consisting of communal associations (*asociaciones comunales)* of 20-30 clients, which are in turn composed of 4-6 loan groups (*grupos solidarios)*.

PMP was founded as and remains a microfinance NGO, an unregulated financial institution under Peruvian law, as opposed to the other categories of regulated financial institutions (e.g. banks, non-bank savings and loans, and EDPYMEs). The major restriction that NGO status creates is that PMP cannot capture savings deposits, except through partnerships with regulated institutions.

This study focuses on one particular product innovations in PMP's microfinance program, funded by BMGF in 2005. The Premium loan is the largest loan PMP has ever offered, available only to experienced borrowers in good standing with the organization (more product detail follows in next section).

In addition to the Premium, PMP currently offers the following loan types:

1) Regular Loan *(Crédito Regular)* – conventional solidarity group-loan product for microentrepreneurs.

2) Seasonal Loan *(Crédito Estacional)* - a parallel loan for meeting short-term capital needs during the regular loan cycle (available as supplement during Regular or Premium loan term; clients become eligible after completing three Regular loan cycles).

3) Feria Loan *(Crédito Feria)* - small-scale credit offered to rural clients; delivery centered on weekly rotating open-air markets in Puno/Juliaca area.

3) Education Loan *(Crédito Educativo)* – parallel credit for use in covering educational expenses (a non-productive loan).

4) Health Loan *(Crédito Salud)* – parallel credit for use in a system of pre-paid preventive health services (a non-productive loan).

In addition to loans, PMP provides access to saving accounts (required with loans and offered via partnerships with institutions regulated to accept savings) and business and human development training. Through alliances with public and private healthcare providers, PMP also promotes integrated healthcare for women and children, and provides counseling and other care for women and families dealing with alcoholism and domestic violence. This healthcare component historically has served to set Pro Mujer apart from many other microfinance providers (see

PMP'S HEALTH & HUMAN DEVELOPMENT SERVICES

From the organization's website:

"Pro Mujer Peru acts as a facilitator rather than a direct service provider of healthcare services. The MFI has established linkages to healthcare providers with which it negotiates reduced rates. Clients choose from a list of public and private providers and receive care at their clinics. Pro Mujer Peru takes advantage of the linked approach to organize regular in-house health campaigns during which healthcare providers spend a day at its neighborhood centers and provide services such as vaccinations, PAP smears and dental care.

These campaigns are intended to increase the accessibility of health services and the number of clients receiving them, as well as help clients feel more at home. In addition, Pro Mujer Peru's health educators follow-up with clients in serious cases to ensure that they receive proper continuing treatment.

Most recently, Pro Mujer Peru in collaboration with a Peruvian healthcare company (and International Planned Parenthood Affiliate) developed a pre-paid package of health services for clients and their families. For about $21, clients and their families receive services including primary care, women's health, family planning, lab tests and other related services over a period of 8 months. The project is currently in its pilot phase and if successful will be rolled out across the entire institution.

Pro Mujer Peru has developed collaboration agreements with MINSA (Ministry of Health) to promote the integral health of women and their children. The institution also offers individualized attention to help women and their families cope with cases involving alcoholism and domestic violence. Students from the Universidad Andina Néstor Cáceres Velásquez provide legal assistance in cases involving domestic violence, claims of paternity rights and alimony.

In partnership with the Ministry of Education, Pro Mujer Peru administers day care centers in Puno, Tacna, Ilo and Moquegua. These centers provide educational activities for the young children of clients. When this initiative was launched in 2004 day care was available only during repayment meetings. Pro Mujer Peru worked with the Ministry of Education to expand coverage. As a result, the Ministry provides kindergarten teachers and Pro Mujer provides the infrastructure and education materials. Currently, the day care centers attend a total of 150 children ages 2 to 5."

(www.promujer.org; retrieved 02/03/09).

text box). The organization also offers a variety of popular business-management training courses to its clients.

The institution achieved financial self-sufficiency by the end of 2002. As of October 2008, PMP reported 47,165 clients, with a gross loan portfolio of $11.3 million and an average loan balance per client of $240. Total assets were reported as $12.6 million.

Client numbers at the two regional branches covered by this research, reported as of November 2008, were as follows:

- Puno: 9,723
- Tacna: 15,908

PMP'S PREMIUM LOAN

PMP describes its Premium loan as a relatively new loan product "aimed towards highly successful clients who have a long repayment history with Pro Mujer" (Pro Mujer, 2009). Its development is rooted in market research conducted in 2006[1] with 375 current PMP clients who had a minimum of six loan cycles each. That research found that 59 percent of those clients were taking up credit products with other institutions simultaneously. This represented a large lost market of experienced clients, who are traditionally less costly to serve (not an insignificant factor as one looks to generate funds internally). These clients were primarily interested in larger loans, between 2,000 and 6,000 soles ($667-$2,000), with a longer term than PMP's 16-week Regular loan. Though PMP initially envisioned an individual product, the market research found a preference for group structure even at this larger loan size.

The Premium product's development followed suit, delivering the largest credit product ever offered by PMP, with a range of $667-$2,000. It is a group loan, targeted at groups of 6-7 people, which are smaller than the Regular loan. The Premium groups sometimes develop as a subset of an existing Regular loan group, though not always. In fact, clients can come together from any number of Regular loan groups to form a Premium group. In all cases, the Premium groups maintain autonomy from Regular groups, with a separate schedule of loan meetings. The term ranges from four to 12 months, longer than the Regular loan. Interest is 4 percent per month (declining basis), which is half of a percentage point lower than the Regular loan. Like the Regular, the Premium product has a mandatory savings requirement (see Table 3 below).

The major qualifying guideline is that Premium clients must have been a client of PMP for a minimum of three years or eight

KEY STATISTICS ON PREMIUM LOAN:

Current Number of Premium Clients:

1419

Range of Loan Amount

$667-$2,000

Overall Average Loan Amount:

$889

Interest Rate

4 percent/month

Term

4-12 months

Average Amount for Puno Borrowers:

$883

Average Amount for Tacna Borrowers:

$835

Avg Amount of 1st Premium Loan (all cities):

$829

Avg Amount of 2nd Premium Loan (all cities):

$954

Avg Amt of 3rd Premium Loan (all cities):

$1054

Current Premium Portfolio:

$847,053

Premium's Percentage of Total Portfolio:

7 percent

Total Amount of Premium Loans Dispersed:

$2,021,073

Total Number of Premium Loans Dispersed:

2273

(All figures provided by PMP as of November 2008)

[1] The results of this market research were shared with the author in October 2007 via a PowerPoint presentation used internally at PMP in the product development process (presentation was titled "Experiencias y Aprendizajes Producto: Crédito Premium," no author listed). Though it is conceivable to compare the results of this study with PMP's research (and to point out discrepancies), such parallels will be drawn only on a limited basis. This is because the studies differed greatly in scale, scope, and purpose. PMP's research helped provide a starting point for investigation of the two innovations; beyond that, the role was purposely limited.

loan cycles, in good standing with the organization (i.e. no history of recent default). These clients were to be relatively successful female microentrepreneurs residing in three urban areas: Puno, Juliaca, and Tacna. A test pilot phase was completed, and the product was launched in November 2007 in all three cities.

Given its link to relatively successful clients, it is significant to note that in late 2007 PMP decided to limit the Premium Loan to 10 percent of its overall portfolio. This limit was explained as an effort to keep the organization focused on serving Peru's more impoverished women.

The features of the Premium loan compare with PMP's other products as depicted in Table 2:

TABLE 2 - PRO MUJER PRODUCT FEATURES

LOAN	LOAN TYPE	SIZE	TERM (MOS.)	INTEREST RATE (PER MO., DECLINING BALANCE)	SAVINGS REQUIRED OVER TERM (% OF LOAN)	PAYMENT FREQ.	COMMISSION
REGULAR LOAN	Group	\$33-667	2-12	4.5%	20	7, 15, 21 or 28 days	2.5%[2]
PREMIUM	**Group**	**\$667-2,000**	**4-12**	**4%**	**10**	**Monthly**	**2.5%**
FERIA	Group	\$30-100	2-4	4.5%	20	Biweekly	2.5%
SEASONAL LOAN	Group/Parallel	\$33-333	1-2	5-5.4%	Not required	Monthly	2.5%[3]
EDUCATION LOAN	Group/Parallel	\$33-83	1-2	5%	Not required	Monthly	2.5%
HEALTH LOAN	Group/Parallel	\$20-25	2-12	2%	n/a	7, 15, 21 or 28 days	2.5%

Source: Pro Mujer, 2008

The figures for the obligatory savings policy associated with the Premium loan are seen below in Table 3:

[2] Lowered to 2 percent after 14th cycle.

[3] Waived during certain holiday promotions, such as Christmas and Mother's Day.

TABLE 3 - OBLIGATORY SAVINGS LEVELS WITH PREMIUM LOAN

LOAN AMOUNT	AMOUNT OF OBLIGATORY SAVINGS OVER LOAN TERM	AMOUNT OF SAVINGS REQUIRED AT ONSET OF LOAN	AVAILABILITY OF OBLIGATORY SAVINGS[4]
$700-833	10%	0%	n/a
$867-1.000	10%	10%	10% of Loan Amount
$1,033-1,333	10%	15%	10% of Loan Amount
$1,367 – 1,667	10%	20%	10% of Loan Amount

There were common misperceptions about these savings policies recorded in interviews—many interviewees thought the rates and requirements for obligatory savings were higher with the Premium loan than with the Regular loan. In fact, the savings rates for the Premium loan are lower overall. The required savings accumulated during the loan term is 10 percent, half of what PMP requires on its Regular loan (20 percent). The level of required savings on deposit at the onset of the loan is lower for the Premium as well–10-20 percent of the loan of amount, as opposed to 20 percent across the board with the Regular loan.

Neither the up-front savings nor the required accumulation of savings can be withdrawn during the loan term. However, withdrawals can be made at the end of the loan term, depending on the status of the next loan cycle. If a client ends or suspends her borrowing with PMP, all funds can be withdrawn. (In such cases, borrowing can be resumed on a later cycle, if the client can produce the necessary up-front deposit.) If a client seeks the same amount in her next cycle, she can withdraw 10 percent of the loan amount—which is to say, the sum accumulated over the last loan term, leaving behind the 10-20 percent needed as up-front deposits for the subsequent loan. If the loan amount increases, she can withdraw whatever portion of the savings that is above and beyond the 10-20 percent needed on deposit for the next loan. It should be noted that this is a relatively liberal policy on withdrawal of obligatory savings—some institutions place far greater restrictions on it.

This availability of savings is an important feature to many clients, who like to know that some portion of their obligatory savings can be released and used if circumstances call for it. (The Regular loan, it should be noted, has a comparable policy on the use of obligatory savings.) Later discussions will elaborate on the significance of this savings flexibility.

ORIENTATION: RESEARCH SITES

The research took place in two Departments (similar to U.S. states) that have served as sites for the pilot and launch of the service innovations. The first is Puno, with roughly 1.2 million residents, and the second is Tacna, with roughly 275,000 residents (INEI 2007) (see map, Figure 4).

[4] These figures assume that the client is continuing with PMP on subsequent loan cycles, with the same (not increased) loan amounts—see discussion below.

As noted earlier, the Premium product was launched in late 2007 in three southern Peruvian cities: Puno and Juliaca (both in the Department of Puno), and Tacna (in the Department of Tacna). For this study, the cities of Puno and Tacna were selected as research sites. Juliaca was eliminated based on the close social and economic parallels between Puno and Juliaca (the two cities, separated by around 30 miles, are seen by some as one contiguous economic zone). Puno and Tacna similarly were the focus of the Financial Landscape study, and focusing there again created continuity between the two studies.

Home to PMP's headquarters, the city of Puno is the departmental capital with roughly 100,000 residents. It is located in the Andean high plain (*altiplano*) at over 12,500 feet above sea level, nearly the upper limit for all permanent human settlements worldwide. The majority of the city's population is indigenous, with familial ties to Quechua or Aymara-speaking communities in the surrounding region. Puno's economy is supported largely by commerce and tourism tied to Lake Titicaca and the nearby frontier with Bolivia. The surrounding countryside is extensively farmed. The stark though densely populated landscape supports a limited number of crops (e.g. potatoes and quinoa) and large-scale pastoralism, especially sheep, llamas, and alpaca.

The second research site was the desert coastal city of Tacna, capital of its department and home to about 175,000 people. Though physically removed from the Andes, many of the city's residents migrated there from sierra communities, giving the city a distinctly Andean cultural feel. Much of the city's livelihood revolves around cross-border traffic and commerce to and from nearby northern Chile. Tacna's arid climate supports a less extensive though significant range of irrigated agriculture in the surrounding countryside.

On the whole, Puno is a much poorer region than Tacna. Its departmental poverty incidence of 76.3 percent is the third-highest among Peru's 24 departments. By contrast, Tacna's poverty figure of 19.1 percent is the country's second-lowest. Extreme poverty figures are comparably divergent: 41.6 percent for Puno, 3.3 percent for Tacna (INEI 2006).

KEY RESEARCH QUESTIONS

As noted earlier, this report focuses on issues surrounding the *use* of the Premium loan, though at times the questions interface strongly with *outcome* issues as well. We gathered basic background information, then proceeded into the client's reasons for taking the loans and plans for its use. We then focused on actual use, from business investments to economic shocks. Questioning on the effects of the loan ranged from whether or not a profit was made, to tangential issues such as whether changes were seen in the business value chain and whether gender relations in the client household were altered.

FIGURE 4 – MAP OF RESEARCH SITES

= site for Premium-related interviews

(MAP SOURCE: PERRY-CASTAÑEDA LIBRARY MAP COLLECTION, UNIV OF TEXAS)

All told, we entered the project aiming to address the following questions:

- What is the typical socioeconomic profile (if any) of Premium clients? Where are most clients in their life cycle?
- Why do clients become interested in the Premium loan? What's the comparative advantage of the loan over competing products, and does that correlate with a certain point in enterprise development? Given that all Premium clients are experienced PMP clients, what is most and least appealing about continuing with PMP as an institution?
- Four comparative questions about use: 1) what is PMP's stated purpose for the loan?; 2) how did clients tell PMP they intended to use the loan?; 3) how did clients actually intend to use the loan at the start?; and 4) how did they end up using the loan? What reasons are cited or observed for any disjunction between the four answers?
- What is the split/distribution between enterprise and household use?
- What are the perceived incentives and risks associated with using the loan to upgrade or expand microenterprises? What incentives or constraints at the household level (e.g. shocks or fear of shocks) factor into decision-making on business investment? Is there any evidence of altered attitudes or behavior since acquiring the loan?
- Does the use of the loan help the client link to a new (or broader) network of commercial relationships in the value chain (horizontal and vertical linkages)? How has the loan compelled the development of these new relationships?
- What effects on household finances do clients report as a result of the Premium loan? If an income surplus is reported, how is it used (education, health, debt reduction, etc.)? Are loan funds employed for consumption-smoothing and/or income smoothing (cf. Morduch, 1995)?
- Did any economic shock occur during the loan period, and how did the loan figure into that?
- How are household savings habits and levels affected? Does increased indebtedness affect savings?
- Do clients report any effect on the decision-making capacity of women within the household or enterprise (specifically as a result of this larger loan, compared with previous smaller PMP loans)?
- How does the Premium loan relate to other PMP products taken up by the clients? Are multiple loans "patched" for a single purpose?
- How does the Premium loan relate to products taken up by PMP clients at competing institutions? Are multiple loans "patched" for a single purpose? What is the share of the Premium loan in terms of the client's total debt?

- Drawing on the answers to the above questions, what are the implications for product design? What are the implications or lessons related to impact?

DATA COLLECTION STRATEGY

The project utilized a single major data collection strategy: individual interviews. The interviews were carried out by a team of two researchers, operating independently over a period of two weeks.

RESEARCH TOOLS FOR INDIVIDUAL INTERVIEWS

Semi-structured individual interviews were the primary data-collection method employed in the field. The interview guide is loosely inspired by a similar tool in the AIMS *Learning from Clients* toolkit[5], though heavily adapted for this particular use. The line of questioning reflected all of the major concerns raised by the above research questions. Each interview also began with a short, demographic survey called the Socioeconomic/Business Profile survey, which recorded basic socioeconomic facts and indicators about businesses and households. Each completed interview yielded three documents: the completed Socioeconomic/Business Profile Survey, a summary of the client's loan history called the Basic Loan Information Sheet, and a Summary Transcript.

INTERVIEW SAMPLING STRATEGY

In the cities of Puno and Tacna, where the PMP has rolled out the Premium product, we carried out three basic types of interviews: current Premium clients, eligible clients who have declined the loan, and key PMP staff.

Current Premium clients were the majority of the interviews in both locations. Sampling of Premium clients was largely random. We drew from client lists provided by PMP and used statistical software to create a randomized primary list as well as several alternates for each selection. We pursued the alternates when clients declined to be interviewed or were otherwise unavailable, and added a handful of purposive selections as well.[6]

In each city, eligible clients who were aware of the Premium product but who had declined to pursue it were randomly selected as well (with eligibility and awareness confirmed before each interview). Questioning in those cases consisted of the normal full interview plus additional questions as to their reasons for declining to pursue the Premium loan. In each city,

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[5] Available free at the following link: http://www.seepnetwork.org/content/library/detail/646.

[6] A total of four interviews, two in each city, were not random but rather achieved through snowballing technique. These arose mostly as last-minute replacements for interviews that fell through, when a client referred the interviewer to an acquaintance who was also a Premium client and represented the general characteristics we were seeking (a particular type of business, residence in a particular neighborhood, etc.).

we also interviewed the PMP staff most heavily involved with the Premium clients, for overview insights on the client base.

In addition, we oversampled two types of clients that were of particular interest to the study. The first type was rural borrowers. The Premium loan was introduced as an urban product, so it was surprising to find a significant number of rural borrowers in Puno.[7] To achieve a well-rounded representation of these borrowers, we did not need to diverge from the initial random sort, but we needed to proceed directly to an alternate in one case.

The second area of oversampling was in the areas of positive deviants. We elected to define positive deviants initially as those with the highest loan amounts among the Premium clients in each city. To isolate these clients, we conducted a secondary random sort, focusing only on the highest echelon of loans (above 6,000 soles in Puno and above 4,000 soles in Tacna). In Puno, only five clients fell into that highest range, and three were residents of Lake Titicaca's Floating Islands. Out of both convenience and interest, we elected to focus on this cluster to explore positive deviance in Puno. In Tacna, 13 clients fell into the highest range, and two were randomly selected for interviews.

In total, 53 interviews were conducted (see breakdown in next section). That number was based on our estimates of the effort required to document a reasonable range of experiences as well as patterns of use.

See Annex B for additional details on sampling.

SAMPLE FRAME

The distribution for each city is seen below in Tables 4 and 5.

TABLE 4 - SAMPLE FRAME FOR INDIVIDUAL INTERVIEWS, PUNO

LOCATION	CLIENT STATUS	INTERVIEW TYPE	SOURCE	NUMBER
Puno	Premium Client	Urban	Initial Random Sort	13
Puno	Premium Client	Urban	Snowball	2
Puno	Premium Client	Rural	Initial Random Sort	2
Puno	Premium Client	Rural	Alternate, Initial Sort	1
Puno	Premium Client	Rural/Positive Deviant	Secondary Random Sort	3
Puno	Eligible Non-Client	Urban	Initial Random Sort	4
Puno	n/a	PMP Staff	n/a	4
			TOTAL	**29**

[7] Rural borrowers were far less significant in Tacna, so they were not similarly targeted for interviews.

TABLE 5 - SAMPLE FRAME FOR INDIVIDUAL INTERVIEWS, TACNA

LOCATION	CLIENT STATUS	INTERVIEW TYPE	SOURCE	NUMBER
Tacna	Premium Client	Urban	Initial Random Sort	15
Tacna	Premium Client	Urban	Snowball	2
Tacna	Premium Client	Positive Deviant	Secondary Random Sort	2
Tacna	Eligible Non-Client	Urban	Initial Random Sort	1
Tacna	n/a	PMP Staff	n/a	4
			TOTAL	**24**

FOLLOW-UP VISIT: FOCUS ON SAVINGS

After the completion of the initial phase of the study in November 2009, the results were compiled in a draft report. In that report, it became clear that, in addition to delivering an array of findings about borrowing behavior, the study offered tantalizing evidence of a potential reinterpretation of mandatory savings.

These findings will be laid out in detail in subsequent chapters. Briefly summed up, we found that under the relatively liberal withdrawal policies at PMP, the mandatory savings had evolved among Premium clients into a fairly flexible resource with real risk-management potential. It seems that for these clients, the meaning of mandatory may have shifted, from “the price of borrowing” (Rutherford, 2005, p. 22) to something useful and accessible (at least at the end of the current loan, if not the middle) when a serious need arises.

Those findings were regarded as preliminary because they were an ancillary part of the initial investigation. A short supplemental investigation was carried out in June 2009 to probe more deeply into these issues. Data collection entailed two strategies: 1) additional interviews with clients, with a new series of probes about savings; and 2) analysis of PMP’s MIS data on savings, for descriptive statistics on the entire client base.

Key interview questions included:

- How do clients feel generally about being forced to save via PMP?
- When clients withdraw the full allowable amount from their savings accounts at the end of a loan, how do they use those funds? Are these end-of-loan sums a useful resource to them? Why?
- Under what circumstances do clients consider withdrawing *all* savings, with the consequence of sitting out at least the next loan cycle? Why?
- How often do clients choose to leave “surplus” savings (i.e. savings built through mandatory contributions but not withdrawn at first availability) in their mandatory accounts?
- What do they do with the “surplus” if and when they withdraw it?

- What, if any, advantages do clients perceive in savings in this manner, vs. savings in a voluntary account with a commercial institution?
- What circumstances compel clients to make “truly voluntary” contributions to their mandatory accounts?
- What do they do with the “voluntary” contributions if and when they withdraw them?
- What, if any, advantages do clients perceive in savings in this manner, vs. savings in a voluntary account with a commercial institution?

Key questions pertaining to the MIS data included:

- On average, what percentage of their loans did Premium clients have on deposit at the start of those loans in 2008?
- On average, what percentage of their loans did Regular clients have on deposit at the start of those loans in 2008?
- How much “voluntary” savings did Premium clients have per person on deposit with PMP in June 2008? December 2008?
- How much “voluntary” savings did Regular clients have per person on deposit with PMP in June 2008? December 2008?

We held four types of interviews: current randomly-selected Premium clients, “outlier savers” among current Premium clients, previously-interviewed clients from the November 2008 investigation, and key PMP staff. The randomly-selected clients were identified using statistical software on client lists provided by PMP. “Outlier savers” were defined as borrowers who had at least 50 percent more than needed on deposit at the start of a loan in the calendar year 2008. Previously-interviewed clients were chosen based on availability and positive rapport established in the first round of interviews.

All investigation took place in and around the city of Puno; interviews totaled 23, as described in Table 6.

TABLE 6 - SAMPLE FRAME FOR SUPPLEMENTAL INVESTIGATION

LOCATION	CLIENT STATUS	INTERVIEW TYPE	SOURCE	NUMBER
Puno	Premium Client	New	Random Sort	7
Puno	Premium Client	Outlier Saver	MIS/Branch Managers	8
Puno	Premium Client	Previous Interviewee	Initial Investigation	5
Puno	n/a	PMP Staff	n/a	3
			TOTAL	**23**

A NOTE ON SAMPLE SIZE & USE

Tables 4 and 5 present the total number of interviews as 53. However, readers should note that these figures include the interviews with PMP staff. When it comes to the analysis that comprises most of this report, the PMP interviews are not included because they are not clients. (The staff interviews were used to comment on client behavior.)

For the most part, readers will note two numbers used to describe sample size in the below analyses: 40 and 45. The former represents the total number of current Premium client interviews. The latter number represents all PMP clients interviewed, including five eligible non-Premium clients. Depending on the purpose, sometimes only Premium clients were included in the analyses, and sometimes all clients were included.

Readers should also take special note that the data from the supplemental visit is incorporated into the report where explicitly indicated—particularly the sections on savings, effects of the global financial crisis, and overindebtedness. The data is not merged with the initial sample when discussing general borrowing behavior (e.g. Tables 10-11 in the next chapter). The supplemental investigation aimed to shed light on specific follow-up issues; it was not intended as a general expansion of the study. The initial investigation still provides the foundation on which most arguments in this paper rest.

METHODOLOGICAL COMMENTS/CHALLENGES

With some exceptions, the focus of this study was respondent-reported data—i.e. what current and potential clients know and have experienced in financial service provision, and their opinions thereof. This reported data is a qualitative representation of the client perspective. Other components of the FSA project, in particular the Welfare Outreach study conducted by the IRIS Center, will complement this data with quantitative inquiries and other methods.

The subjective nature of the findings represents an intentional choice in this phase of the FSA project. The behaviors and motivations of clients are critical to understanding outcomes and impact processes, improving the relevance of products, and the success of programs. At the same time, this orientation conditions research results in a way that the reader must keep in mind at all times. The results are categorically different from, for example, the findings of a survey-based randomized control trial, which may maximize objectivity but lack richness of detail and a well-rounded insider's perspective.[8]

At the same time, the method depends heavily on accurate recollection and the veracity of individual stories. We attempted to promote accurate recollection by limiting most questioning to the past year only. The question of veracity inevitably arises vis-à-vis individual interviews. When people are speaking solely about themselves, as opposed to speaking about tendencies within the community, there may be more temptation to bend the truth and avoid embarrassing disclosures (e.g. loan defaults),

[8] For a recent critique and related comments, see http://www.economist.com/finance/displaystory.cfm?story_id=11535592.

especially in front of an interviewer regarded as higher-status. This risk is inherent. We attempted to compensate for it by stressing the confidentiality and independence (i.e. lack of affiliation with PMP) of the interviews, and by putting clients at ease with a relaxed tenor to the interview. Beyond that, our approach was to assume the truth, unless we saw evidence to the contrary, which never occurred in our interviews.

The data derives from a relatively small sample of PMP clients. This raises the question of representation—i.e. do these interviews just provide select case studies, or can the data be employed to draw more general conclusions about Premium clients? This is an area of sharp debate in the social sciences. The perspective taken here is the latter—that the data can indeed provide the basis for generalization, as long as the extent and nature of the sample is clearly delineated. The process for drawing those general conclusions is consistent with established standards of qualitative research. That is to say, we estimated the number of interview we would need to achieve reasonable patterns and redundancies of findings. We then conducted interviews as planned, making sure that the patterns and redundancies did in fact emerge (otherwise more interviews would have been added). See Annex B for additional details on challenges related to compilation of the sample.

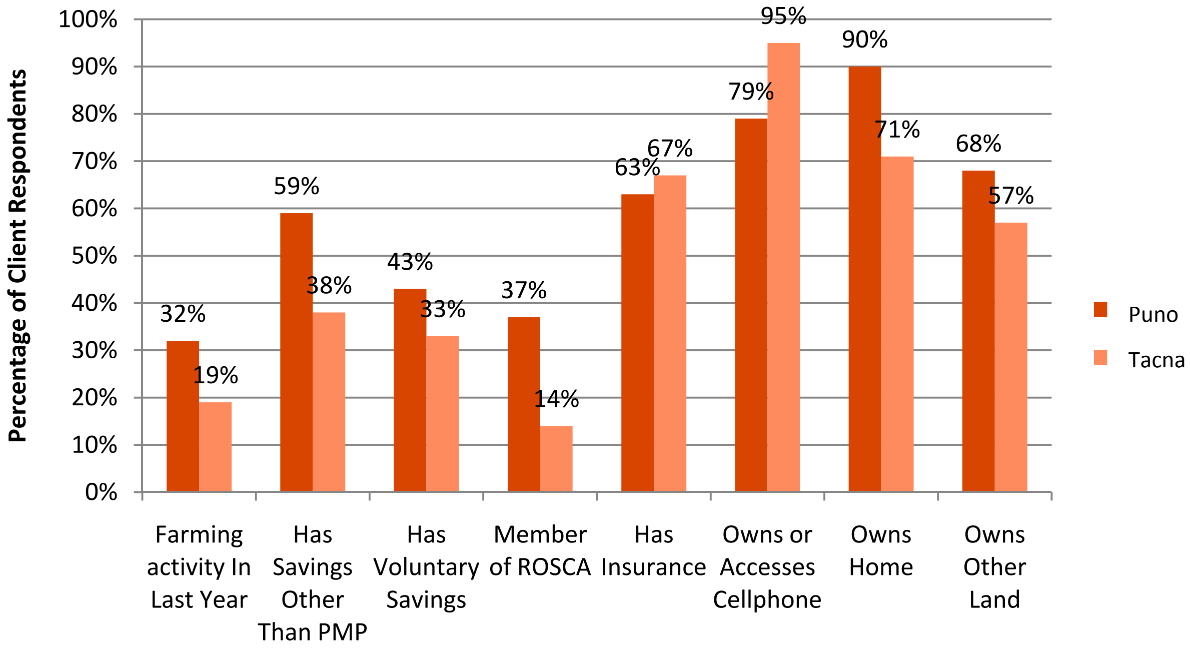
SOCIOECONOMIC STATUS OF PARTICIPANTS

The Socioeconomic/Business Profile survey administered at the start of each interview gathered basic demographic data on the participants. The results of those surveys are summarized in Table 7 and Figure 5, with narrative commentary following.

TABLE 7 - BASIC DEMOGRAPHIC DATA – INITIAL SAMPLE

	NUMBER OF CLIENT INTERVIEWS	AVERAGE AGE (HIGH, LOW)	EDUCATIONAL LEVEL	PERCENT MARRIED	PLACE OF BIRTH	AVERAGE NUMBER OF OCCUPANTS IN HH	AVERAGE NUMBER OF WAGE EARNERS
Puno	23	44 (62, 26)	Primary School Complete	90%	58% city 42% village	5	2
Tacna	22	43 (56, 35)	Secondary School Complete	81%	100% city 0% village	5	3

FIGURE 5 - LIVELIHOOD & ASSET DATA – INITIAL SAMPLE



Discussion

Generally-speaking, these demographic statistics provide informal confirmation of the findings of the Welfare Outreach study, the quantitative survey carried out as part of FSA to examine the depth of outreach (level of absolute poverty) of clients who receive the innovations.

As noted earlier, the Welfare Outreach study employed IRIS's poverty assessment tool to conclude that while 8.1 percent of the sampled regular PMP clients are estimated to live below the $2 a day (in PPP terms) poverty line, the results were 1.28 percent for the Premium clients. Using IRIS's proven poverty assessment methodology, those conclusions were derived from a variety of socioeconomic indicators that demonstrated the elevated status of Premium clients nearly across the board. Premium clients, for example, were substantially more likely than Regular clients to: a) have university-level education; b) own their homes; c) own multiple television sets; d) own a car; and e) own a refrigerator.

In terms of placing these findings within the national context of Peru, the afore-mentioned INEI survey (2006) used a higher poverty line to generate its figures for poverty and extreme poverty in the nation. However, that 2006 survey also estimated the poverty rate for those living under $2/day, producing the figure of 21 percent. We can compare that figure to the results of the Welfare Outreach study to conclude that Premium clients as

FIGURE 6 - AN INTERVIEWEE & PREMIUM CLIENT IN TACNA

well as Regular PMP clients are considerably less poor than average Peruvians. Average Peruvians are roughly 16 times more likely to live below the $2/day line than Premium clients.

Several of the indicators in our survey suggest a similar demographic, though these are presented without the benefit of a comparison group of Regular PMP clients or the general population. Most of the wealth in southern Peru is found in its cities, so being born in the city tends to correlate with higher socio-economic status, as compared with being born in a village. As Table 7 indicates, 80 percent of interviewees were born in the city, with the figure at a unanimous 100 percent for Tacna (as noted above, the wealthier of the two cities). Similar conclusions can be drawn from the relatively low practice of agricultural activity (25 percent overall), with its decidedly rural association.

The savings levels (in addition to PMP) are moderate, and only a minority of these cases (just over 1/3 in all) represent voluntary savings. Though not noted on Table 7, just over 1/5 of respondents have voluntary savings somewhere other than their home. (These savings statistics will be reiterated and discussed in more detail in Chapter IV.) The figures in all four of the last columns in Table 7 (insurance, cellphones, home ownership, and land ownership) are high for their context. It should be noted that the vast majority of respondents with insurance coverage had purchased the voluntary life insurance policy recently rolled out by PMP (see text box on page 62).

In sum, our findings suggest that these are relatively successful and prosperous individuals for the context in which they live.

The Welfare Outreach study proved that point, and results of our Socioeconomic/Business Profile survey generally supported those findings.

Supplemental Sample Socioeconomic Data

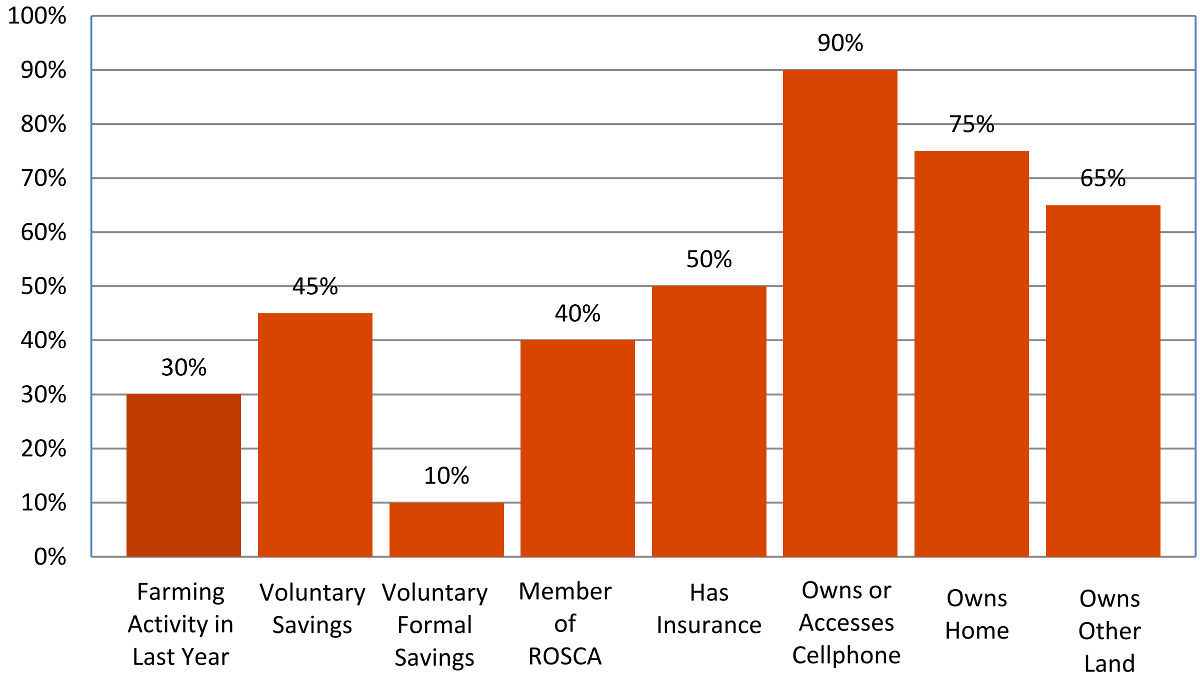
We administered the same survey to the supplemental sample in June 2009. The results were comparable to the Puno sample in the initial investigation in most respects, as seen in Table 8 and Figure 7 below.

One divergence worth noting is that the percentage of clients with a voluntary savings account at a formal institution was even lower than the initial sample—10 percent, as opposed to roughly 20 percent in the initial group. Both low, these percentages will bear directly upon later arguments about views on voluntary vs. obligatory savings.

TABLE 8 - BASIC DEMOGRAPHIC DATA, SUPPLEMENTAL SAMPLE

	NUMBER OF CLIENT INTERVIEWS	AVERAGE AGE (HIGH, LOW)	EDUCATIONAL LEVEL	PERCENT MARRIED	PLACE OF BIRTH	AVERAGE NUMBER OF OCCUPANTS IN HH	AVERAGE NUMBER OF WAGE EARNERS
Puno	20	41 (54, 28)	Secondary School Complete	80%	70% city 30% village	5	2

FIGURE 7 - LIVELIHOOD & ASSET DATA, SUPPLEMENTAL SAMPLE



GENERAL NOTES ON OCCUPATIONS

PMP gathers basic employment information on its borrowers and records their employment status in terms of four general categories: "business," "production," "service," and "agriculture." According to PMP records, virtually all current Premium clients—over 99 percent—fall into the "business" group. Most are traders, vendors, store owners, or restaurant owners. Despite PMP's placement of them in the "business" category, a substantial number of these clients cross over into production. These would include, for example, individuals who produce at least some of the regional handicrafts that they vend to tourists.

Our sample reflected this general make-up of the client base. In short, our respondents were female microentrepreneurs of all sorts, from restaurateurs, to market-stand operators, to tourist industry entrepreneurs, to corner grocery owners (see complete list next page, Table 9.) Many operated more than one type of business simultaneously.

Beyond the shared microentrepreneurship, we can generalize little about this group and their professional lives. They tended to represent the more successful owners of these business types, but even there, outward appearances varied. Some showed clear affluence relative to their context, while others were virtually indistinguishable from their peers in terms of business size and apparent wealth.

One significant distinction we can note within the sample is between owners of business serving local customers and businesses tied more directly to the transnational economy. An example of the former would be the owner of a neighborhood grocery store in Tacna. An example of the latter would the owner of businesses selling goods and services to foreign tourists on the Floating Islands of Lake Titicaca. Around 80 percent of the sample would fit the former category, and 20 percent the latter.

TABLE 9 - TYPES OF BUSINESSES OPERATED BY CLIENT RESPONDENTS

PUNO	TACNA
Single Business:	Single Business:
Sells vegetables (2)	Sells shoes (2)
Restaurant (2)	Sells beauty products
Craftwork (3)	Catering
Sells underwear and jackets	General Store
Embroidery workshop	Restaurant/bar
Gift store	Sells avocados
Second hand clothing store	Sells fruit
Hardware/tool store	
Clothing sale/rental	Multiple Businesses:
	Secondhand fabric sales; shoe store
Multiple Businesses:	Sells craft jewelry and lingerie
Weaving and embroidery work (sweaters, pants, petticoats)	Sells prepared food; cultivates olives
General store; sells quilts and pottery	General store; sells olives
Sells clothes; sells fabric; raises pigs	General store; raises chickens & pigs
Bike shop; teacher	General store; sells prepared food
Sells meat; owns/operates moto-taxis; sells cellphone minutes	General store; trades in sugar
General store; operates bus	General store; candy kiosk
Craftwork; money-lending; boat rental service	Sell empanadas, beer, and soda
Craftwork; boat rental service	Restaurant; bookstore
Sells fish; operates prepared food stand	Raises and sells chickens
General store; sells food from cart	Internet service; sells children's clothes and cosmetics
Sells sweaters; craftwork; sells toys	Restaurant/bar; sells fruit
General store; sells fruit	

The distinction is significant because the latter category of business is much more susceptible to the effects of a global economic downturn, a speculative topic to be picked up later in this report. However, even the local-oriented business would be affected to some extent, since many of the goods they sell to their customers are imported or composed of imported materials.

PROFILE #1: THE GENERAL STORE OWNER

Though it is difficult to speak of truly "typical" cases in a sample as small and as varied as this one, the following case presents variables and experiences that tend to fall along the group averages:

Maltide is a woman in her late 40s, a lifelong Puno resident. She stands about 5'4" with a stout frame, typical for women in the highlands of Peru. She wears Western-style dress—a simple blouse and slacks made of imported synthetic materials—along with a full face of makeup. Her appearance is that of a city-dweller, as opposed to a campesina, a rural peasant who dons traditional skirts, locally woven garments, and perhaps the area's distinct bowler hat. Puneños would likely label Matilde a mestiza, even though her ancestry may be wholly indigenous (ethnicity in Peru is a complicated affair, sometimes having little to do with ancestry). Her middle age is revealed in her long dark hair that is giving way to streaks of grey.

Matilde did not complete her primary education. She is married, with three children. Two of those children live with her; one works part-time and contributes to household expenses, while the other attends secondary school. She has been married for about 20 years.

She meets the interviewer in the dimly-light back room of her general store, cluttered with empty crates and broken furniture. The store itself is a typical neighborhood operation, except slightly larger than most. It serves mostly local residents, with goods ranging from rice and pasta, to stationary, to simple medicines, to liquor. She purchased and began operating the store six years ago, thanks in large part to loans she received from PMP. Prior to owning the store, she sold cooked food in a mobile cart, which she still owns and occasionally rolls out to sell empanadas and other snacks during festivals. The interviewer never sees her home, but is told it is in the heart of the city and she owns it.

Matilde is currently on her second Premium loan cycle. Her first Premium was disbursed in February 2008. She describes the decision to take up the loan as a simple, collective one: a group of six close associates from her Regular loan group felt they could use the loan and asked her to join. She concurred. She took out $900 and invested 100 percent into stock for her store, particularly beer and soda.

The results were positive; she estimates the additional sales generated by the stock have boosted her profits 10 percent as compared with last year. Moreover, the funds have helped open the door to a relationship with a new beverage wholesaler, which deals in bulk and offers better prices.

In September 2008, she and her group proceeded into their second Premium cycle. Her loan was at the same level, and her plans for the funds are the same. All seems to be going well. The profits derived from the two loans recently helped her to *erase a lingering debt that resulted from a loan she took out on behalf of a friend at MiBanco (the friend defaulted and skipped town).*

In addition, over the past year, Matilde has taken out two Regular loans and two Seasonal loans from PMP. The Regular loans were $500 each, and the Seasonal loans were about $300 each. One of the two Regular loans was turned over to her husband, who used it to pay off a debt to a friend. The other Regular loan purchased general stock for her store. The bulk of both Seasonal loans was also applied toward stock, with a smaller portion diverted to unspecified "personal expenses." All of these loans, with the exception of the one she gave to her husband, generated some profits, most of which were reinvested in the store.

She also borrowed $300 in mid-2008 from another local MFI, Manuela Ramos, with which she had completed several loan cycles in the past. Half of that money went to stock, and the other half she passed along to her husband, who used it to pay medical bills for his sick mother in Lima. Matilde and her husband discuss all loans she is considering taking out, but she claims that the final decisions on all loans are hers.

Aside from the health crisis of her mother-in-law, the only major economic shock over the past year occurred when her husband was in a serious car accident and could not carry out his work as a bus driver for about three months. To offset the financial deficit, she applied funds from three sources: 1) normal earnings from the store; 2) another loan of $1,200 from Caja Municipal Arequipa, half of which went toward her husband's medical bills; and 3) several small loans from family members totaling a few hundred dollars.

She describes the period of her husband's recovery as "difficult" and "tight" for the family, but no notable sacrifices (e.g. sales of assets) needed to be made. The family has since restored its normal financial footing. Her husband received effective medical care and is now healthy and back to work. The family loans have been paid off. The Caja Municipal Arequipa loan is only partially paid off, but the part applied to the store is generating significant profits. She was able to apply a sizeable piece of those profits to her son's educational expenses. She describes no long-term effects on the household or the business as a result of the accident and injury.

Currently, business is good. She is profiting well from her enhanced beer and soda sales. Her husband's involvement in her business has declined since last year, which pleases her (he has his own problems to worry about, she explains).

Though her credits have diversified, she remains a big enthusiast of PMP. She credits the institution with getting her business off the ground, and continues to value the confidence they show in businesswomen like herself.

Asked to rate her overall happiness and well-being on a scale of one to 10, she slips momentarily into the melancholy so distinctive among Puneños, mutters about her high blood pressure, and offers a six.

PROFILE #2: THE RESTAURATEUR & FRUIT GROWER

Like the first case, the following case presents variables that tend to fall along averages for the sample:

The interview with Rosa takes place at her home, in what would likely be considered a middle-class neighborhood in Tacna. Homes are hidden by tall front walls; little is visible from the street. Once inside the compound, carefully tended flowers and shrubs dots the outside of a spacious two-story home. The inside of the home is tidy and comfortable, sparsely decorated with local crafts and family photos. Beside the room in which the interview occurs, a teenage daughter and friend laugh uproariously at a DVD played on a large television set.

Rosa's appearance reflects the attributes of a typical Tacqueña mestiza. Her ancestry appears to be mostly but not wholly indigenous. Her dress is Western-style, and her hair and makeup are carefully tended. She looks younger than her age of 45. Her education level is just short of completing secondary school. She has two daughters, one of whom lives with her, and a husband.

The interview begins but is quickly interrupted when a phone call comes through from Rosa's eldest daughter, who is currently living and working in Spain. She apologizes profusely but explains that she must take the call. She provides the interviewer with a snack of two perfectly formed, ripe nectarines from her own small orchard to help pass the time during the wait.

When the interview resumes, the interviewer learns that Rosa is a restaurateur, having owned and operated an establishment near the center of Tacna for seven years. She was able to initiate the business using savings she had accumulated at the time. Her backyard nectarine orchard is a secondary business, from which she generates significant income through sales to local vendors and restaurants. Her husband works as an agricultural engineer in the large irrigated farms that radiate out into the desert from the city of Tacna. They own their home as well as a tract of land outside the city, where they keep herd animals.

Rosa is on her second Premium cycle. She took the first in the beginning of 2008 with a group of longtime friends from PMP. Her interest in the loan was sparked by certain features including the size, low interest rate, and obligatory savings policy. Each loan was just over $800, and 100 percent of each was invested in stock for her restaurants, especially dry goods and beer. The results have been positive. She estimates her profits are up 20 percent over the previous year. She invested a *sizeable chunk of the profits in a new freezer for the restaurant, and is considering opening a second establishment if the profit trend continues.*

Additionally, over the last year, Rosa has taken out two Regular loans, one around $550 and the other $400. Like the Premium loans, these were invested wholly in the restaurant, and specifically enabled her to add a new breakfast service. Profits have flowed consistently. She estimates the overall application of her profits from the past year as follows: 30 percent reinvested in the restaurant, 30 percent used for household consumption, and 40 percent saved each month with a bank she declines to specify. (Her husband's wages and fruit sales cover the remaining household expenses.)

Rosa has also taken out four Seasonal loans of $400 each over the past year. She explains that she uses these readily accessible loans for payroll and to pay utility bills at her restaurant. She admits that this may not be an effective use of the Seasonal loan, given the relatively high interest rate. But she continues to rely on it out of convenience.

The only non-PMP loan Rosa has taken out this year was $500 from Caja Municipal Tacna. That loan, she explains, was used partially for her daughter's educational expenses, and partly for home improvements.

It has been a fortuitous year in Rosa's household in terms of economic shocks. The only difficulty that arose was the general strike in Tacna in October 2008 that forced many businesses to shut down. Rosa managed to keep her restaurant open during this period, mostly because she had stockpiled so much food and drink using the Premium and other loans.

Rosa sees a bright future in the restaurant business. She has plans for various improvements and additional investments. Her husband has become more involved in the restaurant over the past year. The business is more complicated, and more decisions need to be made, she explains. She welcomes her husband's assistance.

Rosa appreciates PMP a great deal. She finds her group meetings enjoyable. She and her fellow members socialize and have fun, but also provide each other with valuable business advice. She used to seek most of her credit at commercial banks in town, but she has given that up. She knows they offer better interest rates, but feels those features are outweighed by the benefits of PMP.

"I'm happy," she says. "I feel accomplished as a mother, wife, and businesswoman." And the extra capital from PMP has "made me feel free." On a scale of one to 10, she rates her happiness and well-being a solid 10.

IV. MAJOR TRENDS & ISSUES

OVERVIEW OF FINDINGS: HIGH CAPITAL NEEDS, PATCHED LOANS

The nearly-universal shared motivation for seeking the Premium loan was that the clients simply wanted more capital for their businesses, and the Premium was a new vehicle for doing that. A secondary though also quite significant factor in seeking the loans was group decision-making and peer pressure. The Premium loan groups generally develop out of Regular loan groups, and in many cases clients felt compelled to follow the lead of their peers and friends interested in the Premium product (it should be noted that in these cases, the original Regular group generally stays intact and continues to borrow, on top of the new Premium borrowing—see below).

In nearly every case, these clients realized their plans for the loan, which is to say, all of the funds went directly into business investment. Most clients reported some kind of economic shock in the past year, but they were able to use other resources to compensate (see additional discussion of economic shocks later in this chapter). Almost no one employed Premium funds for household expenses. In other words, unlike many survivalist borrowers, the Premium clients did not divert these productive loan funds to non-productive purposes. Their cash-management skills were well-honed and consistent in this respect.

But the Premium loan was just one piece of a much broader credit picture. Generally-speaking, the respondents in the study could be characterized as aggressive entrepreneurs fueling their business through a variety of loans. As noted in Table 10 on the next page, on average, the Premium clients had taken out 5-6 separate loans, most for business purposes, over the past year.[9] (It should be noted that enterprise loans other than the Premium loan were occasionally diverted to household use, though not very often.) Not a single Premium client's borrowing was limited to one loan, and there was only one case of the borrowing being limited to two loans over the year.

There were varying degrees of overlap in these loans, depending on their source and nature. Contrary to our expectations entering the research, for example, the Premium loan was nearly always taken out simultaneously with the Regular loan at PMP. (Our assumption was that the new Premium product would be replacing the Regular loan in client portfolios.) Loans with competitors overlapped with PMP loans just over 80 percent of the time.

The average total credit over the year was just over $5,000 in Puno and just over $5,400 in Tacna. The Premium loans taken up by clients in the past year comprise, on average, less than one-

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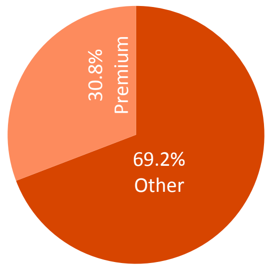
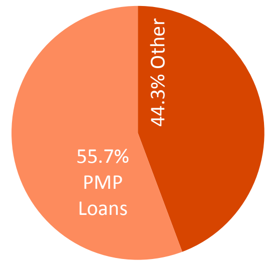
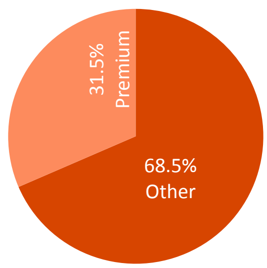
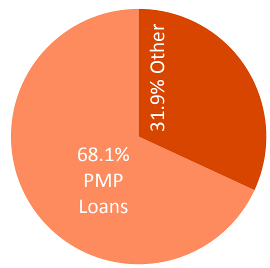
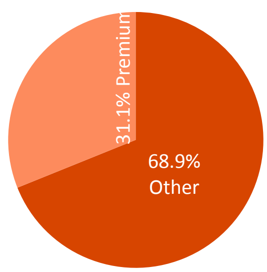
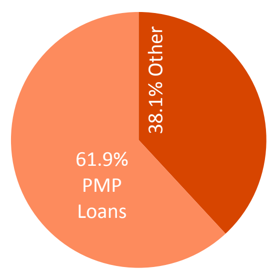
[9] The reader should note that Tables 9 and 10 do not incorporate data from the sample of eligible non-clients interviewed—only the current Premium clients.

third of their total credit obtained. The Premium loan combined with all other PMP credits (mostly Regular and Seasonal loans) comprised 56 percent of total borrowing in Puno and 68 percent in Tacna.

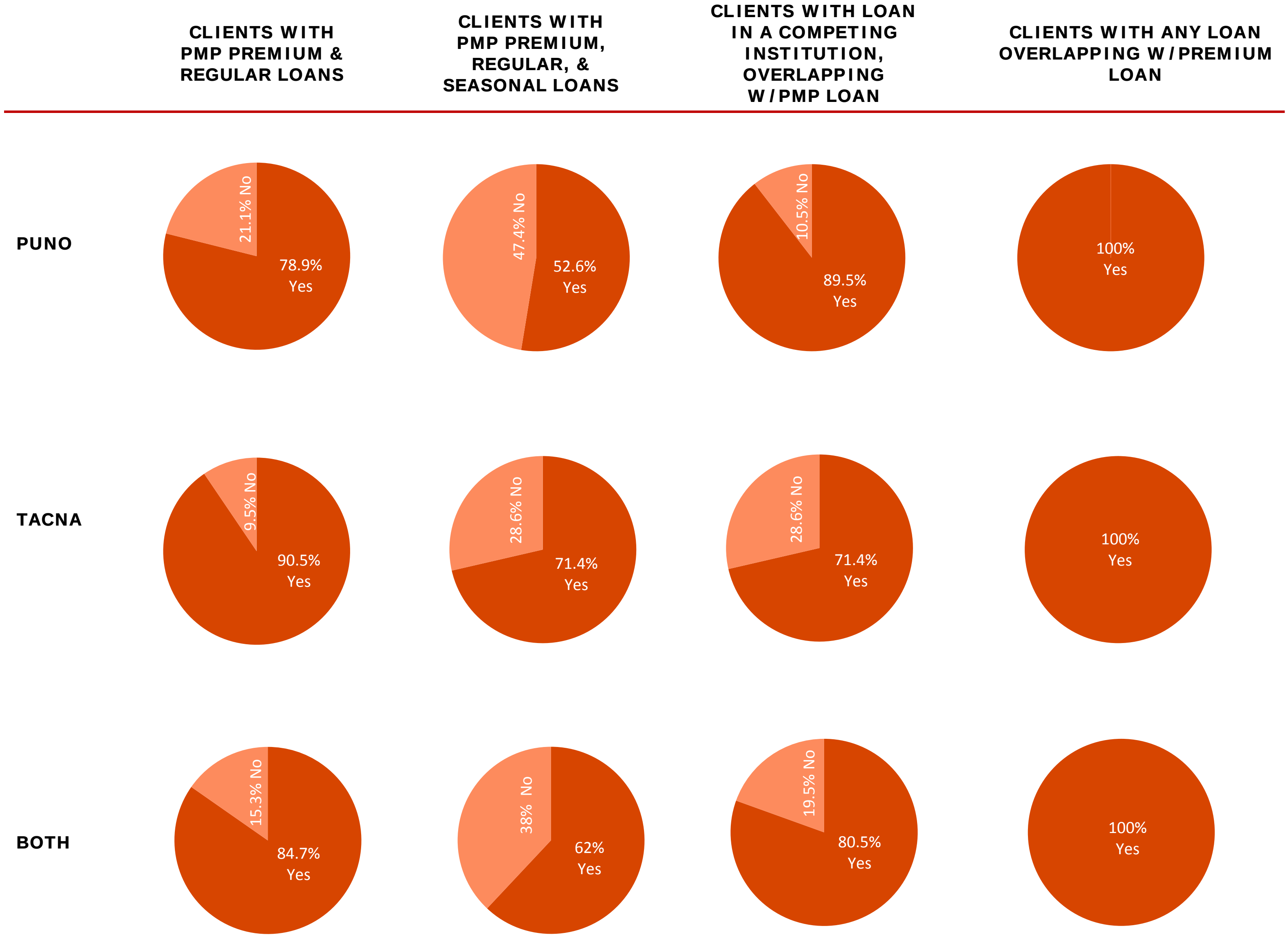
TABLE 10 - AVERAGE TOTAL CREDIT & PMP'S SHARE

	AVERAGE NO. OF LOANS (ANNUAL)	AVERAGE TOTAL CREDIT (ANNUAL)	THE PREMIUM LOAN'S PERCENTAGE OF THE TOTAL CREDIT	COMBINED PMP LOANS' PERCENTAGE OF THE TOTAL CREDIT
Puno	5.47	$5,011		
Tacna	5.52	$5,432		
Both	5.5	$5,232		

As the discussion already suggests, the overwhelming pattern of in the use of the credit was loan "patching," meaning the Premium loan was taken up simultaneously or in sequence with other credits and applied toward the same purpose of business investment. The pie charts in Table 11 provide ample illustration of this trend. Taken together, these findings suggest a client group skilled in the implementation of complex cash-management strategies.

The pattern included heavy use of other PMP products—what might be termed "maxing out" the available resources at PMP.

TABLE 11 - LOAN "PATCHING" PATTERNS



The clients saw multiple opportunities to take out loans with PMP, and they generally seized upon all of them. On top of their Premium loans, 85 percent of respondents had taken a Regular loan in the past year, and 62 percent has taken a Regular and Seasonal loan. (It is important to note that the Premium and Regular groups operate independently, meaning each comes with its own set of loan meetings and associated transaction costs.) In addition, over 80 percent had taken up a loan with a competing institution in the past year, and 100 percent of these loans overlapped with at least one Premium loan. Together the loans composed “patching” strategies that varied from combining all credits for a single purpose in a single business venture (e.g. pooling money to buy a boat), to multiple purposes spread across several ventures (e.g. investing some funds in the purchase of a moto-taxi, while investing a separate portion in the purchase of livestock, and saving yet another portion for the future purchase of a automobile taxi).

In terms of the Premium loan’s place in this larger picture, in some cases the loan provided a boost that significantly raised the scale of a client’s business or spurred the opening of a new venture. In other cases, the Premium was one slice of capital in an ongoing business plan that did not depend on any one particular loan. There was no evidence the Premium changed client attitudes regarding business upgrades. For some, the loan was a new way to realize expansion plans, but generally those plans pre-dated the loan. Moreover, many clients had made investments/upgrades as big or bigger using other credit in the past. In discussing their business investments, nearly all clients agreed that such investments came with substantial risks. However, these risks did not constrain their actions, with or without the Premium in the picture.

At the same time, the Premium had a clear net effect on the total amount of capital in circulation among these clients. As noted above, the Premium represented just over 30 percent of the total credit taken out by clients over the past year, but most evidence suggested that this was 30 percent of supplemental credit—additionality rather than substitution within their credit portfolios. In other words, they added the Premium loans to the loans they had taken out in the past. Nearly all clients sustained their pre-Premium borrowing habits at PMP, which is to say, they sought out all available Regular and Seasonal loan as often as possible (and often simultaneously with the Premium loan). Likewise, there was little indication that taking the Premium loan made them any less inclined to borrow from other institutions.

An interesting question related to this observation on additionality is *why*. If these clients have existing appetites for credit, and other large loans are available, why should the appearance of this new but not unique loan at PMP push credit loads up 30 percent? The evidence gathered in the study suggests a conglomeration of at least three factors to explain this trend: 1) PMP clients cannot always qualify for the large loans offered by other lenders (especially when collateral is required); 2) growth in the Peruvian economy was strong through the end of 2008, so the timing of the Premium rollout was fortunate; and 3) most clients are more willing to risk a large loan coming from PMP because they know and trust the institutions to a high degree. The latter point is perhaps the most important of the three; the report will expand on this theme later in this chapter in the section entitled, "PMP Status in Competitive Environments."

IN FOCUS: SAVINGS BEHAVIOR & THE PREMIUM LOAN

Attitudes toward mandatory savings

As noted in the Introduction, these clients displayed a particular enthusiasm for the obligatory savings associated with the Premium loan. It was among the most frequently-cited popular features of the Premium loan.

When describing their feelings toward the obligatory savings, client generally spoke of being pleased that "there would be something there at the end" of the loan. In other words, clients were content with the knowledge that policies were in place to ensure that the savings sums would build over time. Moreover, these sums would be available for withdrawal at the end of loan cycles if circumstances required it (see Table 3). Deposited in an "internal account" managed by their *asociación comunal* at a commercial bank, these funds also earn interest, which is divided up among the loan group members, minus some administrative fees, for a small payoff at the end of each loan cycle. Quoted as 0.12 percent monthly in a recent interview with PMP management, the rate is less than conventional savings accounts at commercial banks.

According to PMP, most clients routinely withdraw the allowable portion of accumulated savings at the end of a given loan cycle ("allowable" in the sense of not disrupting the next loan cycle—see Table 3). This tendency was borne out in many of our interviews, by clients who said they prefer to withdraw this money and use it for routine business or household needs, rather than "letting the money sleep" (see withdrawal options #1 and #2 in text box at right). In the interviews, there were also three cases when clients cited withdrawals of the allowable portion of PMP savings to help offset serious economic shocks.

In these scenarios, entailing relatively quick cycles of savings accumulation and withdrawal, the mandatory savings mechanism can be seen as a cash storage scheme. It is a safe and convenient place to keep money, away from family, friends, and others who might make claims on it. The money is stored for a set period of time (i.e. the loan cycle) and then becomes available in full, plus a bit of interest, depending on the client's plans for the subsequent loan cycle. These clients are constantly borrowing and so they are constantly building these sums, which pay off in a predictable, periodic inflow of cash, almost like another loan, except that it is already paid off—almost a form of "saving up" within a "saving down" or loan scheme (cf. Rutherford, 2000).

WAYS TO SAVINGS (& WITHDRAWALS) WITH THE PREMIUM LOAN

Imagine a Premium client who takes out her first three Premium loans in the following amounts: $830, $950, and $1,030 (figures not far from the program's average amounts for the first three loans). Following the policies laid out in Table 3, for the first loan, she would not have to have anything on deposit. She accumulates 10 percent or $83 over the course of that loan, which she cannot withdraw unless she drops out of the program at the end. She does not drop out, instead taking out $950 in the next cycle. First of all, she will need to come up with $12 to make the 10 percent of $95 needed on deposit for that second loan. Then, over the course of the loan, she builds another 10 percent or $95. She continues on to the next cycle with a loan of $1,030 loan. She starts with $190 in savings and builds another $103 over the loan term, for a total of $293.

In other words:

	Up Front	Over Term	Total Savings
1st Loan	0	$83	$83
2nd Loan	$95	$95	$190
3rd Loan	$103	$103	$293

Options for withdrawals:

1) At the end of the 2nd term, she can withdraw $87 with no disruption in this borrowing sequence.

OR

2) At the end of the 3rd term she can withdraw $190, while continuing to seek up to $1,030 in the fourth borrowing cycle.

OR

3) She can take the more drastic step of withdrawing all of the $293 at the end of the 3rd term. The immediate consequence is that she would be ruled out of at least one subsequent borrowing cycle (though free to resume after that, whenever she could restore the necessary up-front sum).

OR

4) She can let the $293 ride, continuing to borrow and accumulate savings until a serious need arises.

Less common is the option of withdrawing *all* of the accumulated savings (see withdrawal option #3 in text box). This can only be done at the end of a loan cycle and requires that the client submit a formal letter to the *asociación comunal*. There is usually a short waiting period, as these funds must be retrieved from the bank by an *asociación* manager, but the process rarely takes longer than one day. The immediate consequence of such a withdrawal is that it will disrupt at least one subsequent borrowing cycle, because the borrower will no longer have the necessary up-front deposit in place.

Unlike more precarious survivalist borrowers, however, Premium clients could plausibly withdraw all of this money in an emergency situation, and then restore the deposit and their borrowing one or two cycles later. The reason: they are diversified and well-resourced, with multiple sources of cash and credit. A survivalist borrower might not be able to replace the sum and resume borrowing for years, so the decision to withdraw all the funds would be a rather grave one. Similarly, if the lump-sum need occurred in the beginning or middle of a PMP loan cycle, when the funds were unavailable, the Premium clients most likely could tap other resources to offset the expense or buy time until the PMP funds became available. Survivalist borrowers typically lack this level of flexibility, due to scant resources.

None of the Premium clients we interviewed had taken the step of withdrawing all of their PMP savings in the period under investigation. However, many of them mentioned this option as one they would not hesitate to pursue if they found themselves in a needful situation.

A final option in this mandatory savings scheme is to defer withdrawals and let the savings build over several loans (see withdrawal option #4 in text box). This is an intriguing option from an investigative point of view, in that the sums will build quite quickly, and the surplus of accumulated funds (i.e. what is not needed for the next loan cycle) takes on many of the characteristics of voluntary savings.

There is a policy in place at PMP that encourages borrowers to wait until the end of a loan cycle to withdraw this “surplus” savings build-up. However, according to PMP management, a client can always submit a special request to her *asociación comunal* to receive the withdrawal in the midst of a cycle. Hence, with a bit of advance planning, the savings becomes fairly liquid and convenient, available at any loan-group meeting or disbursement (though not between meetings). Importantly, the transactions also take place at a safe and trusted site for the exchange of cash.

In the initial investigation, we had a mix of indicators as to the incidence of this manner of saving. As noted above, many of our interviewees spoke of their desire to keep their money working rather than “sleeping” in this kind of account. Others, however, spoke openly about their desire to build and save, and their accounts of PMP were viewed as part of that savings strategy.

Discussion: Mandatory vs. voluntary savings

For anyone interested in expanding access to microsavings, the findings of the initial investigation provide tantalizing evidence of a potential reinterpretation of mandatory savings. We have seen that, under the relatively liberal withdrawal policies at PMP, the mandatory savings has evolved among Premium clients into a fairly flexible resource with real risk-management potential. Compared to commercial savings, saving in this way may yield less interest, but it offers appealing advantages like the comfort of the loan-group setting (as opposed to an unfamiliar commercial bank).

It seems that for these clients, the meaning of mandatory has shifted, from "the price of borrowing" (Rutherford, 2005, p. 22) to something useful and accessible (at least at the end of the current loan, if not the middle) when a serious need arises. This kind of risk-management function and potential for offsetting economic shocks is precisely what leading scholars have posited as the core value of microfinance (e.g. Sebstad and Cohen, 2001). The twist here is that the risk-management potential comes from an unlikely source.

The rule one might distill out is that the more economically stable the client, the more flexible obligatory savings becomes. Another twist one might note here is that mandatory savings is usually seen as helping institutions manage risk, rather than helping clients manage risk. Here it functions both ways.

Of note here is the age of these women—44 on average, or middle-aged, with several participants well above 50. It is likely that the risk-management perspective on the savings was conditioned to some extent by their place in the life cycle. There is even some indication that these clients are adopting a "nest egg" view of the mandatory savings resource (a view that would surely be reinforced if these women could be enticed to build a larger surplus over time). Retirement was imminent for some of the women and not terribly far off for most. These women were keenly aware of the range of resources that might serve them as they aged, and the savings at PMP was one such resource.

An interesting related finding was that while obligatory savings works well in this way for these clients, conventional voluntary savings apparently do not work for or appeal to the majority of them. As noted in Table 12, only a minority had voluntary savings accounts outside of PMP—just over 1/3 in total, and just over 1/5 if we exclude informal savings accounts at home. In other words, nearly all clients who expressed an opinion said they liked savings and the idea of savings, but only a minority took the initiative unless compelled by a lender.

TABLE 12 - LOCATION AND FREQUENCY OF SAVINGS OTHER THAN PMP

	HOME	BANK	NON-BANK SAVINGS & LOAN	OBLIGATORY SAVINGS W/OTHER NGO	OVERALL – VOLUNTARY SAVINGS	OVERALL – VOLUNTARY SAVINGS W/ FORMAL INSTITUTION
Puno	21%	11%	11%	16%	43%	22%
Tacna	14%	19%	0%	5%	33%	19%
Both	18%	15%	6%	11%	38%	21%

NOTE: Percentages represent the proportion of clients interviewed with any amount of savings in that location or of that type.

PMP itself also allows clients to make truly voluntary savings contributions, on top of the mandatory payments required with their loans. At any meeting, a group member can turn over voluntary savings to the group leader, who records the deposit and passes it on the management of the *asociación comunal*, and then finally to the *asociacion*'s "internal account." Voluntary deposits made in this manner then become available instantaneously, with no waiting period, at any group meeting.

According to PMP, the incidence of such truly voluntary contributions is high, but the amounts are paltry, almost negligible—less than $2 per client, on average.[10] Thus the significance of truly voluntary savings, even at the trusted institution of PMP, may be quite low.

In the initial investigation, clients offered little in the way of clear explanation for their decisions to forgo voluntary savings in a regulated commercial institution while embracing at least some mandatory savings. However, as observers we can speculate that perhaps they felt they could save no other way, given the day-to-day pressures of family, business, etc. It is a common scenario, as aptly described by Rutherford:

> *Much tougher is keeping the cash safe from the many claims on it—claims by relatives who have fallen on hard times, by importunate neighbors, by hungry or sick children or alcoholic husbands, by your mother-in-law (who knows you have that secret hoard somewhere) and by landlords, creditors and beggars. Finally, even when you do have a little cash left over at the day's end, if you do not have somewhere safe to put it you will most probably spend it in some trivial way or other (2000, p.2).*

The mandatory savings policy built savings in a way that no other person or circumstance could challenge—there was simply no choice in order to have the loan. Moreover, it was not available for withdrawal in its entirety at all times, which could help clients deflect at least some of the claims on it. In other words,

[10] Source was an internal PMP report entitled, "CCREP 2008 PMP – Dic 08," provided to investigator in February 2009.

there was some illiquidity to these accounts, and that could be an advantage.

To some extent, these findings challenge the arguments of microfinance scholars (cf. Rutherford 2005; Hirschland 2005; Churchill, et al. 2002; Robinson 2001; Robinson 2006) on the virtues of voluntary savings over mandatory. The arguments have tended to center around the idea that mandatory savings just are not accessible or flexible enough to serve client needs for lump sums. The Premium clients turn this idea on its head. To them, PMP's mandatory savings are flexible enough, and voluntary savings is so unappealing and/or impractical that few do it. These findings also run counter to some critiques of the village-banking model, which have characterized forced savings as a hindrance to the proliferation of credit and have called for less of it (e.g. Westley, 2004). If anything, this client group wants *more* obligatory savings.

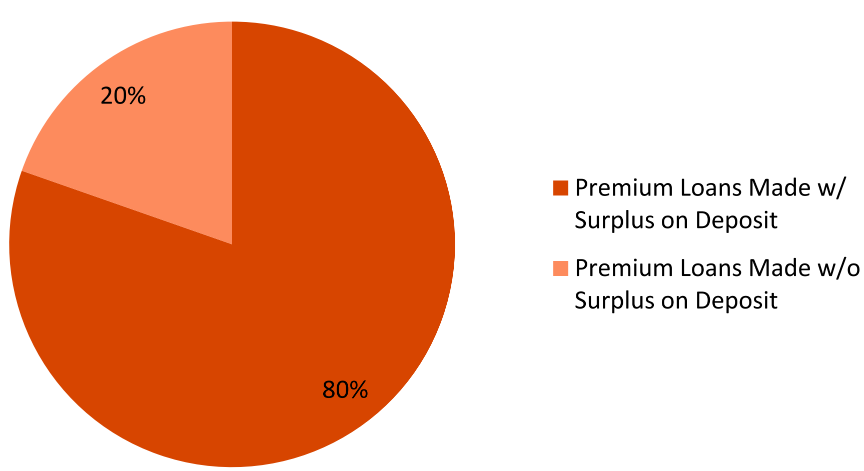
FOLLOW-UP: Supplemental Investigation into Savings Behavior

The return visit to Puno in June 2009 provided the opportunity to seek additional support for these arguments.

<u>MIS Analysis</u>

To help frame the qualitative arguments about savings behavior, the follow-up investigation included an analysis of PMP's MIS data related to savings. We requested and received MIS data for every Premium disbursement over the calendar year 2008. Excluding the first-cycle borrowers at each level (no deposit is required at the onset of the first Premium loan, and virtually no one makes one), we found that the vast majority of Premium borrowers did in fact have more than the minimum on deposit (i.e. a "surplus") at the time of their Premium disbursement, as shown in Figure 8.

FIGURE 8 - BREAKDOWN OF PREMIUM LOANS W/ MORE THAN MINIMUM SAVINGS, 2008



Phrased another way, 20 percent of borrowers withdrew the maximum amount from their savings account upon completion of a Premium loan in 2008; 80 percent voluntarily left some portion of the funds as they proceeded on to their next loan.

This is not to suggest that the "surplus" amounts left in these obligatory accounts were uniformly high. To the contrary, among those who maintained a surplus, the averages were fairly low, as shown in Table 13.

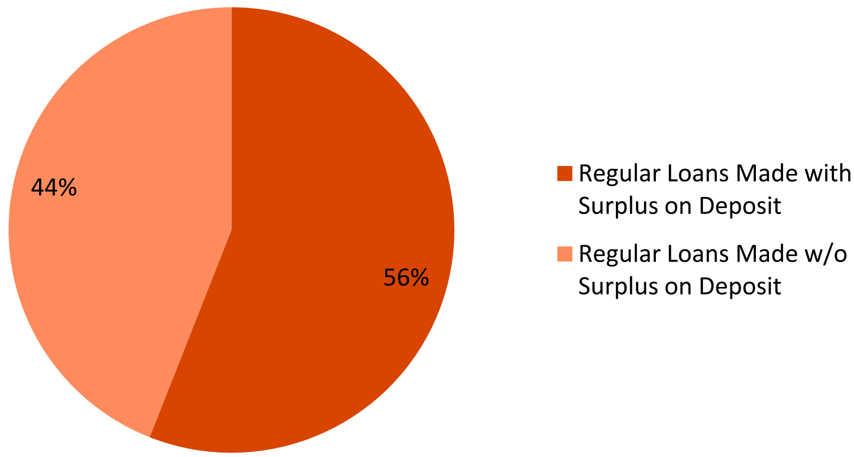
TABLE 13 - AVERAGE & HIGH EXCESS SAVINGS, PREMIUM CLIENTS

LOAN RANGE (SOLES)	AVERAGE EXCESS	AVERAGE EXCESS IN USD	HIGH EXCESS	HIGH EXCESS IN USD
$1,367+	6%	$98	16%	$273
$1,033-1,333	5%	$60	10%	$120
$867-1,000	5%	$51	16%	$164
$700-833	7%	$57	60%	$513
ALL	7%	$59		

However, $59 in the household budgets of these Puneños is by no means insignificant. That amount might function well as an emergency reserve. And we see from the "High Excess" amounts that there were subpopulations saving considerably more. For example, in the three upper loan-amount brackets, 16 percent of borrowers had at least 50 percent more on deposit than they needed at the time of disbursement.

By comparison, Regular loans issued in 2008 came less frequently with excess savings on deposit, as shown in Figure 9. This finding fit with expectations—that is, Premium borrowers are more likely to leave surplus obligatory savings in their accounts because they are better-off generally.

FIGURE 9- BREAKDOWN OF REGULAR LOANS W/ MORE THAN MINIMUM SAVINGS, 2008



It is worth adding that the analysis of Regular loan data did reveal an unexpected finding: among those who do keep a surplus in their accounts, the average percentage of that surplus relative to the loan is actually higher than the Premium loan, at 23 percent. Generally, the Regular borrowers who saved were all over the board in terms of surplus deposit level, with outliers as high as eight times (800 percent) their loans.

The analysis also looked at "voluntary" savings data among Premium clients. It will suffice to say that the findings here mirrored PMP's statements on the subject—that clients leave negligible amounts in these accounts. The 2008 average among Premium clients at the time of disbursement was less than $1, and only nine cases had a balance of more than $10.

<u>Interview Data</u>

Across the supplemental sample, inclusive of new randomly-selected Premium clients, "outlier saver" clients, and previously-interviewed clients, we recorded a variety of tendencies in the use of the obligatory accounts. These ranged from clients who routinely withdrew the maximum allowable amount after each loan, to those who routinely built surpluses and saw considerable utility in the sums, to those who built surpluses but misunderstood their range of rights in using the sums.

A clear majority of interviewees in all categories viewed the mandatory savings policy at PMP in a positive light, with some notable exceptions (see below). There were two major reasons for the positive view:

First, clients liked the idea of savings, and more specifically, they liked being forced to save. Clients repeatedly attested that saving any other way is difficult for them. They noted the many claims on their funds they face, especially from within their families.

Saving this way in an account was a novel and pleasing experience for some. "We have savings now, apart from what we keep at home—we never had that before," said one. Moreover, saving with PMP was seen as relatively painless—they barely noticed the extra cost spread among their loan payments.

Second, clients spoke of considerable distrust of commercial financial institutions. This is likely a product of the clients' relative inexperience with these institutions. They have never seen these institutions as catering to small-scale clients like them, and therefore have not used their services. Clients repeatedly asserted that banks and Cajas require high minimum balances and charge substantial fees when the balance is not maintained. This is not universally true of commercial institutions in the Puno area, but the belief was widespread.

This attitude toward commercial institutions also undoubtedly derives in part from the checkered history of banks in Peru. "Banks disappear!" attested one client. Conversely, clients had long histories and a great deal of confidence in PMP, which is a consistent finding throughout this investigation. They trusted PMP not to abscond with their savings. A few also noted they can keep very small balances in their PMP accounts, unlike banks and Cajas.

Confirming the MIS data, clients said they deposited little to nothing in their PMP voluntary accounts. Almost no one offered a clear explanation for the lack of interest in voluntary savings, though one can logically connect this trend to their statements on the mandatory accounts—i.e. they do not save much voluntarily because those accounts do not require them to save.

In terms of use patterns, among those who generally withdraw the total allowable amount after each loan, use tended to be in the area of routine household expenses. Often these clients viewed the savings as a "bonus" or "little surprise" they received at the end of each loan. Some used the funds for non-essential household need, like entertainment or the purchase of new television. There was limited use for business purpose among these clients.

Among the clients who tended to let their savings sums build into a surplus, areas of use tended to be more substantial. Some made investments in their businesses. Others used the withdrawals for larger periodic expenses like family celebrations or education expenses.

None of the clients interviewed had taken the step of withdrawing all of their savings with PMP because of a sudden need for cash (though one tried—see discussion below). Many said they view the balance as a legitimate resource in this regard and would use it in an emergency. However, in a somewhat unexpected finding, all clients viewed this option with finality in terms of their relationship with PMP. In other words, it would put an end to their borrowing from PMP, both from their point of view and the institution's. None spoke of the possibility of restoring the savings balance and resuming borrowing down the road.

Amid the largely positive view of obligatory savings with PMP, the interviews also revealed a serious drawback to strategic use of the obligatory savings as a financial resource. As part of the group-loan methodology, at PMP as at other institutions around the world, these savings balances can be appropriated by the institution to compensate for group members who are having trouble making payments.

At PMP, the decisions on when to appropriate savings in this way are generally made by the groups' promoters, though the overall policy is set by PMP's management. The clients themselves within the group do not make the decisions on when to appropriate savings. All told, this policy means that when clients build savings in these accounts, their plans for and access to the savings can be derailed by the actions of others in their group and reactions of their promoters.

Payment problems of course can develop within a group at any moment in time, but they are especially likely in a weakened economy. This point was driven home by comparing the experience of interviewees in the supplemental visit in June 2009 against the original interviews in November 2008. Peru ended 2008 with a fairly robust economy, with inflation balanced by strong economic growth (INEI, 2009). However, it appears that the first half of 2009 has brought the global recession to Peru's doorstep (see additional discussion later in this chapter), and the effects are evident in the default rates within many loan groups.

This situation especially impacted the accumulated savings of two interviewees (from the follow-up sample of 20). Both had considerable surplus in their accounts, and definite plans to use those funds. One became seriously ill in December 2008 and wanted to withdraw all of her savings from PMP to offset the bills (she planned to drop out of her group and cease borrowing from PMP). The other intended to use her accumulated savings as a capital infusion for her growing home-based fruit juice business.

In both cases, other members of the loan groups were unable to make payments in recent months. As a result, PMP took control of the group's savings deposits to cover for the imperiled borrowers. This scenario is part of PMP's group lending methodology, undoubtedly stipulated in the contracts clients sign. But neither of these clients seemed prepared for it.

Both clients were furious and embittered about their inability to access their own savings. They felt it was unfair that PMP makes use of the savings without their consent. Both clients, along with others we interviewed, thought PMP was in fact loaning these funds to borrowers in default, charging interest on them but paying nothing to the clients whose savings formed the basis for the loans. "PMP doesn't lose no matter what," sniped one. According to PMP management, the money is not loaned but simply appropriated—which, if true, would placate the sense of unfairness over PMP profiting from defaults, but may be more discouraging in the end because these funds will never be recovered (as when a client pays back a loan).[11]

The two clients noted that because they were the biggest savers within their group, they suffered disproportionately when the group's financial health soured. Both were angry at their fellow group members, whom they felt were irresponsible, and at PMP, for policies they felt penalized the wrong people. "The group guarantee is great when things work in the group, but it can come back to hurt you later," explained one.

Both clients remained pessimistic about recovering these savings; they felt the borrowers may never pay it back. (Again, if PMP's policy was in fact followed in these cases, it was guaranteed that the funds would not be recovered.) One has made the decision to discontinue her borrowing from PMP, even if she recovers the savings.

In interviews, PMP staff acknowledged that clients are becoming increasingly cognizant of the potential for savings to be appropriated in this way. As a result, some clients are becoming more reluctant to save anything but the minimum, and/or the clients are viewing the savings as purely a loan guarantee.

From these experiences, it would appear that earlier statements about the utility of the obligatory accounts should be amended. These accounts are most likely to be viable "saving up" resources when: 1) the clients are relatively well-off; AND 2) the economy is relatively strong.

Two other points of note emerged in the interviews:

First, reflective of the MIS data, almost no one indicated that they made substantial use of the "voluntary" accounts. Interestingly, on the subject of these accounts, we heard many complaints about the lack of interest paid and the cumbersome process of withdrawals. We did not hear many such complaints in reference to the obligatory accounts, suggesting clients have different expectations for the two types of accounts.

Second, there was considerable misinformation in circulation about the savings accounts. When asked, most clients said they fully understood the rules and regulations of saving with PMP, but their testimony sometimes suggested otherwise. For example, many lacked a clear understanding of the distinction between "surplus" and "voluntary" savings. Also, most clients thought the mandatory accounts paid no interest, instead of the modest rate they have paid recently (0.12 percent monthly).

Several clients suggested that PMP promoters have advised clients in ways that added to the confusion. Clients claimed that some promoters discouraged building of surplus in the savings

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[11] At the time of publication, there was no clear explanation for this discrepancy between PMP's official policy and the testimony of multiple interviewees. Further investigation is required to eliminate this confusion.

account—they wanted the exact required amount on deposit, nothing more. Other clients said promoters discouraged withdrawals for any reason other than payments. Regarding the latter, in interviews, PMP management noted that they were aware of certain cases of promoters portraying the savings in this way (i.e. solely as a loan guarantee), and were attempting to put an end to it, as this was not organization's official view.

OTHER ISSUES OF SPECIAL INVESTIGATION

The Premium loan and economic shocks

Economic shocks were common in this sample. Of the 45 clients interviewed (including the eligible non-Premium clients), only 15 said they experienced no significant shock. Of the other 30, experiences were as minor as a downturn in business and as emotionally devastating as the death of a child (see box).

The major reason for questioning respondents about shocks was to determine the role, if any, of the Premium loan in helping offset those shocks. We asked clients directly if the Premium funds were employed for this purpose. Only two respondents answered affirmatively, one saying 30 percent of the loan was applied toward a shock, and the other saying 100 percent of the loan was applied toward a shock. Three other clients indicated that they used other PMP credits (e.g. Regular, Seasonal) to help with shocks (three cases also included withdrawal of the allowable portion of obligatory savings with PMP).

As seen in Figure 11[12], the most common strategy among Premium clients for offsetting shocks overall was simply the use of ongoing earnings from businesses (21 instances). Many clients routinely reinvested such earnings in their businesses, but when the shock occurred, they ceased reinvesting for a time until the shock passed. The second most-common strategy was use of informal loans (15 instances), mostly from family, friends, and ROSCAs. Clients used non-PMP savings in 10 cases, and formal loans (including PMP) in eight cases. As noted above, PMP savings were drawn upon in three instances.

In a context when shocks are so common, the nominal role of the Premium is somewhat surprising. However, we must bear in mind that loan funds are essentially fungible, and it may be somewhat arbitrary to state that earnings are employed rather than a loan already possessed or subsequently acquired by the client. They are all funds controlled by the client at the same time, and one might view them as part of a single pool—i.e. the client may not need the earnings to keep her business running or smooth consumption *because* she also has the loan.

EXAMPLES OF ECONOMIC SHOCKS CITED BY CLIENTS

Few clients in the sample escaped economic shock in the previous 18 months. Experiences included:

Health

- Client became ill and could not work for a time
- Client required major surgery
- Husband became ill and could not work for two months
- Husband suffered head injury
- Husband required major surgery
- Mother-in-law became sick
- Son suffered head injury
- Unspecified health crisis of child
- Father underwent chemotherapy and client had to close business temporarily to care for him
- Death of mother (expenses for treatment and funeral)
- Death of stepfather (expenses for funeral)
- Death of child (expenses for treatment and funeral)

Employment/Other Fiscal

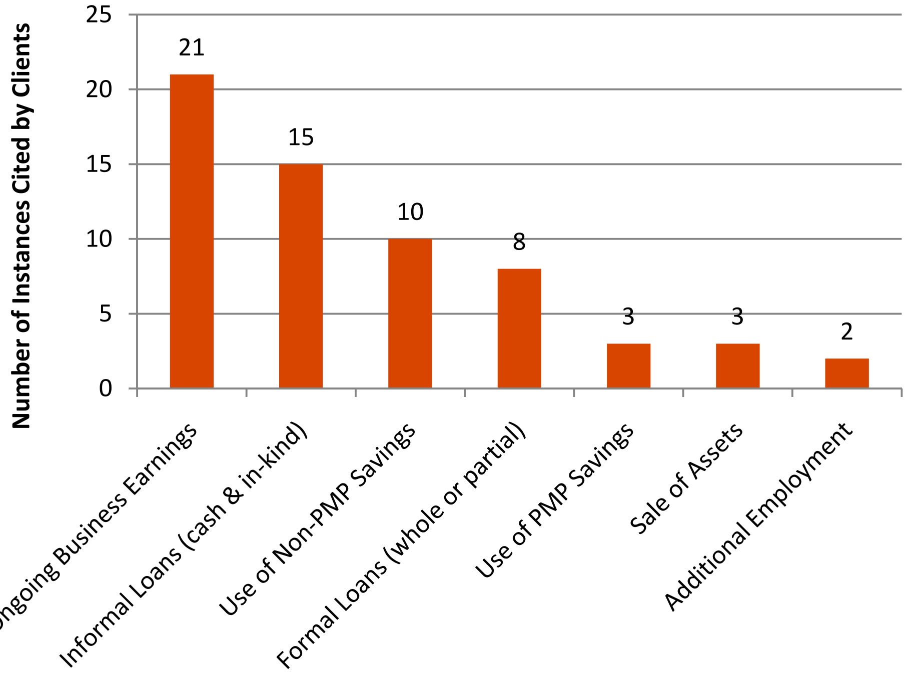
- Husband lost job
- Goods seized by customs officials at border (fees demanded)
- Sibling borrowed money and had trouble paying it back, which left client short of funds
- Husband took out a loan on behalf of someone else (possibly a mistress), using the family home as collateral, then nearly lost the home as a result.
- Co-signed a loan for a friend who then skipped town
- Substantial downturn in business lasting a month or more

Accidents/Other Misfortunes

- Accident in car
- Accident in moto-taxi
- Bus client owns caught fire, injuring passengers and damaging vehicle
- Burglary in home
- Crisis of confidence in government with economic panic, causing sales to plummet
- General strike severely disrupted business for several weeks
- Foxes ate chicks, thereby destroying new business venture

[12] Regarding Figure 11, the reader should note that most respondents employed more than one coping mechanism.

FIGURE 10 - COPING MECHANISMS FOR ECONOMIC SHOCKS AMONG PREMIUM CLIENTS



Even so, once again the picture that emerges here is of a group of clients with relative financial stability. Shocks are common among them, yet most get by just fine with little more external help than small loans from family and friends. Beyond the emotional toll of many of the experiences, there were very few long-term fiscal implications reported by clients. What this suggests overall is a group with a multitude of resources as well as well-honed cash management skills to weather all manner of adverse circumstances.

Effects of Premium loan on gender relations

The Premium loan is the largest ever offered by PMP, and at present it is offered exclusively to female clients. Historically, there has been considerable attention devoted to the links (both presumed and documented) between microcredit and female empowerment—i.e. the control of loan funds can sometimes give women more control over their own lives, economic and otherwise. An implicit theory of change in this thinking is that the larger the loan, the greater the potential for female empowerment (cf. gender correlations noted among microfinance clients in Peru by Dunn and Arbuckle, 2001). Hence this was an obvious area in which to seek evidence of impact of the Premium loan.

The research found two dominant models of cooperation between spouses. The first and most common model was one in which each half of the couple managed his/her own business (a reflection of the typical diversification of livelihood strategies seen in this client segment). They would assist each other on an occasional and as-needed basis—for example, the husband might assist the wife in loading heavy crates of fruit for sale at the market. The second less common model was one in which the couple devoted themselves equally to one or more businesses, with side-by-side cooperation. An example here would be the client who specialized in sales of cleaning products and described her husband as “my right arm” in the business, in charge of promotions and sales. In most cases of households with older children, those children became involved in the business as they reached their teen years, to varying degrees based on other commitments such as school. There was no apparent distinction between male and female children in terms of this involvement.

In terms of changes in these relations that might correlate with the introduction of the loan, research found little evidence. The vast majority of interviewees simply said gender relations in the household were identical now as compared with the period before the Premium loan. Of those that did describe some kind of change, the results were evenly split between those who described the husband now having a lesser role in the client’s business and those who described the husband having a greater role on the business (roughly four cases of each).

The cases of the husband having a lesser role were usually linked to the husband’s growing involvement with his own business, which was being infused with new capital alongside the wife’s business (sometimes taken out in the wife’s name, a common phenomenon reported by Karim, 2008 and others). As one respondent explained: “He has his own business matters to worry about now.” Of those who described a greater role for the husband, the following description was typical: “My husband is more involved now, just because the business is bigger and more complex, and there are more decisions to make. I still play the managerial role.” There was also one interesting instance of a reciprocal escalation of involvement in each other’s businesses, described as follows: “We are both more closely involved in each other’s businesses now, as compared with a year ago; the businesses are bigger and more complicated now, and we need to support each other’s efforts more.”

Collectively, the evidence suggests that this group of women was relatively empowered even before the introduction of the Premium loan. The loan has been a significant capital boost to many of them, but not enough to alter their relations with their partners.

Effects of Premium loan on value chain

Value chains were another area of potential impact covered by the investigation. Interviews included questioning as to whether respondents were running their businesses differently as compared with the period before the Premium loan, and especially whether new business relationships (e.g. wholesalers, trade organizations) had entered into that change. Again, this is an area that has historically been of interest to the microenterprise sector (cf. Dunn and Villeda, 2005; Fries and Akin, 2004; Snodgrass and Sebstad, 2005), and nature of the Premium loan invites such questioning. The implicit theory of change here is that higher levels of capital open up new opportunities and business relationships that realign the value chain, presumably to the client's advantage.

The results showed some significant change in this area among Premium clients. Twelve interviewees, or roughly 30 percent of the sample, indicated that value-chain relationships had changed substantially for them in the period since the introduction of the Premium loan. The 30 percent figure is especially notable in that value-chain relationships are dependent on multiple variables (e.g. personal business networks) and may be slow to change in some cases, regardless of any new capital.

In the convention of current value-chain research (see Dunn and Villeda, 2005), we can consider these changes in terms of the three most commonly-identified dimensions of value-chain behavior: 1) horizontal cooperation and coordination; 2) vertical cooperation and coordination; and 3) upgrading opportunities.

The most common examples of change fit squarely into the category of vertical cooperation and coordination. Specifically, these were altered buying relationships with wholesalers or suppliers, linked to the infusion of new capital and the larger sums clients could bring bear on their buying. The basic equation here was that increased capital meant buying in larger quantities, which meant better prices. Examples of this noted by respondents included:

- The seller of fish in the Puno market working with new wholesalers who only work on a larger scale.
- The owner of a neighborhood grocery store dealing with new beer and soda distributors in bulk and getting better prices.
- The restaurateur who now buys her materials in larger quantities and gets better prices; she noted that this worked to her advantage during the recent general strike in Tacna, when she had enough goods stockpiled to keep the restaurant running.
- The grocery store owner who said that her new wholesalers not only provided better prices but advice on product marketing and promotion—the latter being an example of what Dunn and Villeda termed "Information Flows" within vertical relationships (2001, pp.38-40).

FIGURE 11 – A BAR/RESTAURANT OWNER IN TACNA

There were also changes noted on the sales end of business operations, including the following:

- The clothing seller who now sells more in bulk to commercial operations in Cuzco.
- The chicken farmer whose business growth allowed her to begin selling to a specialty buyer that only dealt in chicken breasts.
- The olive-grower in Tacna who had recently joined up with other successful growers to create a collective that now deals exclusively with importers of their products in Brazil.

The first two of these would be similar alterations to vertical relationships, based on the same equation: more capital means greater quantity, which means better prices. The second case is an interesting twist in that her business reached a scale that opened the door to particular buyer interested only in one valued *component* of what she sold, presumably paying a Premium price for it. Both of these first two cases also represent what is termed "channel upgrading" (ie. selling to new market channels) in value-chain research (Jenneder Sebstad, personal communication, 2009).

The third case differs from the rest in that it resides in the realm of retooled horizontal relationships. It was based on the alliance and collective bargaining ability of a peer group that came together to alter the value chain. That case might also be seen as an instance of what Dunn and Villega termed "Functional Upgrading" (ibid., pp. 33-34) meaning the olive vendors were bringing their products closer to their consumers, by dealing exclusively with importers in Brazil (rather than, for example, Peruvian intermediaries).

An important caveat here is that respondents generally linked these changes to the total credit they had received over the past year—not the necessarily the Premium loan. As noted earlier, the Premium loan represents about one-third of the total credit on average, though probably it represents additionality (not substitution for another loan) in their total credit load. The Premium may very well be making the difference that changes these relationships, though it is difficult to say conclusively. One can safely say that the Premium is making a contribution to this change.

Seen another way, the potential for change in value chains drove the demand for credit, and the Premium loan was there (in part) to meet that need. Although demand was higher than that provided by PMP, as demand grows, PMP was part of the picture. The availability of credit, including that of PMP, did not create or cause change in the value chain, but rather helped support it.

There were a handful of cases of change in the value chain that are clearly unrelated to the Premium loan. An example was seen in the Uros Islands of Lake Titicaca, where suppliers of artisanal materials had recently begun traveling to the islands to sell materials, rather than making residents come to Puno to buy. Uros residents noted that prices were higher, but the arrangement brought a net savings when one included the transaction costs of getting to Puno. We can say this change was not linked to Premium for two reasons: 1) the arrangement pre-dated the introduction of the loan; and 2) the mobile sellers do not focus on Premium clients over other buyers on the islands. One might speculate, however, that the suppliers were inspired to begin traveling to the islands by the knowledge that the residents had substantial funds to spend—part of a trend of credit provision in the islands that began with PMP years ago and has recently culminated with the introduction of the Premium loan.

Rural vs. Urban Borrowers

A special effort was made in the investigation to examine cases of rural Premium borrowers in the Puno area. This portion of the investigation was not planned initially, as the Premium was set forth as an urban product, and we expected the breakdown of clients to follow suit. However, our random selection of clients in the Puno area yielded a significant number of borrowers from outside the city. Subsequent discussions with PMP management confirmed that these rural borrowers are a significant segment of the Premium portfolio in Puno, estimated at 15 percent of all Premium clients at that branch. (No rural borrowers appeared in our random sort in Tacna, and PMP management confirmed that the numbers there are much lower; hence we focused on the rural sub-segment only in Puno.)

What distinguishes these rural borrowers from their urban counterparts? Our investigation included interviews with six such rural borrowers, but had difficulty pinpointing common factors. Residing in areas with limited access to and low use of formal financial services (as confirmed in the Financial Landscape report), these clients are most likely outliers within outliers in their contexts—unusual in that they take formal loans at all, and unusually successful within the minority of peer borrower in their communities.

Beyond that, it is difficult to generalize. The livelihood strategies of these respondents ranged from ownership of a community store (clearly the largest store in its area) to a market trader specializing in a wide variety of metal goods. Three of the six interviewees were previously-mentioned residents of the Uros Islands, whose specialized tourist businesses, relative prosperity, and aggressive borrowing places them in a location-specific class of clients virtually unique (as noted earlier, these individuals were also interviewed as “positive deviants” because their Premium loan amounts were at the very highest end of the spectrum).

The total credit amounts for these rural borrowers varied, from over $14,000 (well above the overall average including urban borrowers) to about $1,700 (well below the overall average). The number of loans (indicating the propensity to patch) ranged from three to six, which is on par with the overall sample. Some borrowers relied entirely on PMP, while one took only 12 percent of her loans from PMP.

In short, these rural borrowers appear to be relatively aggressive entrepreneurs showing many of the same characteristics and variations as the urban borrowers. Clearly there is some entrepreneurial opportunity in Puno’s rural communities, and these individuals have seized on it. They undoubtedly stand out in their rural communities, and in the absence of locally-available formal financial services, they have felt compelled to seek out capital resources in the city. The Premium product has met some of their needs, just like their urban counterparts.

Effects of the Global Financial Crisis

This was an issue that was not originally envisioned as a matter of prime investigation. However, the global financial crisis, or rather series of crises, intensified as a the Product Use study was in the planning phases, so it was decided that the November 2008 study would remain vigilant in terms of documenting potential effects on the microfinance landscape of Peru.

Only a minority of respondents made reference to the crisis and its effects of their lives. We estimate that perhaps 20 percent referred it in some form, though the precise meaning of the statements was often elusive. Only a very few respondents used terms like “global recession;” the more common phrasing was along the lines of “things are getting worse around here,” which may or may not refer to recent turns in the global economy.[13] The specific content of these statements generally fell into three categories: 1) complaints about higher prices for raw materials; 2) complaints about declining sales in businesses; and 3) worries about impending (rather than current) effects of the crisis.

In fact, on a macroeconomic scale in 2008, Peru did not see a great deal of impact from the global crisis to that point. Inflation in Peru closed last year at 6.65 percent, which was the highest rate since 1996, far exceeding the central bank's annual target of 2 percent, plus or minus 1 percentage point (INEI 2009). (Such figures jibed with respondent complaints about rising prices.) At the same time, the effects of inflation were balanced to a considerable extent by booming economic growth of Peru's economy, which is expected to have topped 9 percent last year (ibid.). On the whole, Peru and its microentrepreneurs have endured much worse in the past.

In sum, after the initial investigation, the global financial crisis remained largely an open question in terms of impact on this segment of clients, and on Peru's microfinance as a whole.

FOLLOW-UP: Supplemental Investigation into Effects of the Global Financial Crisis

As noted earlier, the supplemental visit in June 2009 was initiated to probe savings behavior. In the course of that investigation, several other issues surfaced, indicative of the changed circumstances for the Premium client base. The most significant of these was a weakened economy that was having considerable effect on the finances of Premium clients.

There are limited macroeconomic indicators available to characterize trends in Peru's economy in 2009. Some suggest considerable stagnation compared to last year (cf. Latin America Monitor, 2009).

In any case, our sample was rife with accounts of repayment difficulties. Of the 20 clients interviewed, 55 percent (11 of 20) said there were serious financial problems within their groups; defaults had either occurred or were felt to be imminent. In another important indicator, about 20 percent of the sample had taken out a smaller Premium loan in the period since November 2008; leading up to November of last year, the trend was nearly universal in terms of rising loan amounts.

Clients generally linked these problems to declines in commerce. Reports of decreased revenues ranged from 20 to 50 percent (with about one-quarter to one-third reporting no drop or change in business). The severity of the economic crisis varied by business type. The more localized business providing staple goods and services—e.g. neighborhood grocery stores—tended to fare best and have the steadiest incomes. The businesses that linked up more closely with the global economy—e.g. tourism vendors in the Uros Islands—saw the greatest drop. Among

[13] That general characterization of the Peruvian economy is a sentiment that the author of this report has been hearing regularly from Peruvians since his first visit in 1996.

those affected, some complained about inflated prices on raw materials, but most commonly they said the problems stemmed simply from fewer customers and decreased sales.

We recorded some interesting coping strategies among those affected by the crisis. Some heavily-indebted clients were beginning to make loan payments selectively, allowing payments (and hence relationships) with some lenders to lapse while faithfully maintaining others. Interestingly, in these cases, the PMP loans tended to be prioritized, meaning clients paid that loan first in order to sustain that relationship above the others—indicative of the value placed on PMP by many of its clients.

We also saw a remarkable group coping mechanism in the Uros Islands. In years past, when tourism business was strong, each island was in charge of luring its own visitors. This system often gave the edge to residents who owned boats—i.e. they ferried the tourists in their own boats to their own communities—but there were sufficient numbers of tourists that each island eventually received some portion of the commerce. As tourist numbers dwindled in 2009, the islands instituted a formal "rotation," whereby each island takes its turn receiving visitors on an established schedule. The goal, explained one Ureño, is to ensure that "everybody can eat."

We do not currently have access to precise data to document default trends within the Premium program. However, in interviews, PMP management spoke openly of wide overindebtedness within the Premium client base. One manager cited a figure of $200,000 currently in default within the Premium program, adding that 60 Premium *asociaciones* have recently closed due to payment problems. A branch manager interviewed said that her roster of Premium groups had recently shrunk by one-third, with groups shutting down due to payment problems.

PMP management confirmed that clients are beginning to shy away from the Premium loan in greater numbers over concerns the debt will become too burdensome. The clients are also increasingly viewing their savings as part of the debt equation—i.e. they increasingly expect the savings at some point will be used to cancel their own debt or the debts of other group members.

In sum, the available evidence suggests that the Premium program may be at something of a crossroads. The optimism and aggressive spirit we witnessed among both clients and staff last year has faded considerably. The ultimate outcome is difficult to predict, as it will likely hinge on the state of the Peruvian economy as a whole. One likely outcome is that the Premium program will contract, with the client base pared down to a smaller group of more conservative and solvent entrepreneurs.

Insights from Eligible Non-Premium Clients?

The investigation included, for comparison purposes, five PMP clients who were eligible for the Premium but who had chosen not to pursue it.[14] (At the start of each such interview, we confirmed with respondents that they were aware of the Premium loan and their own eligibility for it.) The focus of these interviews was to be the reasons for not pursuing the loan, especially reasons that might shed light on perceived disadvantages of the product or its features. As noted earlier, separate lists of such clients were obtained from PMP, and a separate random sort was used to select them for interviews.

Most clients chose not to pursue the Premium loan for one of three reasons:

1) Incomplete information or misinformation about the loan requirements. Some said they had not paid attention or fully understood their loan promoter's presentation on the process and requirements. Some had initial misimpressions based on comments made by fellow group members.
2) Group decision-making and peer pressure. In an inverse of the pressure to join, two respondents said no one else in their Regular loan groups was interested, so they followed suit. As noted earlier, the evolution of a Regular loan group into a Premium loan group is the most common route to Premium loan take-up.
3) Two respondents said they did not think they could use that much additional capital for their businesses.

None of these reasons are unexpected or particularly illuminative about the Premium program. The group decision-making is a common feature in microfinance, and it stands to reason that the larger loan would not work for a majority of members in some groups. Likewise, some clients logically would be at point in the development of their businesses when a new infusion of capital was inappropriate.

There is no reason to conclude that PMP's dissemination of facts about the loan is a widespread problem. In every case, the clients said that either their misimpressions had been corrected or that they were unsure about the accuracy of their misimpressions; in other words, no one was solidly misinformed. Said one client: "They did the disbursement a week ago, and unfortunately now I realize how the loan actually works!" All five clients said they intended to investigate the loan for possible takeup in the future.

[14] Five interviews of this type were conducted, and four of those were in Puno. The reason for the drop-off in Tacna was that Puno came first, and the results from the Puno interviews were not particularly insightful about the pros and cons of the loan. Accordingly, we made the decision to devote less time to this sub-segment in Tacna.

PROBING THE "WHY" IN BORROWING: RELATIONSHIPS BETWEEN KEY VARIABLES AND BORROWING PATTERNS

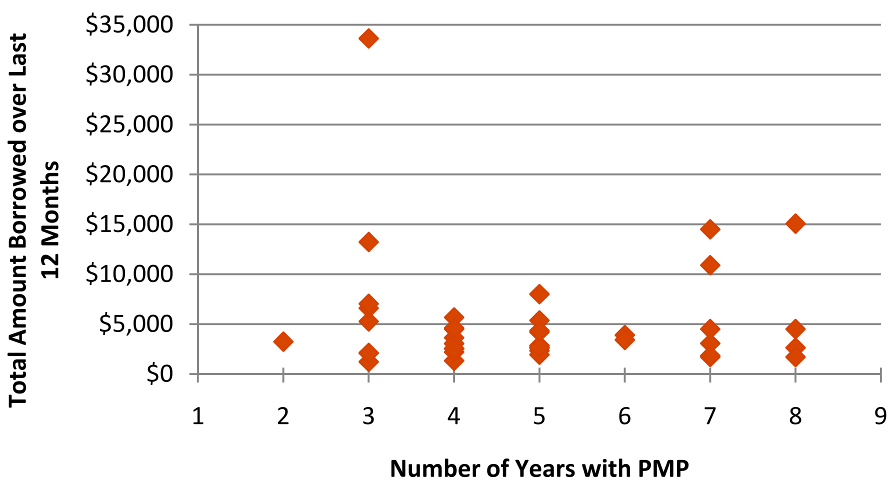
The research included an informal statistical examination of the data for correlations between key indicators of borrowing patterns—i.e. total annual credit and total annual number of loans—and other key variables presented by the respondents. In particular, we sought to examine correlations between borrowing patterns and variables of experience with PMP, age, and number of dependents.

The reason for undertaking this exploratory analysis was to understand more about the motivations and propensities of this particular client segment. The preliminary identification of promising correlates to borrowing behavior can serve as a foundation for additional studies and analyses which may, ultimately, be able to tell us a great deal about why clients borrow the way they do.

Relationship between level of experience with PMP and debt patterns

In considering the relatively high debt levels seen in these client groups, several factors were investigated for correlation with debt levels. Among these was the extent of experience with PMP—i.e. does more experience with PMP translate into heavier total borrowing or lighter total borrowing? The results are seen below in Figure 12 in scatter-graph form, and in Figure 13 in line-graph form.[15]

FIGURE 12 - EXPERIENCE WITH PMP VS. TOTAL BORROWING

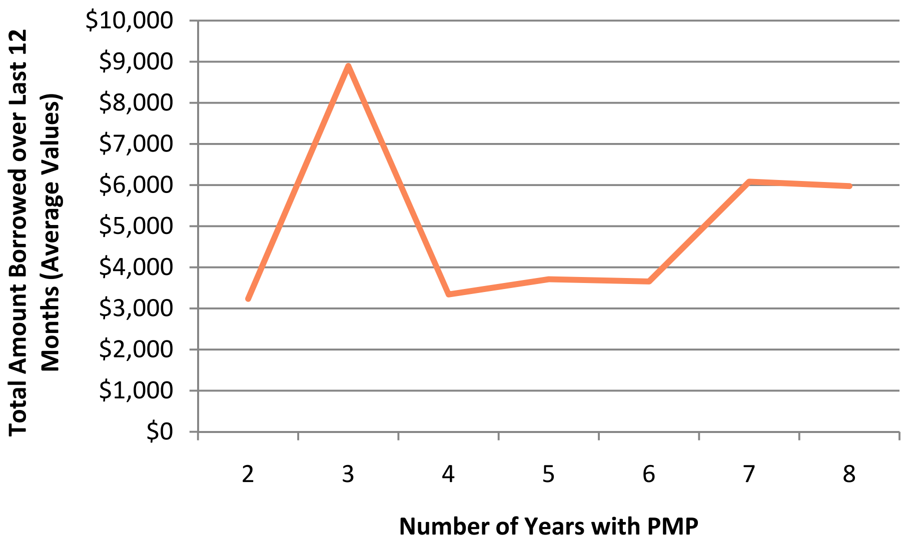


As the reader can see, the graph shows the most aggressive borrowing as occurring among those with three years of experience, though an individual outlier here should be noted and explained. One respondent, responsible for the highest

[15] All line graphs in this section of the report employ average values on the x-axis (e.g. one average value for total borrowing among all clients with three years of experience). This approach was taken as the only viable to create line graphs with this data set.

value in year three, relied heavily on substantial moneylender loans every month, borrowed and paid back in quick succession over 23-day cycles. This borrowing pattern was unique in the sample and pushed her total borrowing to more than twice the next highest total.

FIGURE 13 - EXPERIENCE WITH PMP VS. TOTAL BORROWING (AVERAGE VALUES)



Removing year three from the group, we do see some trend toward escalation in total debt toward year eight. This is likely explained by growing capital needs for the growing businesses of these relatively successful entrepreneurs, though increasing comfort with and receptiveness to the idea of credit might also be a factor. Although purely conjecture, if we wanted to use the graph for hypothesis generation, one might speculate that the spike in year three might have to do with the patterns of business development, with the first few years characterized by caution, moving to a more aggressive approach when the business is well-established. But this would not explain the drop-offs in years five and six.

Similar correlations were also explored between level of experience with PMP and the number of loans over the year—i.e. were the more experienced clients more or less likely to patch loans? The results, seen in Figures 14 and 15, were inconclusive, peaking with the most experienced clients, but mostly due to a single outlier with 16 loans.[16] The sample overall showed no observable trend in that direction as level of experience rises, although no formal statistical tests of correlation were applied.

[16] Moneylender patterns like the outlier noted on the previous page were considered a single loan rather than a series of separate loans for this graph.

FIGURE 14 - EXPERIENCE WITH PMP VS. NUMBER OF LOANS

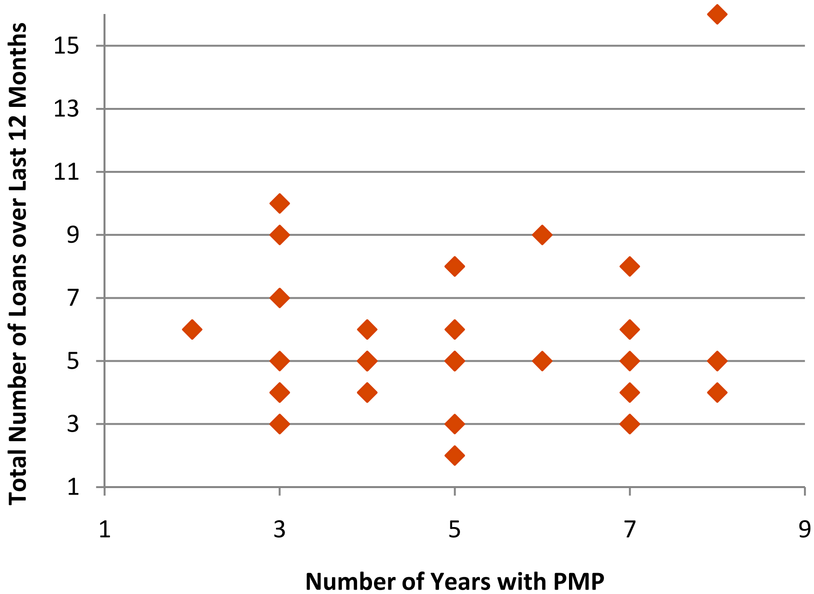
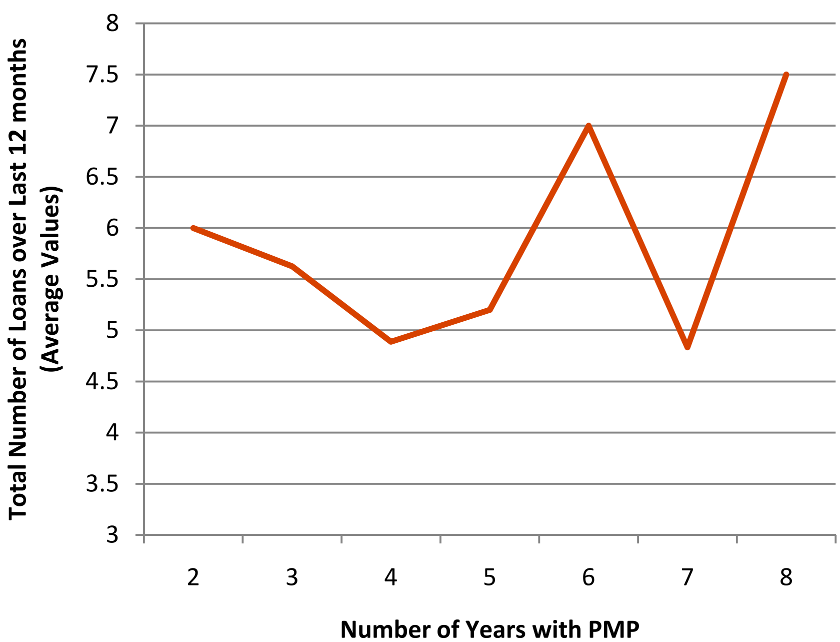


FIGURE 15 - EXPERIENCE WITH PMP VS. NUMBER OF LOANS (AVERAGE VALUES)



Relationship between age and credit patterns

Similar correlations were investigated between age of the clients and borrowing patterns. As above, we considered whether advanced age had any relationship with total debt load. The results of our exploratory investigation of correlation are seen below in Figure 16 and Figure 17.

FIGURE 16 - AGE VS. TOTAL BORROWING

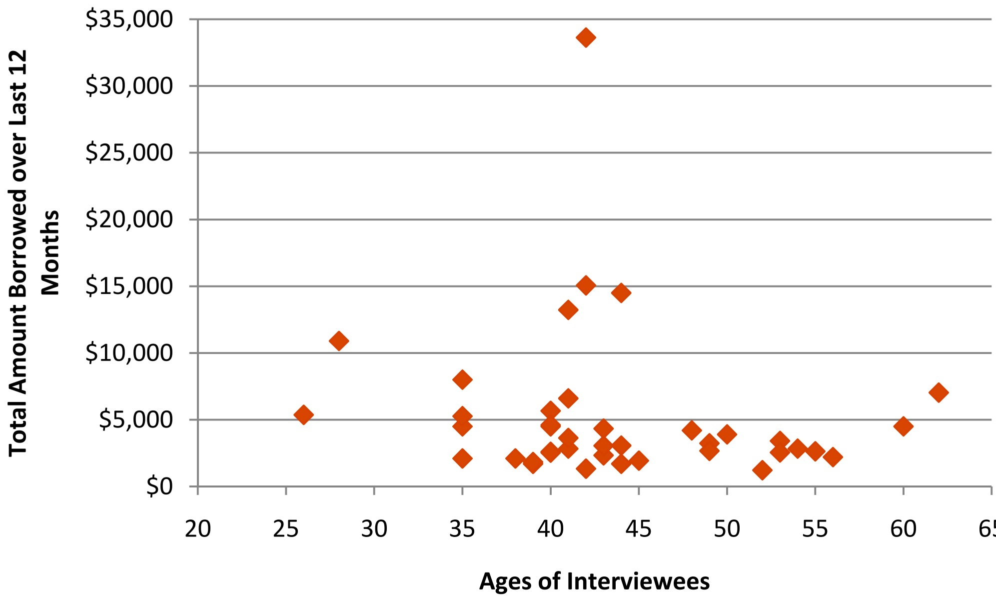
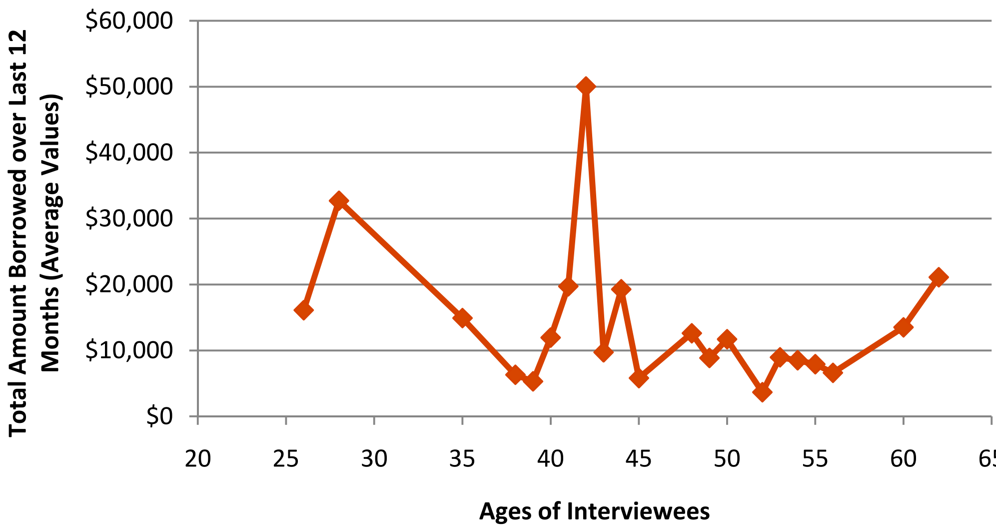


FIGURE 17 - AGE VS. TOTAL BORROWING (AVERAGE VALUES)



Here we see some suggestion of more aggressive borrowing among the younger participants, but the effects are uneven. The 38-39 year-olds, for example, borrowed less than the eldest subjects interviewed.

Clear, observable correlations were similarly elusive in comparing the number of loans (i.e. the extent of “patching”) with age. A hypothesis here might be that the number of loans would decrease with age, as borrowers become more conservative and more established with lending institutions, which are willing, in turn, to disburse larger loans. But the evidence, seen below in Figure 18 and Figure 19, suggests no such pattern, although no formal statistical tests were applied to the data.

FIGURE 18 - AGE VS. NUMBER OF LOANS

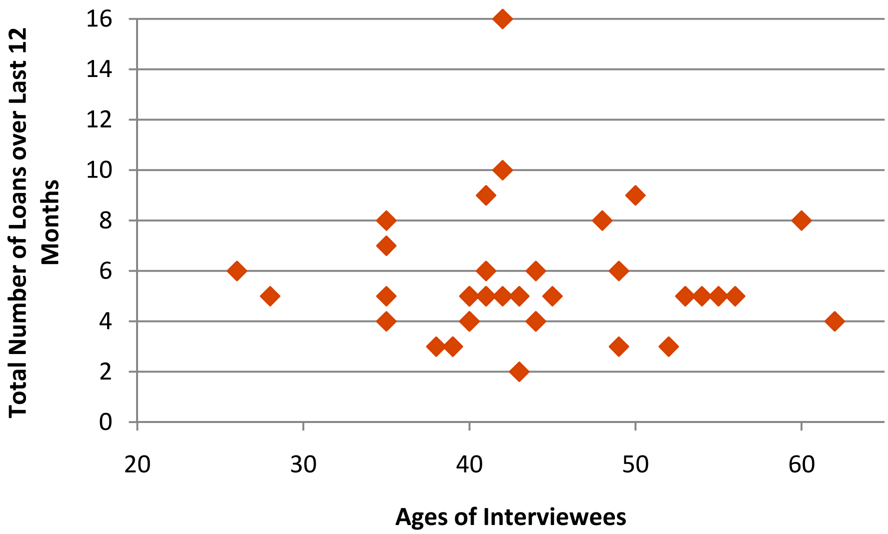
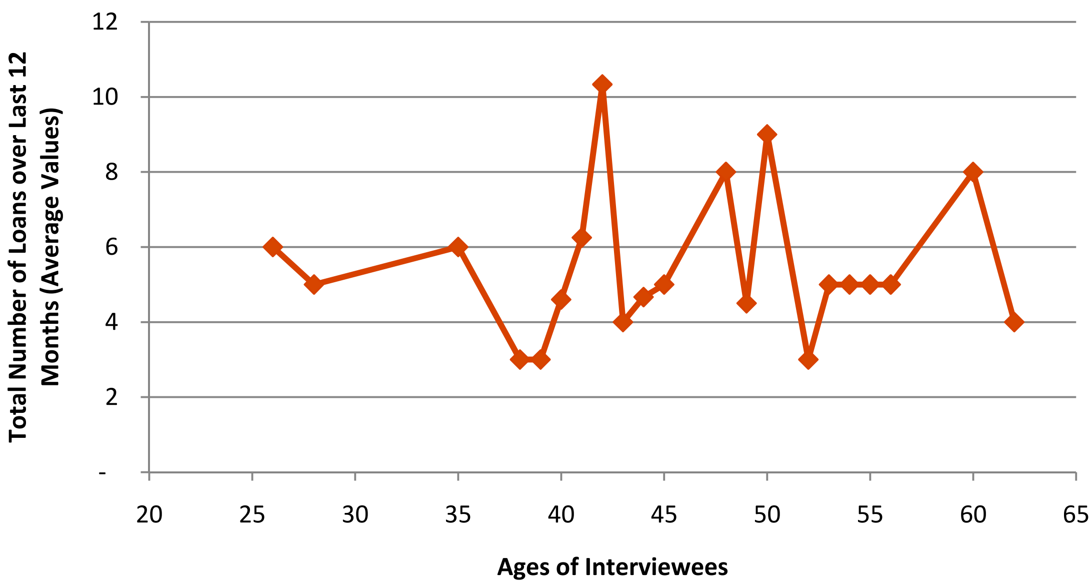


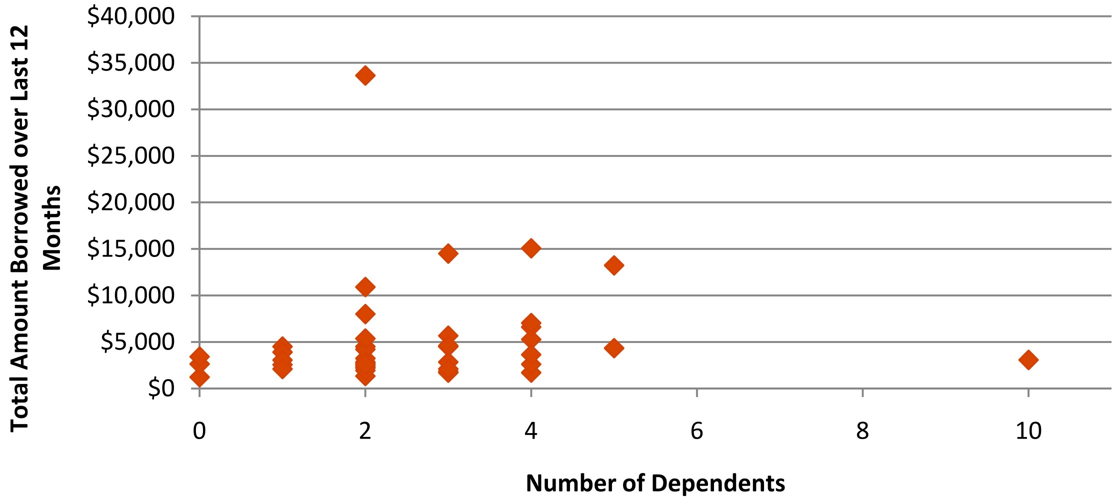
FIGURE 19 - AGE VS. NUMBER OF LOANS (AVERAGE VALUES)



Relationship between number of dependents and credit patterns

In a final exploratory comparison, borrowing patterns were weighed against number of dependents (defined as anyone not earning money over the past year) in the household. As above, the first comparison looked at total credit over the course of the year. The results are below in Figure 20.

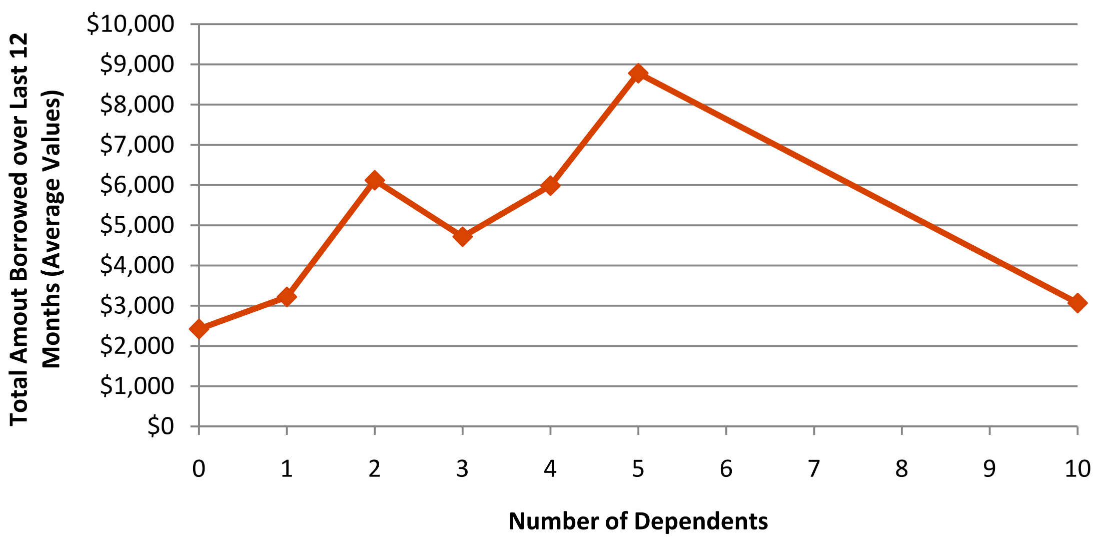
FIGURE 20 - NUMBER OF DEPENDENTS VS. TOTAL BORROWING



Here we see the clearest suggestion of correlation thus far. Disregarding the single outlier with two dependents (the same one discussed above, who employed the continuous 23-day moneylender loans), observed trends in the data imply that when more dependents are present in the household, the amount borrowed increases.

This correlation is more easily observed when the numbers of dependents are averaged into single data point. Those results are seen below in Figure 21. Excepting the single outlier with 10 dependents, whose total was somewhat lower, we see a clear upward slope as the graph progresses toward more dependents.

FIGURE 21 - NUMBER OF DEPENDENTS VS. TOTAL BORROWING (AVERAGE VALUES)



A parallel comparison was made to examine the relationship between dependants and number of loans. The results are less conclusive. This suggests that the households with more dependents may have higher capital needs, but they do not necessarily need to resort to greater numbers of loans (i.e. more "patching") to fulfill those needs. The results are seen below in Figures 22 and Figure 23.

FIGURE 22 - NUMBER OF DEPENDENTS VS. NUMBER OF LOANS

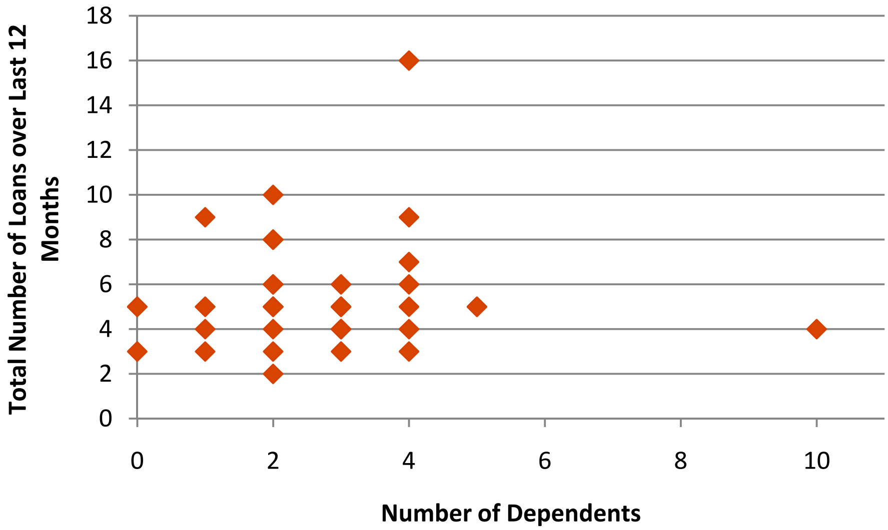
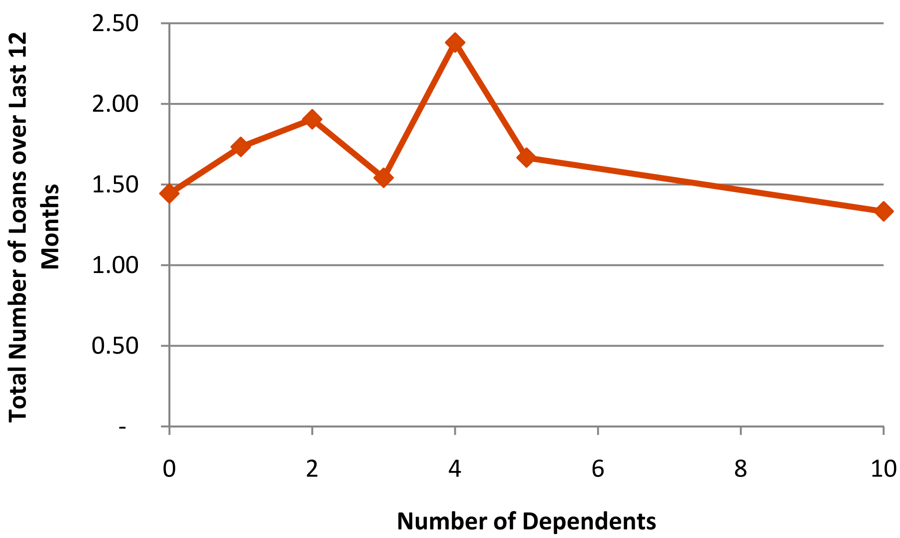


FIGURE 23 - NUMBER OF DEPENDENTS VS. NUMBER OF LOANS (AVERAGE VALUES)



Discussion

With the possible exception of the suggested correlation between number of dependents and total borrowing, very little patterning emerges in this analysis. Although these explored correlations do not represent a formal statistical analysis, and we recognize that as of yet undetermined factors may be influencing our observations, this lack of correlation in itself is an interesting finding. It may suggest that the habits of this client segment are not governed by many of variables that influence the borrowing of other kinds of MFI clients. It may be that relative prosperity, fueled by relatively aggressive business sense, is what compels or constrains this group, more than the personal and demographic factors that factor into decision-making for other microfinance clients. Again, we can point to a divergence from the findings one might anticipate with a survivalist borrowing group.

CLIENT PREFERENCES & PRODUCT DESIGN

The research extended to the area of client preferences in terms of the design of the Premium product. The features of the loan that appealed most to clients were no surprise in that they are the features that distinguish the product from the Regular loan. Clients liked the larger loan size, the longer term, the less frequent payments, and the slightly lower interest rate. Many clients also spoke positively of the obligatory savings attached to the loan. Though our sample deals largely with positive cases (i.e. those who elected to take up the loan), it seems likely that PMP's product design was solid in addressing client preferences in these areas.

In terms of comparing the Premium loan to PMP's other products, all Premium clients preferred the Premium loan over the Regular loan in terms of product design. A number of clients, however, expressed some doubt about continuing with the Premium loan in the future, simply because they were unsure that they needed the additional capital and were concerned about overindebtedness. Three participants indicated with certainty that they intended to discontinue the Premium loan in the future for this reason.

It is interesting to note a particular area of Premium design that did NOT generate complaints: the combination of a large loan and group structure. Some in the microfinance industry might wonder whether such design would resonate with borrowers, since it puts group members at substantial personal risk if any member of the group defaults on her (relatively large) loan. While many clients complained about paying for the irresponsibility of others, the Premium loan did not draw a disproportionate share of these complaints (clients complained as much or more about this risk vis-à-vis the Regular loan). One might speculate that this pattern ties into the overall default rate for the Premium, which is half the default rate of the Regular loan—i.e. clients are less inclined to complain because they do not end up paying for the failings of others as often with the Premium loan.

A few participants in Tacna indicated a preference for the Seasonal loan over the Premium, at least for certain purposes. These pertained to instances when a rapid infusion of cash was needed—for example, to take advantage of a special sale on inputs needed for a business. Here the quick availability and rapid disbursal of the Seasonal loan clearly complements the business and cash-management strategies of some traders. However, none of these clients indicated that they would discontinue the Premium loan and focus only on the Seasonal loan.

PMP'S STATUS IN COMPETITIVE ENVIRONMENTS

The Premium features such as loan term and interest rate may provide advantages over PMP's Regular product, but they do not necessarily compare favorably to the loan products of PMP's many competitors in Puno and Tacna. The Financial Landscape study duly confirmed this point. For example, as an unregulated financial institution (NGO), PMP will almost certainly never be in a position to offer a better interest rate than regulated financial institutions (e.g. banks, *Cajas Municipales*, EDPYMEs), due to variations in Peru's tax structure.

These facts invite speculation that there may be broader factors that compel clients to take up new products like the Premium and to stick with PMP as a lender over the long term. That is, what distinguishes PMP from its competitors in these two very crowded urban microfinance markets?

Building on similar questioning applied in focus groups for the Financial Landscape study, clients were asked what they liked most and disliked most about PMP as an institution. The composite results, ranking features based on how frequently they were cited, appear in Table 14.

TABLE 14 - CLIENT PREFERENCES REGARDING PMP

WHAT DO YOU CLIENT LIKE MOST ABOUT PMP?	WHAT DO YOU CLIENT LIKE LEAST ABOUT PMP?
1. Group support/solidarity/social opportunities	1. Paying for group members who default
2. Minimal requirments/paperwork for loan	2. Time-consuming meetings
3. Obgliatory savings with loans	3. Relatively low loan amounts
4. History of willingness to lend to microentrepreneurs/informal sector	4. Relatively high interest rates
5. Training programs[17]	5. Lack of security around repayment sites (Tacna)
Also mentioned prominently: Life insurance policy; friendly staff; increases in loan amounts over time.	*Also mentioned prominently:* Inadequate evaluation of credit-worthiness of group members; shifting meeting sites; staff turnover.

In much the same way as the Financial Landscape results, the combined likes and dislikes cited here suggest ways in which PMP might be trumped by its many competitors. As in many parts of the world, the group-loan model draws both high praise and ardent criticism from those involved with it. For those who like the solidarity and support of the group (and perhaps cannot

[17] This item encompasses both the business training and health education/training offered by PMP. However, the business training was cited far more often by clients.

furnish the collateral required for a large individual loan, e.g. the title to a house), as many as 10 other institutions across the two cities offer them. For those who grow tired of covering the defaults of other group members and who can meet the collateral requirements, well over a dozen institutions across the two cities offer individual loans to small-business owners.

On other individual attributes, such as loan size, term, and interest rate, PMP cannot match many of its competitors, simply by dint of its legal status as an NGO, and many clients took note of that in responding to this questioning.

The evidence does suggest a few tangible advantages over its competitors. PMP's training programs in business management and health were among the first offered in these areas, and they are still very well-regarded. It should be noted here, somewhat surprisingly, that the business management training was cited far more often than the health training, which received scant mention. This pattern might again point to a difference between Premium borrowers and the more survivalist borrowers found in PMP's general client base—i.e. the Premium borrowers are more secure and more business-oriented, so they are less interested in receiving training on basic health issues. In addition, more recently, PMP added a voluntary life insurance program (see box), which is relatively unique in these areas among NGOs. (Interestingly, the availability of the Premium loan was never mentioned as a preferred reason for continuing with PMP.)

Collectively, however, the evidence both here and in the Financial Landscape point to other more *intangible* factors in explaining clients' continued loyalty to PMP. As alluded to in item #4 of the "Likes" list above, PMP was one of the very first microfinance institutions in these areas, especially in Puno, and that history carries considerable weight. The institution has simply been around, and everyone knows that the institution has catered to microbusinesswomen in the informal sector for years when most other institutions ignored them.

A key intangible product of this history is loyalty, which is fueled by familiarity and trust. Explained one respondent: "There may be better deals for loans out there in Puno, but we don't know the other institutions as well, and we don't trust them. All of our friends are with PMP." Said another: "Pro Mujer is different in that they treat you like family."

Another key intangible product of PMP's history is inertia, which is to say, clients tend to stick with the direction they have traveled for many years. In discussing their reasons for continuing with PMP, a disproportionate number of clients said simply "habit" or "custom" was their prime motivation. Here the commentaries often overlapped with discussion of group solidarity and the histories of individual clients with their groups. Many had been borrowing with the same cluster of women for five years or more, and both the habits and friendships were deeply engrained. Even if better deals came along with competing institutions, they had no intention of abandoning their loan group or PMP (more likely they would just

PMP'S LIFE INSURANCE PROGRAM

Launch Date

March 2008.

Eligibility

PMP clients, age 18-65. Policy is optional and supplemental to all other PMP programs.

Cost

$0.33/month.

Coverage

Natural or accidental death (exclusions include suicide and deaths related to criminal or terrorist activity).

Benefits

Natural death - $800.

Accidental death - $1,600.

Number of Clients Enrolled

38,837 (as of November 2008).

(Source: PMP, November 2008.)

add the new loan to their portfolio). Or they might remain indifferent to competing offers. As one respondent notes: "I have heard that the cooperatives in Tacna have better loans, but I haven't taken the time to look into it."

Taking a broad speculative overview, one might infer that these are relatively traditional people for whom stability and lack of change hold considerable appeal. That inference seems strengthened by some of prominent dislikes cited, including staff turnover among PMP promoters and shifting meetings sites.

Another intangible aspect of PMP's appeal is the welcoming and supportive atmosphere that the institution projects. Many clients spoke of promoters who welcomed them to the PMP "family" and encouraged their efforts to build businesses.

Here the commentaries often cross over to loan requirement issues. The evidence suggest a sharp contrast between the relatively light requirements of the PMP group loans and more stringent requirements, typically including property such as a home as collateral, of the large individual loans with savings and loans and commercial banks. The latter loans may represent much better payoff in terms of loan amount, interest rate, and term, but not all Premium clients can meet the requirements. Moreover, not all of these clients feel comfortable dealing with those institutions. As one client summed it up: "There's no other institution where your word counts as much as it does at Pro Mujer."

PROFILE #3: TOURISM ON THE FLOATING ISLANDS

We apply the term positive deviants to cases of Premium clients who seem especially successful with the loan. The criteria used to identify such cases in the sample was the qualification for and the take-up of loans at the very high end of the Premium loan scale. The following is one such case:

The Uros Islands of Lake Titicaca, a few miles offshore from the city of Puno, are not islands in the conventional sense. They are man-made structures, created by piling the lake's native reeds into great heaps that eventually rise above the water and provide a surface on which to live. Stepping onto the islands for the first time can be disconcerting, in that the surface is semi-solid. One sinks substantially into the mass of reeds with each step.

The people living on the Uros Islands are historically known as Uros themselves. They are an ethnic group distinct from the region's dominant Aymara and Quechua-speaking indigenous populations. Archaeology and oral tradition dates their presence in the area back several millennia.

Today a few thousand area residents self-identify as Uros, though most now reside on the mainland. Only a few hundred remain full-time residents of the floating islands. For them, livelihood depends heavily on the tourist trade. The islands are nearly unique in the world, and as such they are one of the prime tourist destinations for visitors to Lake Titicaca. The

Uros residents take part in every phase of the tourist trade, from transportation to the manufacture and sales of crafts. In the off-season, many supplement their household consumption with traditional fishing and waterfowl hunting on the lake.

I meet Ines on the floating island where she makes her home. She is a rotund woman in her mid-30s, with bright eyes and sly grin. She wears a traditional Uros outfit, which is nearly indistinguishable from the traditional campesina outfit seen on the mainland: heavy layered skirts, blouse, embroidered petticoat, and bowler hat. Her long hair falls from her shoulders in two neat braids.

Ines supports three children, who live with her in a complex of three reed-based structures she owns on the island. (She also owns a tract of land to herd animals on the mainland.) She identifies herself as single, though she also makes reference to a partner who may or may not be a common-law husband. In any case, it is clear that Ines is beholden to no one. Beneath her grin one can discern a tough-as-nails businesswoman, fiercely independent.

FIGURE 24 - AN UROS SETTLEMENT

Currently she operates three businesses: 1) craft sales to tourists; 2) a boat that she owns and rents out to other captains to ferry tourists; and 3) moneylending to other residents. She has been carrying out some combination of those businesses for the last 13 years. With the exception of the boat, her businesses *started small, with no particular start-up funds and have grown over time. Her first use of credit came about six years ago, with PMP. PMP, she notes, was the first lending institution that started paying attention to Uros residents and offering loans.*

Ines is on her third Premium loan cycle, which means she and her loan group sought Premium funds as soon as they became available in the Puno area. Her current loan is the maximum allowable amount in Puno at the time of research—$2,000.

Her two most recent Premium loans were divided and employed equally for two purposes: 1) to purchase craft materials; and 2) to provide part of the funds needed to buy a boat. That boat purchase, replacing an older, smaller vessel she owned, took place in September 2008. The total purchase price was over $20,000, which she claims she paid in full (installment plans being unavailable). She describes the breakdown of funds for that purchase as follows: 1) $2,000 from two Premium loan; 2) $1,000 from a PMP Regular loan; 3) $7,000 from an individual loan with MiBanco; and 4) the remainder from ongoing earnings and savings.

She explains that owning a boat brings multiple advantages. First, she rents it to a captain who pays her around $250 a month for the privilege. Second, the rental arrangements come with guarantees that the captain will ferry his tourists to Ines' island, as opposed to all the other floating settlements, which virtually ensures sales of her crafts.

The boat has been in operation a few months now, and she says it has generated some net earnings. Those earnings have been applied toward expenses for her children as well as more craft materials. Overall, the venture has not been as lucrative as she was expecting. If the profits do not pick up, she will consider selling in the boat in the coming year. If that occurs, she will continue to seek loans aggressively but she will increase her attention to moneylending as a business venture. Historically, she has done considerable moneylending in her community, but it tapered off recently with the investment in the boat.

Her other borrowing over the past year included two Seasonal loans from PMP at $650 each. These were used for two purposes: 1) to purchase craft materials; and 2) to pay education fees for her children. She also took out a $300 loan from Manuela Ramos for unspecified "personal expenses," and a $500 loan from local MFI ADRA. The ADRA loan was used to purchase more craft materials and to make payments on her PMP loans for a couple of months in early 2008. The latter PMP payments occurred in the low tourism season on the Uros; she was not concerned about using one loan to pay another because she knew business would pick up later in the year and help compensate (which it did).

It has been a year of ups and downs for Ines. On the negative end, she watched her mother pass away after a long illness in early 2008. There were major expenses leading up to that point *in the form of medical treatment, and major expenses associated with the funeral. Her ongoing earnings eventually covered most of these. She says that at one point, she approached PMP for a loan specifically for her mother's expenses and was rejected. Friends and family provided some material support, but most of it went to her father instead of her. There was also a deep emotional toll in the loss of her mother that weakened her motivation to work for several months. Luckily, this occurred in the low tourism season, when commerce is limited.*

Aside from the introduction of the new boat, she is now running her businesses in much the same way as a year ago. She is worried about tourism dropping (she often hears talk of effects from the global economic turndown), but to date it remains fairly steady. She also worries about rising prices, having seen some significant increases already this year.

She remains an ardent supporter of PMP. She vividly recalls PMP's first forays into lending to island residents when no other institutions would do so. She also values the friendships and business relationships she has developed in her loan groups. She has borrowed and continues to borrow from commercial banks as well, but dislikes their paperwork and collateral requirements.

Her only complaints about PMP have to do with other clients: 1) some show up late to meeting and waste everyone's time; and 2) some are irresponsible about paying their loans. She adds that mainlanders are the prime culprits on both counts; Uros people tend to be more responsible.

She first rates herself on a happiness and well-being scale as a 10, then changes it to a eight, explaining that irresponsible group members sometimes get her down.

PROFILE #4: THE RESTAURATEUR & BOOKSTORE OWNER

For the purposes of comparison, we intended to highlight at least one case in which the Premium loan and perhaps borrowing in general yielded distinctly negative consequences. In fact, our sample did not encompass anyone who "bombed out" of the Premium program, by defaulting on the loan or heavily on other loans. As noted earlier, we had three cases of individuals stating that they did not intend to continue with their Premium cycles because they were worried about overindebtedness. In addition, we had one case of a client who got behind on several loans, including the Premium, and nearly lost her house, but ended up saving it by tapping into savings and resources from friends. (The rest of the year went much better for that client.)

Several other cases suggested patterns of borrowing, including the Premium loan, that seemed problematic, though no serious consequences were currently evident. The following case is one of those:

Luisa is in her mid-30s, born and raised in the city of Tacna. She appears to be mostly of indigenous descent, though her dress and personal style marks her clearly as an urban mestiza. She has some university education, which would assure her of mestiza status, if nothing else. Her features are unusually petite and slender, as compared with the majority of women sharing her background.

Luisa has been separated from her husband for about two years. She lives in a rented home with her sister, her sister's husband, her sister's two children, and her own two children, ages 10 and 12. The three adults pool their earnings for much of the household expenses.

Luisa owns two businesses: 1) a restaurant specializing in regional seafood; and 2) a bookstore specializing in scholastic texts. She has been operating both for about eight years, though with some disruptions. Luisa has a very small amount of savings (apart from here obligatory PMP savings) kept at home.

She just took out her second Premium loan for $800, having taken out her first for $700 early in 2008. Her motivation for seeking the Premium loan was simply that it was a new source of capital with which she could build her businesses.

She has already spent the funds for her most recent Premium loan. About 80 percent went to stock for her restaurant, with 20 percent going to pay off a moneylender (see below). She says business has been good in the restaurant, up significantly from last year. The investment was recent, so profits are just beginning. She expects they will come, and expects to reinvest most of them in the business.

Her previous Premium loan, along with a Regular loan for $600 and a Seasonal loan for $700, were invested in the bookstore. These included investments in stock (books), renovations to the store, and a special sales campaign aimed at attracting student customers. The campaign included major expenditures on events at the store and advertising. She describes that campaign as a total failure, in that it swallowed up her loan funds and generated virtually no profits. The bookstore in general has not been a consistent money-maker for her. Twice she has closed the store for extended period, once for a year, due to inability to operate in the black.

Other borrowing over the past year included a $330 Educational loan from PMP, which she did not apply toward education but rather toward renovations of her restaurant. She also applied some savings she had accumulated toward that renovation. The project required closing the restaurant for several weeks, but she says the results have been positive. The appearance of the restaurant was significantly improved, and her customers have responded well to it.

Over the past year, she also borrowed $300 from a consumer lender, after she hit a low point in sales at both of her *businesses. At that point, she had missed a couple payments on her PMP loans, and she used the loan from the commercial lender to make up the missed payments. She says she was able to pay off the loan to the commercial lender within a few months.*

Over the last year, and extending into years past, she also borrows from a moneylender on regular 23-day cycles. She borrows about $160 at a time and pays it back in daily installments over the 23-day term. She takes another sum as soon as the previous sum is paid off. She uses the funds to pay bills and for other shortages of cashflow. She said these loans have been essential in keeping her businesses running. She says the moneylender is a friend of hers, but she still knows these loans are bad deals in terms of the interest incurred. She has plans to end using the service and take up more conventional loans.

Luisa says she has endured no particular economic shocks this year. In terms of changes in running the businesses, she says she had been learning more about accounting and is keeping tighter books. Thanks to increased capital, she is also buying fish in larger quantities and getting better prices.

Luisa is a strong supporter of PMP. She complains about long meetings, but she also tells a story from several years past, when she had a loan from a commercial bank and encountered difficulties making the payments. She defaulted and was essentially barred from further credit with commercial banks or savings and loans. Around that time, she was able to get involved with a PMP loan group, and group guarantee allowed her to sidestep the black mark on her credit record. She remains grateful to the institution for this opportunity.

On the subject of her general well-being and happiness, she explains, "Everything is good, thanks to god." She rates herself a 10 on our index.

V. KEY ISSUES & REFLECTIONS

ISSUES & REFLECTIONS

Here the report turns to a series of important questions that have arisen in the research or been posed to the author by those familiar with the preliminary results.

Are these clients adopting dangerous strategies of credit escalation, from which they will have difficulty emerging?

In the initial investigation in November 2008, there were few overt signs of overindebtedness. Families were fed, business remained afloat, and, perhaps most significantly, loan payments were made across the board. The clients appeared to be skillfully managing their cash and other resources. Instances of default rates reported in the investigation were scarce, and these findings were mirrored by the overall default rates reported by PMP—0.01 percent for the Premium loan, as opposed to 0.02 percent for its Regular loan clients.[18]

Yet even if these overt signs accurately encapsulated these clients' present situations, they did not tell a complete story. We had no way of knowing concretely whether these clients' economic lives had improved as a result of the high levels of debt they carried, including the Premium loan. How would things be different if the available loans were smaller and fewer in number? Such analysis was beyond the scope of this study, and difficult to deliver conclusively using any methodology.

In a nod to growing school of thought within microfinance (see, e.g., report on BMGF position by Guth, 2008), one can argue that these clients would be better-served by adopting savings strategies to finance their businesses, rather than borrowing strategies like the Premium loan—what Rutherford termed "saving up" rather than "saving down" (2000). The underlying premise is that if these clients are able to make every Premium loan payment, including interest, they are better-served by setting aside and saving that amount of money each month, until the necessary sum equivalent to the loan amount is reached. Such strategies of course eliminate the sizeable interest debt.

However, such arguments hold water only in cases when the loan itself does not generate added income that allows it to be paid off. In other words, are clients able to make their loan payments only because they had the loan in the first place? The Premium loans are indeed used almost exclusively for business investment, and many clients reported increased profits as a result of taking the loan. In complex cases of multiple patched loans like these, it is very difficult to tease out the tangible

[18] Reported by PMP in January 2009. PMP defines default as "the failure to pay principal and/or interest within the established dates."

economic effects of one particular piece, and this qualitative analysis does not attempt to do so. So the question remains: could these clients have saved $150 a month for 10 months to amass $1500, rather than taking a Premium loan for that amount and paying $150 per month plus substantial interest?

The question of whether these clients *can* execute such a savings may be superseded by the questions of whether they *would* execute such a savings plan. There was little indication that these clients were inclined to adopt such strategies even when they could—voluntary savings levels across the board, even in this relatively successful segment of the population, were low. Yet the participation in and enthusiasm for the obligatory savings programs of PMP and other group-lenders were quite high. This was especially true for the Premium loan. Many clients liked being compelled to save, while admitting that they were not saving any other way. Here the familial and societal pressures noted by Rutherford (ibid.) can become a very strong deterrent.

UNDERSTANDING THE "DEBT TRAP"

The term "debt trap" appears in microfinance-related literature with some regularity, though it is rarely defined precisely. The de facto definition in many cases is a situation in which a borrower has no realistic prospect of rising out of debt any time soon and takes out additional loans to make payments on earlier ones. The total debt burden of these borrowers is growing rather than shrinking, and a downward spiral has ensued. Often the characterization is associated with the charge that the loans are quite expensive and that the practices of the lenders are partially predatory in nature (see, e.g., Allianz 2008.)

An extreme case of such traps would be South Asian practice of "debt slavery," where the borrowers' debt is set up with unrepayable terms, which becomes the sanction converting them into bonded laborers for the creditors (cf. United Nations Commission on Human Rights 2000).

(Additional Source: Richard Rosenberg, personal communication 2008.)

FOLLOW-UP: Overindebtedness Takes on New Salience in 2009

Most of these questions remained open after the initial study because it was a snapshot of one moment in time, and few clients seemed to have debt troubles at that time. The follow-up visit in June 2009 allowed us to peer into their future and look for any change. As described earlier, despite the relatively short lapse of time, a great deal had changed within this client group.

In 2009, with a weakened Peruvian economy, many Premium clients are struggling with their debt loads. As noted earlier, over half of the supplemental sample reported current or imminent defaults within their Premium groups. We heard of clients attempting to juggle their multiple loans, allowing some to lapse while maintaining others (with PMP usually assigned the highest priority). For their part, PMP management openly acknowledged the overindebtedness problem in the Premium program, noting how the combination of Regular, Premium, and Seasonal credit have become too much for many clients.

It is certainly possible that some clients have fallen into "debt traps" (see text box), beginning even before the economy soured but becoming fully evident now. It is also possible that this debt will undermine the current prosperity of substantial numbers of Premium clients, though such outcomes are purely speculative. It is possible that the Peruvian economy will recover quickly and with it, the Premium clients' financial health. Such outcomes will manifest in the years to come.

FOLLOW-UP: Who is most at risk in current economic climate?

In the initial investigation, very few interviewees mentioned recession as significant concern. There were a few, uncommon references to business dropping off, or fears of business dropping off soon as a result of the crisis. Some complained about rising prices, but none spoke of being sufficiently worried about the economy in the near-future to change their business habits (borrowing or otherwise) in any significant way.

These findings largely jibed with the macroeconomic picture of Peru over 2008. At the time of research, Peru's economy had weathered the global economic storm of 2008 fairly well. Inflation was steep but tempered by strong economic growth of 9 percent (INEI 2009).

The nation and its economy have taken a different turn in 2009, and the effects were duly evident in the follow-up visit in June 2009. The ripple effects of the global economic slowdown have been substantial yet uneven in 2009.

Some clients saw nominal effects on their businesses; their borrowing/repayment from PMP and elsewhere was unaffected. The clients most likely to fall into this category were those engaged in the provision of staple goods to a very local clientele—the owner of a neighborhood general store, for example, or the seller of locally-grown fruit at the central market.

Those most likely to be affected were those with businesses more intimately tied to transnational economics. Perhaps the most obvious examples among the interviewees were the clients of Lake Titicaca's Uros Islands, whose livelihood depended almost entirely on a steady stream of international visitors from developed nations.

We interviewed three PMP clients in the Uros in each of the preliminary and follow-up investigations (two of the same clients were interviewed on both visits). The pictures these clients painted of their lives were vastly different at those two points, with commerce reduced by as much as 50 percent in 2009, and defaults spreading across their loan groups. One can easily imagine damaging effects in the Uros as scores of European tourists cancel their month-long holidays to Peru, as yearly bonuses melt away and layoffs set in.

Though the follow-up investigation did not extend to Tacna, we can speculate on another example there of someone perhaps profoundly affected by the global slowdown. In November 2008 we interviewed with a shoe vendor in Tacna, whose income derived primarily from Chileans crossing the border to purchase Peruvian shoes. Chile's emergent economy is profoundly at-risk in any global recession, and one can easily imagine this flow of shoppers slowing to a trickle.

How is total debt being regulated?

The question of whether MFIs or other entities are monitoring total debt or trends toward overdebtedness is a critical one. The scope of this study does not extend to other lenders or entities, so the conclusions that can be drawn in this area must be focused on PMP.

PMP does indeed monitor the total debt of all clients to whom it issues Premium loans by way of Inforcorp reports.[19] Infocorp is a Peruvian credit bureau reputed to be relatively reliable in terms of capturing the debt information for microfinance clients (see box). PMP's official policy is that Premium loans will be denied in cases when Infocorp indicates a total debt in excess of $5,000. (PMP also will deny the loan if Inforcorp indicates past problems with default, though there are no strict guidelines for these cases, which are evaluated on an individual basis.)

The enforcement of this policy seems mostly confirmed by the results of this study. By clients' own reports, only one respondent among the 40 Premium clients interviewed had more than $5,000 in debt at the time of being issued a Premium loan. In that one case, the client had a large loan from a commercial bank with a balance exceeding $5,000 at the time of the Premium loan. It is unknown why an exception was made in that one case. However, one can speculate that the staff has some discretion to override the total debt criterion based on extenuating factors. This particular client was quite successful and a long-time PMP client. In this and similar cases, PMP may weigh these considerable histories and consider exceptions to the rule.

However, it is important to note that in many other cases, the clients did have a total debt exceeding $5,000 at some point during the year—just not at the moment the Premium loan was issued. Of the 40 Premium clients interviewed, 13 or 33 percent had debt in excess of $5,000 at some point during the last year. This suggests that clients are well-aware of PMP's policy in this regard and time their loan requests to avoid running afoul of this Infocorp-based regulation. (Once again, keen evidence of the skill of the client group in the area of cash-management.) If this practice has contributed to rising debt, it would be difficult for PMP or other lenders to address. The system favors the savvy borrower who wants to acquire additional credit in this manner.

PERU'S INFOCORP

What It is

A Peruvian credit bureau associated with international U.S.-based conglomerate Equifax.

Infocorp and Microfinance

Since 1998, Infocorp has collaborated with COPEME (a Peruvian consortium of microfinance providers and support organizations) to draw information on client debt from member organizations. In exchange, Infocorp/Equifax has provided training on credit and risk management and special pricing to COPEME members.

Scope of Credit Reporting (as of 2004)

Most microfinance in Peru (approximately 81 percent) is provided by regulated institutions (commercial banks, cajas municipales, etc.;, all regulated institutions submit data to the Banking Supervision Department, which is in turn captured by Infocorp.

Of the 19 percent of microfinance provided by non-regulated institutions (e.g. NGOs like PMP), information on approximately 75 percent of such loans was submitted by COPEME to Infocorp.

Therefore, we can estimate that 95 percent of all microfinance loans were being submitted to and reported by Infocorp as of 2004.

(Source: http://www.nextbillion.net/files/Track%202B-Ploder-Credit%20Bureaus%20in%20Microfinance%20.ppt)

Is the trend toward rising total debt a recent one?

There was anecdotal evidence to suggest that rising total debt was a recent trend, at least among Premium clients. Several PMP staffers and former staffers commented to that effect, though the opinion was not unanimous.

One industry insider suggested that the trend stems from growing confidence about business investment within this client group, combined with more aggressive loan promotion by PMP. The latter would include the launching of the Premium product itself, which provides a new means of adding to one's total portfolio (by perhaps 30 percent or so) at PMP. Another insider suggested that the rising competition among MFIs in both cities has compelled more aggressive marketing (and more aggressive take-up) across the board.

[19] This is in contrast to the Regular loan, for which Infocorp reports are drawn half as often—upon application for every other loan. Exceptions are made if the institution has reason to believe (e.g. through word-of-mouth information) that a client is carrying especially high debt load.

For the most part, the history behind this pattern fell beyond the scope of this study and will have to be taken up in another investigation.

What are the possible explanations for the pattern of multiple loans and patching?

For these microentrepreneurs, business growth is governed by a simple, prevailing principle: increased capital for investment means increased profits and household income. By their own accounts, this principle is borne out by their experiences taking loans. For that reason, the appetite for credit among this client segment is voracious; it is seen as the key to building on past success and improving one's station in life.

For most of these clients, the bulk of their credit and hence their business capital continue to come from unregulated NGO lenders. The reader might recall that PMP alone comprised 56 percent of total borrowing in Puno and 68 percent in Tacna, and many borrowers had additional loans from other NGOs. (Some had commercial bank loans that dwarfed the NGO lending in scale, but these were a minority of cases.) In Peru, NGOs represent the most basic phase of financial service provision in the sense that they are very restricted in the range of financial services they can provide under Peru's regulatory framework. The scale of their lending tends to be smaller than other types of institutions (e.g. EDPYMEs, Cajas, commercial banks), and the loan sizes themselves tend to be correspondingly small. In this context, we see a lender like Pro Mujer making six loans totalling $5,000 over the course of a year, rather than a single 12-month loan for $5,000.

But does the pattern have to be so? Would it make more business sense for PMP to offer a single $5,000 loan to cover the whole year—or even a single $8,000 loan that covers all the credit the client would pursue at PMP plus its competitors? From a certain perspective, particularly that of transaction costs, it seems to make a great deal of sense. However, these practices tend to be governed by the relatively low tolerance for risk one finds among many MFIs, particularly the non-commercial smaller-scale NGO institutions like PMP. A single loan of $5,000 is seen as a greater risk, simply because the lender has that total sum in the hands of a single borrower at a single moment in time. When the loan is issued, the full $5,000 is out of the lender's hands, with the balance gradually decreasing over time. By contrast, adopting a staggered strategy like PMP's, an MFI might never have more than $1,000 of its loan funds in the hands of any one borrower at a given time. Though the underlying logic is debatable, such strategies are widely accepted as a way of spreading and diffusing risk.

One area where PMP's policies seem less explicable in terms of industry trends is in its practice of issuing the Premium and Regular loan to a single client around the same time, or even simultaneously. Here the argument about diffusing risk over time does not hold. These are both full-scale credits, not short-term capital "boosts" like the Seasonal Loan (which many MFIs issue in comparable form, parallel to their regular credits, at times of year when extra funds are needed). Together the Premium and Regular loans concentrate funds in the hands of borrowers much like a single larger loan would, with seemingly comparable risk. PMP's never offered a precise explanation for this policy, except that the two products were promoted together, but does seem to addressing the underlying quandary with the development of its Line-of-Credit product (see discussion below).

In terms of PMP's competition, there are indeed lenders, generally savings and loan institutions (*Caja Municipales* and *Caja Rurales*) and commercial banks, that offer loans of $8,000 or larger to small-business owners. One might wonder why PMP clients do not simply drop their multiple PMP loans and seek out these loans. Undoubtedly a certain percentage of successful PMP client do just that, though their numbers cannot be estimated by this study. For those that remain with PMP, the critical issue appears to be the relatively stringent requirements of the savings and loan institutions and banks in issuing these larger loans. They typically require extensive paperwork and business balance sheets, as well as major collateral along the lines of a title to a home. Though the Premium clients are relatively successful, many noted that they could fulfill neither requirement, especially the collateral requirement, which is an insurmountable obstacle for some. (For them, the alternative of the group guarantee holds great appeal.) Moreover, some bank lending programs deal only with businesses in the formal, tax-paying sector, to which few Premium clients belong.

Another reason for the pattern of multiple patched loans, reported by the clients themselves, is habit. These clients have been with PMP for up to eight years. They have developed relationships with both institution staff and other members of their loan groups. They have no intention of leaving that behind even when their capital needs grow beyond PMP in scale. They are accustomed to being part of the PMP family, and they are accustomed to juggling multiple loans (and occasionally, if needed, using one loan to pay another).

Moreover, maintaining these small group loans may bring practical value beyond friendships. The economic significance of social capital has been well-studied and well-documented (e.g. Mosely and Verschoor, 2005; Fafchamps and Minten 1999; Woolcock, 1998; Farr, 2004; Manski, 2000). These small loans may be providing only a fraction of the capital needs of some borrowers, but they also are sustaining social networks that can reap immense rewards in terms of mutual aid and other forms of material and non-material support between group members.

The force of habit and perhaps the value of social capital is driven home by cases like one client interviewed in Tacna. Despite having recently taken out over $13,000 in loans from two commercial banks, she continued to pursue $200-300 Seasonal loans from Pro Mujer whenever they were available. That suggests a motivation beyond conventional materialism.

A final possible motivation for multiple patched loans is the potential as a diversification strategy. Peruvians tend not to have a great deal of trust in their financial institutions. Having multiple loans might be seen as a way to spread the risk of failed institutions or soured client relationships (though no client articulated this as a motivation in any interview).

Diversification with multiple lenders/loans also brings the potential to use one loan to pay another in times of constricted budgets. Though no one would argue such practices to be sound financially over the long term, it occurred with some frequency within the sample (9 respondents among the 45 client interviews, or 20 percent of the sample). It was generally a short-term strategy from which the client made a full financial recovery later in the year.

What are the implications of the pattern of multiple loans and patching?

There are enormous transactions-cost disadvantages to a multiple, patched loan strategy, as compared with a larger single loan. The Financial Landscape study conducted in Peru in fall 2007 included transaction-cost estimates (real costs as well as opportunity costs of time) by clients of PMP and competitor loans. The up-front costs included preparation of documents, transportation to the office, and then several hours of waiting and meeting with PMP officials. The loan maintenance costs were even more striking, centered on the biweekly group meetings that most clients were required to attend. Costs included transportation to the meeting sites, meeting fees amounting to several dollars on each occasion, and hours spent waiting for members to arrive before conducting business.

The bulk of these costs are avoided by those able to pursue a single-loan strategy with savings and loan institutions or banks. The up-front preparation is more intense and time-consuming, but once the loan is issued, the demands are far less. These are individual loans, so no time or money is spent on meetings. Rather, the individual-loan recipient stands in line once a month to make his/her payment at the institution.

Yet there are other considerations. First, not all these borrowers can meet the collateral requirements for larger individual loans with commercial lenders (e.g. the title to a home). For them, the group guarantee as a alternative form of collateral supersedes the transaction costs. Second, social capital once again enters the picture. These clients generally like PMP, and they appreciate their loan groups. Despite the aggravation of fees and wasted time, it was clear that many derive considerable enjoyment and perhaps material benefits from these meetings. They use the meetings to test ideas and seek advice on business plans from their peers. Some clients spoke of these peer networks as powerful components of their success.

An open question raised by loan patching is whether the trend might contribute to overindebtedness. It is more difficult to monitor total debt and credit-worthiness when the debt is spread among many institutions. Infocorp does not capture 100 percent of institutional loans, and never captures some kinds of debt (e.g.

moneylending). Moreover, clients included in this study demonstrated their adeptness at evading the limitations created by Inforcorp reports, simply by timing their loans properly. It seems logical that the efficacy of credit-monitoring would be enhanced by smaller numbers of larger loans.

Is PMP aware of the loan-patching pattern and responding to it in any way?

Discussions with PMP's management as well the international management of the Pro Mujer parent organization suggest that the answer to this question is, in short, yes.

According to Pro Mujer's international management, the organization has known for some time that their successful clients tend to have more than one loan with PMP and also with the competition—a pattern that holds for many of the countries in which they work. Their attempts to understand the pattern tend to center on three questions: 1) do the clients need that much capital?; 2) are the clients using loans from one MFI to pay off another?; and 3) is it a diversification strategy to have relationships with many different institutions (as PMP tries to do when it borrows capital)? The general sense is that all three questions enter into and influence client decision-making, in varying proportions.

Pro Mujer's most recent and most decisive response to the pattern has been the development of a new Line of Credit product for the Peruvian market that brings the potential to limit loan patching for at least some clients (see text box for details on product). The product was inspired in part by a program of Caja los Andes in Bolivia, in which the institution developed a strategy to determine the total debt of their "preferred" clients and then offer them a single credit to consolidate debt and cancel all other loans.

As of January 2009, the organization was set to begin the market research for the Line of Credit in both Peru and Bolivia. Results are expected by the end of February, with prototype development to follow by the end of March. PMP will pilot the product with its Premium clients. The organization is undertaking a capacity-to-pay analysis with clients for the Premium loan and will do so as well under the Line of Credit.

Pro Mujer's international management has suggested that this program is only likely to work when the answer to their first question ("do the clients need that much capital?") is affirmative. It is likely to fall short in cases when the other two questions predominate. At the very least, their hope for the product is that it will help work toward resolving the issue of multiple simultaneous loans within PMP (e.g. the Premium loan and Regular loan), if not the loans of competitors.

What do these findings add to our understanding of the value proposition of the Premium loan?

The Financial Landscape study focused on two aspects of the value proposition of the Premium loan: 1) its role in client

LINE OF CREDIT PRODUCT CONCEPT SUMMARY (ABRIDGED)

The line of credit product will be designed to improve upon Pro Mujer's current basic working capital loan provided via the communal association model. The new product will replace Pro Mujer's existing product after clients demonstrate their ability to manage credit, after about two to three loan cycles.

The current working capital loan designed for micro-businesses is Pro Mujer's core product and all borrowers begin with this loan. The loans are approved and guaranteed by the entire association of 15 to 25 women. In addition, once clients have borrowed this basic loan, they have access to parallel loans for additional business or family cash flow needs. These additional loans are designed to respond to business opportunities, healthcare expenses, and education expenses.

Although Pro Mujer has been a pioneer in designing diversified loan products to meet the needs of the poorest microfinance segment, Pro Mujer finds a few disadvantages with its current product offering: **1) Inflexiblity,** because to access the parallel loans, a client must form a sub-groups with fellow association members who also want the same type of loan at the same time, and not all women in the larger group can access the parallel loans at the same time, even if they need them. In addition, the loan term cannot vary by individual client; and **2) High transaction costs** for the client because the loan request and approval process must be repeated for each subsequent loan, including the business and residence verifications.

The line of credit product would specifically address the above weaknesses while maintaining the strengths of the community association model such as the social aspects of the group including the solidarity group guarantee, empowerment and responsibility engendered through the auto-approval process and collection of payments, access to credit with few requirements, and the savings component. Each client will have their credit line limit approved by their group at the beginning of the loan cycle. Any need for additional cash during the cycle will be pre-approved and clients will only borrow the amount they need at any given moment, knowing that they have access to the full amount whenever they need more during the loan cycle.

The benefits from the new product will include:
Flexibility – it will satisfy the clients' capital needs in an individual manner.
Lower transaction costs – both for clients and PM operational staff because each amount borrowed will not have to repeat the loan process.
Convenience – clients have access to the right amount of capital when they need it.
PM's asset management – it should help to smooth out the cyclical nature of PM's portfolio.

(Source: Pro Mujer 2009)

retention and prevention of "graduation;" and 2) its potential to fill a niche need for larger group loans (rather than individual loans).

Overall, the results of Product Use study suggest that the relevance of the Premium to the issue of client retention (countering any "graduation" trend) may be limited in several respects:

1) The idea of a growing loan to meet the growing needs of prosperous clients is not upheld by the evidence. In fact, the Premium loan meets just a fraction of these clients' total credit needs—30 percent or so, on average. The loan most likely has given PMP a somewhat larger share of the clients' total debt, but there was no indication that this elevated share compelled clients to stick with the institution over its competitors.
2) Clients like the features of the Premium loan and consider them an improvement over PMP's other loans. But there was no indication that they disliked PMP's older loans so much that they were prepared to leave the institution unless a better product became available. On the contrary, the vast majority of clients continued taking out the older PMP loans, particularly the Regular and Seasonal credits, along with the Premium. Their overriding concern was loan size, and it is important to note that the upper-end Regular loans are only incrementally smaller than the beginning range (i.e. the first few cycles) of the Premium loans.
3) These clients remained with PMP as they acquired the Premium loan, but that did not stop them from adding credit from other institutions. In fact, two-thirds of them had a loan with a competitor in the past year. Some of the clients successfully pursued vastly larger loans than anything Pro Mujer offers—seemingly the very definition of "graduation," except that they kept all of their smaller loans including PMP along with the larger one.

Our study came with a bias in that it examined only the positive cases of client retention—an unknown number of PMP perhaps did "graduate" to focus exclusively on larger loans with other institutions. But the evidence shows that even in these positive cases, the real effect on retention is less clear-cut than imagined.

The findings also call into question the nature of "graduation." Some MFIs have assumed that clients with large capital needs and access to much larger loans with competitors will pursue those larger loans while dropping the smaller ones. Our findings suggest that a significant number of such clients do indeed pursue the larger loans, but they keep the smaller ones at the time, driven at least in part by the value in social capital. Social capital, in a sense, reshapes the notion of graduation.

As for the second value proposition point, the loan's value in serving a niche of clients who need more capital but prefer group loans over individual loans, these clients did tend to speak fondly of their experiences with the group loan. They like the solidarity between women as well as the business advice and occasional aid exchanged between group members (i.e. the mechanics of social capital). They enjoy the social and leisure activities incorporated into the groups, from parties to volleyball tournaments. Some clients also emphasized that group loans work well for them because they cannot meet the collateral requirements for large individual loans—e.g. the title to a house.

However, again the value of the product in this regard may face limitations, for three reasons. First, though these clients like group loans, the preference was not exclusive or overwhelming. In fact, 65 percent of the Premium clients interviewed (26 of 40) had had an individual loan with a formal institution (ranging from large bank loans to small consumer credits) in just the past year. Second, there was greater availability of large group loans among competitors than reported in the Financial Landscape study in 2007. This 2008 research found clients holding a significant number of group loans close to the Premium in terms of size, offered by a half-dozen different competing institutions. It is unknown when or why the policy changes occurred that brought these competitors into the market for large group loans. Third, the evidence suggested that the *size* of the group loans may have had little to do with the client's decision to continue with them. Other factors (friendships, business networks, habit) tended to drive the decisions.

What do these findings add to our understanding of the result of the Welfare Outreach study?

What does it mean to be slightly more prosperous than one's peers in a context like southern Peru? Within this sample, an accompaniment on the path to prosperity is a heavy load of debt. We cannot say conclusively whether the loans have helped or hindered that prosperity. What we can say is that the debt is there, that this group continues to pursue loans aggressively, and that the strategy has not *prevented* them from rising over their peers on the socioeconomic scale. Is this a sound long-term business strategy? Is the prosperity fleeting? Can it withstand a downturn in the global and regional economy? These questions remain unanswered.

VI. LESSONS FOR THE INDUSTRY

KEY LESSONS

Rethinking the value of mandatory savings

Many these clients continue to view mandatory savings in an unconventional way, bolstered by the relatively liberal withdrawal policies of PMP. Instead of a necessary burden for borrowing, the savings has transformed into a usable resource in several different ways, particularly short-term cash storage and longer-term building of surplus. There is enough flexibility, continuity, convenience, and reliability (cf. Morduch and Rutherford, 2003, on the key qualities of microfinance) built into these savings to make it a practical resource. There are also desirable qualities such as privacy, in the sense that only group members see the evidence of savings; husbands and others who might claim the savings are excluded from the process. This all occurs within the confines of PMP, a venerated and trusted institution within the microeconomic sector.

For some, mandatory savings may equal or exceed the net value of formal voluntary accounts, and the account can become a way for MFIs to encourage savings using resources they already have in place. Yet the follow-up investigation brought to the fore a critical kink in the utility of these accounts—blocked access when payment problems develop within the group. In sum, MFIs like PMP must make a critical choice: 1) encourage savings by limiting or abolishing the involuntary use of savings as a group loan guarantee; or 2) retain current methodologies and dispense with the idea of promoting savings.

A third option for PMP and other MFIs facing these circumstances might be to shift emphasis from group loans to individual loans, while retaining some mandatory savings requirement. Recent research (Gine and Karlan, 2009) suggests that repayment rates may not be affected in such a switch. However, the testimony of PMP clients suggests they would be deeply conflicted about this shift. On the one hand, their savings would not be jeopardized by others in the group. On the other hand, they would lose the group dynamic and social capital that they value highly. In addition, collateral requirements on individual loans would almost certainly be a problem for some.

The idea of growing loans to meet growing client needs may miss the point

MFIs may know that their more successful clients require increasing amounts of credit, but they may not grasp the extent of that need. They also may not grasp the borrowing patterns that fulfill those needs, especially when it encompasses a variety of the MFI's own loan products as well as simultaneous loans from competitors. This is especially true for sought-after successful clients—the "good payers"— whose habits and preferences tend to be most complicated but are most economical to serve. PMP's Line of Credit pilot is an example of a logical and reasonable response to these conditions. However, in all likelihood, increased loan sizes from a single non-commercial MFIs will never meet the capital needs of many of these clients. The MFI that understands this can shift its efforts to reinforcing retention and loyalty among these clients through other means, including intangible elements like the pleasure derived from long-term group friendships and relationships with loan officers.

Is credit always the answer?

PMP is a lender, disempowered by law to accept savings, except through partnerships with savings and loan institutions and banks. Yet these findings still bear upon current debates about savings versus loans in the microfinance world. Clearly these clients appreciated the idea of saving, and there appeared to be sufficient funds in circulation in these families to suggest that putting aside a set sum every week or month is within their reach. Are these clients prime examples of those who should be encouraged to save rather than "max out" their credit? And how best to facilitate that? These clients were quite keen on the obligatory savings that went with PMP products, but only a minority had additional voluntary savings. They liked being forced to save, while perhaps feeling unable to save any other way (due to day-to-day family pressures, etc.). Will these clients be better-off in the long run if they choose to save rather than to borrow? All of these are issues that PMP cannot directly address, though they are part of a central debate at BMGF and other institutions.

Clients may "graduate" yet still remain with their first MFI

An oft-discussed fear among MFIs is that their best and most reliable clients will become so successful that they leave their original MFI behind to seek larger loans with commercial competitors—in a word, "graduating." This study complicates the notion of "graduation" because many of the clients in fact "graduated" in the conventional sense (i.e. sought bigger loans with competitors), but they retained the smaller loans at the same time, compelled mostly by social capital and habit. (Also, some borrowers, even successful ones, will likely have difficulty meeting the collateral requirements for larger individual loans.) Understanding these retention factors will help the MFIs reinforce them, which may inspire even more of the "good payers" to stick with their original MFI, even as they diversify their loans.

It is worthwhile to rethink institutional risk aversion and its connection to loan patching

Some clients, the most aggressive of the entrepreneurs, may never have their capital needs met by a single MFI, but what about the rest? Would they be better-served if PMP were willing to deliver $5,000 in a single loan? Would institutions like PMP benefit financially? There are arguments to be made on both sides of the issue, with transaction costs on both the demand and supply ends at the heart of the debate. On a basic level, the fact that these clients need more than five different loans over the course of a year to meet their needs suggests that something is askew. At the very least, MFIs might consider their level of tolerance for risk and how it may be feeding these patterns, and they might take a look at potential responses along the lines of PMP's Line of Credit.

Transaction costs are significant but may not drive decision-making

Many of the arguments for change surrounding risk tolerance and loan size center on transaction costs—i.e. one big loan costs a lot less in time and money to maintain than six small loans. Yet at the same time we must acknowledge that transaction costs seem to have no decisive influence on the borrowing patterns of some clients. We consider again the cases of clients borrowing large sums from commercial banks, while retaining their small group loans with PMP, including all the time and costs of attending meetings as often as every two weeks. Clearly those clients saw value in those loans (e.g. networking, friendships) that superseded the transaction costs.

Impact can be more than dollars-and-cents measures

In a competitive environment such as this, with multiple loans in play for nearly all clients, the economic impact of any one provider or product becomes extremely difficult to tease out. As this study shows, however, impact can take many forms beyond the conventional bottom-line. For many of these clients, the social capital provided by PMP supersedes the monetary capital. Where economic impact cannot be measured, sometimes the social impact can. A properly-attuned impact study should take this into account and measure all forms of impact.

MFIs should investigate client borrowing habits to the fullest extent possible

Seeing how a loan product fits into a clients' total credit picture requires a specific sort of market research. Focus groups will not suffice. The research must be targeted and precise, including detailed individual surveys and/or interviews. When properly executed, the results will inform and enhance product development, moving beyond simple statements from clients about what they want and need, to an appreciation of the MFI's own position in what may be a vast and complex cash-management picture.

ANOTHER PIECE OF A BROAD IMPACT PICTURE

As presently envisioned, these results will be paired with the results from the Welfare Outreach study and Financial Landscape study. Together they will combine different methods and different moments in time to deliver a composite portrait of how conditions change, as well as why they change. The expectation is that the results will contribute significantly to the learning agenda of BMGF and the field of microfinance in general.

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ANNEX A

SPECIAL NOTE ON BEHAVIORAL ECONOMICS

In this report, specific problems and questions are addressed in a particular context, drawing on empirical observations at several investigation sites. The mostly qualitative work here will be part of an ongoing investigation into the impact of service innovations funded by BMGF.

At the same time, by revealing the behaviors and motivations of clients, the report has broader aims of engaging with and contributing to professional and scholarly discourse on the current state of microfinance. As a case study, it brings that potential because it touches on so many of the hot-button issues under debate in the field.

The Product Use study was implemented with a special eye toward contributions in the emergent field of behavioral economics in microfinance. Behavioral economics challenges the standard economic model by positing that economic decisions have rich sociological[20] underpinnings and that many personal and cultural factors constrain "rational" decision-making (cf. Mullainathan and Krishnan, 2008; Bertrand, et al., 2005; Mullainathan, 2004; Bertrand, et al., 2004). Rather than focusing on constraints *among* individuals or *between* individuals and institutions, behavioral economics redirects attention to constraints *within* individuals as actors in a particular social milieu. When applied to microfinance, behavioral economics tends to focus on the following: 1) how clients say they prefer/intend to use a service (which may or may not be the "rational" use); 2) how they actually use the service; and 3) the reasons for any disconnect between the two, particularly as related to the precarious life circumstances of low-income populations (see Mullainathan and Krishnan 2008).

It was anticipated that behavioral economics would provide a suitable theoretical framework to enhance the investigation of the different dimensions of use of the PMP innovations. A core aim of the Product Use study was to capture the issue of use from a client's perspective, which can be seen in clients' intended and actual use of the loan. First, these could be compared to PMP's stated intentions for the innovations, to determine whether product development may have missed key drivers of choice. Second, the study would focus on explaining the continuity or disconnection between clients' intent and use, to help reveal what those drivers may be. For example, how does aversion to risk affect the realization of the client's own economic goals? Does the entrepreneurial history and relative affluence of the client mediate her tolerance for risk, relative to others (more

[20] Though the behavioral economics literature often employs the term "psychological" in describing its investigations, that term has been deliberately avoided here. It is based on the author's contention that behavioral economic connects more directly to sociological or cultural realms, evidenced in the internalization of norms of behavior by individuals. The orientation of such research is the collective conscience, not the individual conscience.

entrepreneurial = less risk-adverse = more successful)? Has the client become more or less risk-adverse after the introduction of the loan?

In the end, this theoretical direction proved somewhat less productive than anticipated, because the answers to key questions tended to provide little fruit for discussion. As later discussions will detail, there was nominal disconnection between PMP's stated intent for the loan and actual use, and a minimum of disconnection between clients' initial intended use of the loan and actual use. In other words, these clients do not divert their Premium funds for the most part.

That finding in itself is highly significant—in fact, it is central to the core arguments about this client group that dominate this report. But these cases provide little substance to examine, confirm, or refute the core tenets of current behavioral economics, simply because that school of thought focuses mostly on loan diversion and other instances of financial plans going awry. Perhaps the one major point that one might draw is that the model and research prescriptions of Mullainathan, et al. leave little room for meaningful examination of relatively successful segments of the microfinance market, where "rationality" may indeed preponderate on some levels.

ANNEX B

ADDITIONAL DETAILS ON SAMPLING

The process for the selection of clients was as follows: we obtained the most up-to-date available lists of Premium clients and eligible non-clients from PMP. Using SPSS software, a random selection of roughly 25 clients in each city was made, plus several alternates for each selection. Most were current Premium clients, plus a smaller group of eligible non-clients in each city. The Peru-based consultant then began making contact with these individuals, using alternates when the first selections were unavailable or unwilling to participate.

At the same time, we conducted interviews early on with key PMP staff, most of whom were managers of Focal Centers or branch offices within the two cities. A total of four such interviews were conducted in Puno, and five in Tacna. We probed these PMP staffers for their perspectives on the typical socioeconomic profile of Premium clients, especially the variation seen in sectors of employment.

As the list of contacted (randomly-selected) clients began to shape up, we compared the characteristics of these clients with the typical profiles described the PMP staffers. Our goal here, above all, was to produce a sample of clients reasonably representative of the whole. Given the small scale of our random selection, we wanted to ensure that we were not oversampling or undersampling important elements of this client group by chance. What we found was that the information from PMP was consistent with our random selection. All clients were microentrenpreneurs, representing all the major sectors of business mentioned by the PMP managers, with a reasonable geographic spread across the neighborhoods of the two cities. Hence the names yielded by our initial SPSS sort became the basis for most of our client interviews.

As noted in the report, there were certain exceptions to the purely random basis for selection. A total of four interviews, two in each city, were not random but rather achieved through snowball sampling. These arose mostly as last-minute replacements for interviews that fell through. An opportunity for a replacement arose after a client referred the interviewer to an acquaintance who was also a Premium client and represented the general characteristics we were seeking (a particular type of business, residence in a particular neighborhood, etc.).

In addition, we oversampled two types of clients that emerged as of particular interest to the study. The first type was rural borrowers. The Premium loan was created as primarily an urban product, so it was surprising to find a significant number of rural borrowers in Puno. To achieve a well-rounded representation of these borrowers, we did not need to diverge from the initial SPSS sort, but we needed to jump directly to an alternate in case.

(Rural borrowers were far less significant in Tacna, so they were not similarly targeted for interviews.)

The second area of oversampling was in the areas of positive deviants. We elected to define positive deviants initially as those with the highest loan amounts among the Premium clients in each city. To isolate these clients, we conducted a secondary SPSS sort, focusing only on the highest echelon of loans (above 6,000 soles in Puno and above 4,000 soles in Tacna). In Puno, only five clients fell into that highest range, and three were residents of Lake Titicaca's Floating Islands. Out of both convenience and interest, we elected to focus on this cluster to explore positive deviance in Puno. In Tacna, 13 clients fell into the highest range, and two were randomly selected for interviews.

ADDITIONAL SAMPLING CHALLENGES

Challenges of the PMP client lists

- For reasons not entirely clear, the PMP Premium client lists provided to us in October 2008 were not fully updated to include all clients who had enrolled in 2008. Generally, however, this was not considered a limitation, because we were seeking the clients who had had a bit more time and experience with the loan (see below).
- The Premium client list included a substantial number of clients who did not in fact have the loan. It is unknown why this was the case. These individuals had to be purged from the selection and replaced by alternates, after initial contact disclosed this fact.
- We aimed to limit the sample to individuals on at least their second Premium cycle (i.e. those who had had a substantial amount of time to use and evaluate the loan). Since the number of cycles was not evident in the records provided by PMP, we attempted to achieve this filter by specifying a minimum number of months having had the Premium loan (i.e. enough months to have completed their first cycle and moved on to a second). By and large, this technique worked, though some single-cycle Premium clients, particularly in Tacna, did slip through and ended up in the sample.
- Locating clients required the assistance of the PMP's focal centers (essentially branch offices) around the two cities, since PMP's computer records did not list include contact information. Though all focal centers were cooperative, some did not have the required contact information readily available for us. On this basis, some selections on the list were dropped and replaced by alternates.
- Like the Premium clients, the lists of eligible non-clients were not fully up-to-date as of October 2008. As a result, a substantial number of these eligible non-clients had in fact become Premium clients in the intervening period. These cases had to be weeded out from the sample and replaced with alternates.

Field Challenges

- Many clients undertook last-minute travel, especially for business purposes, that disrupted appointments and schedules. In these cases, we attempted to wait and interview them upon their return. When this was impossible, we replaced those clients with alternates.
- A substantial number of clients did not live at their address on file with PMP, especially in cases of rented homes. Most often we were able to track these individuals down by questioning neighbors, etc.
- Though most clients were receptive to the interview, some insisted on time to think about it, requiring multiple visits before the interview took place.
- In Tacna, a citywide general strike took place in the weeks before the research period. The city essentially shut down. This considerably hindered the planned legwork to contact clients and set up appointments prior to the interview period. It also made coordination with the focal centers more difficult. As a result, the planning in Tacna was more last-minute in the days leading up to the interviews (e.g. less flexibility to make repeated attempts to contact individuals on the list).
- Tacna's urban sprawl includes many poorly-documented new neighborhoods on its outskirts. It was difficult to locate some clients in these areas.