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GROUP VS. INDIVIDUAL LIABILITY IN MICROFINANCE

AN ONLINE SPEAKER'S CORNER DISCUSSION LED BY NATHANAEL GOLDBERG AND DEAN KARLAN AND HOSTED BY microLINKS.ORG

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WELCOME

Post by Dean Karlan and Nathanael Goldberg

Hello e-Conference Participants,

We would like to welcome everybody to the Speaker's Corner on Group vs. Individual Liability in Microfinance. As we all know, in popular perception, for 30 years microfinance has been nearly synonymous with group lending, and the Nobel Prize was awarded to Muhammad Yunus and the Grameen Bank on the basis of their success in harnessing group liability to offer credit to the poor in the absence of collateral. But we also know there are many more ways to offer credit beyond Grameen-style solidarity lending, from individual loans to village banking and everything in between. With the rise of ASA and the conversion of the Grameen Bank to Grameen II, two of the world's largest microlenders now offer individual-liability loans within a group-lending model, meaning there is no legal recourse to demand payment from fellow group members if a client defaults on her loan.

Both ASA and Grameen have achieved remarkable growth and repayment rates with individual liability. But these are unique institutions and it remains unclear what their success implies for other programs. Innovations for Poverty Action has been working on this issue for several years. We conducted a field experiment with the Green Bank in the Philippines in which we kept all aspects of the program the same except for whether the clients were offered group or individual liability. We will discuss the results on Day 1 of the conference.

The discussion topics for each of the three days of the e-conference are as follows:

Day 1: What's the case for individual liability—empirical evidence and practitioner experiences

Day 2: Switching to individual liability—what have been people's experiences with making the switch?

Day 3: Are there alternative options (e.g., hybrid forms of liability, collateral substitutes)?

We hope to learn from the experience of both researchers and practitioners. We look forward to a great discussion!

Sincerely,

Dean Karlan
Assistant Professor of Economics, Yale University
President, Innovations for Poverty Action

Nathanael Goldberg
Project Director, Innovations for Poverty Action

DESCRIPTION OF RESEARCH INTO GROUP AND INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

Here is the description of our research into group and individual liability. Tell us what you think - will it hold up in other settings? On the basis of these findings would you consider converting? Do you think the "middle ground" option will work best? Working with the Green Bank of Caraga, we took 169 group-lending centers of approximately 25 clients each from Leyte Province and randomly selected half the centers to be converted to individual liability, with the others to serve as a control group. All other aspects of the program remained the same: clients still met in weekly in groups and made the same payments each week. Group and center savings were dissolved in favor of personalized savings, but there was no change to clients' total deposits. This assures us that the only difference between the treatment (individual-liability) centers and the control (group-liability) centers is the change in liability. Therefore, any differences between the two groups at the end of the study period can be confidently attributed to the change in the program.

After tracking both group-lending and individual-lending (converted) centers we found that default did not increase in the converted centers, client retention increased, and more new clients borrowed under individual liability. This provides empirical support that clients prefer individual liability.

The results suggest that individual-liability lending can work, but they do not by themselves indicate that individual-liability lending is profitable for the lender. Repayment is only one aspect of profitability. Group lending shifts the burden of screening clients and enforcing repayment from the lender to clients, and creates an element of insurance, whereby clients in difficult weeks can rely on their peers, reducing their chance of default. If repayment was maintained in the converted centers only through intense effort by loan officers, the cost of individual lending will be prohibitive. We examined this possibility by conducting an activity-based costing exercise in which each credit officer kept a detailed diary of their activities. We found no significant differences in the way credit officers allocated their time, and though the results were not statistically significant, credit officers spent less time on loan enforcement, though they spent more time on the approval of new loans.

Observers might note that however interesting these findings may be, they have only limited applicability to other settings because the subjects are a very particular group: clients who joined a group-lending program thinking they would stay in a group-lending program. It would not be possible to continually screen future clients by claiming this. To extend the findings we are conducting related research with the same program, in a new area.

The sample villages in the new area are randomly assigned to one of four groups:

1. group liability

2. individual liability

3. group liability for the first loan cycle only, after which group liability will be removed

4. control group

This way we can compare clients who sign up for group liability to those who sign up for group liability. Additionally, we are testing out a middle ground option (#3 above) to see whether another option may combine the best of both worlds.

DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

Welcome to Day One of the Speaker's Corner on Group vs. Individual Liability in Microfinance. We would like to start off the conference by examining the case for individual liability.

There are sensible arguments for both group- and individual-liability lending. Group liability uses clients to screen out bad credit risks and to support and pressure each other to repay. But group liability can cause problems, too. Groups can screen out poorer borrowers because they fear they won't repay, and clients can have incentive to default on their loans when other group members fail to repay (as in, they may find it preferable to default on their loan rather than repay both their loan and the loan of their fellow group member—this would be especially likely if more than one member of a solidarity group defaults).

We will send out a separate post describing our research into group vs. individual liability. In the meantime we'd like people to start sharing their experiences with group liability (tomorrow we're going to cover experiences with individual liability)—do you find that these theoretical arguments for and against group liability exist in practice? For instance, if clients practice "strategic default," that is, defaulting when their fellow group members default rather than repaying both loans, then we should see predominately good groups and bad groups, but not many groups with middling repayment histories. Have people noticed this trend?

We look forward to hearing from you!

One item to point out as we begin: the cases of ASA and Grameen Bank remind us that it is important to distinguish between group liability and group lending. Group liability means that clients are responsible for each other's loans, and group lending means that clients are organized into groups for the purposes of managing repayments. You can have group lending without group liability—some MFIs (e.g., ASA and Grameen) find it more efficient to serve clients this way. If anybody knows of an example of group liability without group lending please share.

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Zvi Galor

Hello, I would like to bring my contribution to the subject. First I would like to give my understanding to what should be a MFI. I would answer here:

A MFI exists to best serve the clients - beneficiaries (I consider both as synonyms in the case of MFIs).

Regarding group lending: I bring here something from my personal experience. The Moshav in Israel. The Moshav is a multi-purpose cooperative and at the same time a rural community. The Moshav has been established during the twenties of the former century, and from its beginning tried to find solutions to the question of credit needed to agricultural production of its members - all very young and highly poor people.

The way out was in the fact that the Moshav has presented, toward the financial institutions at that time (one can find more background materials, if interested, on my website), the Mutual Guarantee made by all its members vis-à-vis the FI (financial institutions) to which a demand for credit was presented. The Moshav is composed of an average of 60-80 agricultural exploitations, equal in size to all members. All the members were guarantors to the credit the Moshav has taken as a client on their behalf. The Mutual Guarantee was not initiated in Bangladesh, but well before.

The Moshav looked for credit according to the needs of the members. It distributed the credit to members on the basis of their needs in production and charges them on an average rate of interest of all the financial resources the Moshav has obtained thanks to this Mutual Guarantee. The Moshav charged the members at the lowest possible rate of interest, in order to enable them to reduce their cost of production, and by so doing to enlarge their ability to increase and to maximize their personal net income or profit. This policy turned to be very important to the development of the members-farmers individually, and the Moshav as a whole.

So, I think that the MFIs should render the best possible service to enable their client to generate the highest possible profit out of their income generating projects (IGP).

I would bring here another possibility, concerning rural development. Many, if not most of the MFIs, aiming at rural areas are concentrating their efforts on giving credit to develop the farming and the agriculture.

In my view it is a huge mistake. The developing world doesn't need more farmers. It needs less farmers and more modern ones. I would add here and say that this policy, repeated for the last fifty years, is not developing the rural areas, but rather destroy them. (if wish, one may read more here:

40. SMALL SCALE INDUSTRIES - CONCEPTS AND REALIZATIONS: THE ISRAELI CASE STUDY - THE CREATION OF NON-AGRICULTURAL EMPLOYMENT (NAE). Non-agricultureEmployment.doc http://www.coopgalor.com/i_publications.html

Or here: CO-OP DIALOGUE - An ICA ROAP Journal Vol. 12, No, 1&2, 2002 Applying more constructive policy by MFIs in the development of the rural areas may bring better results.

Another option which was developed recently is the introduction of the BDS approach. Once again, the whole approach was too restrictive. These BDS services did not respond to the need of the Clients. A more efficient BDS should contain elements of the Essential Triangle of Production (ETP) as well as Production Planning, financial planning, cash flow calculations and productivity calculations, as well as a very important element needed badly by the poor: not to be alone. Many MFIs are afraid of group development, called by others with a term spoiled to many ears now-a-day, as cooperatives.

Another source of further reading on the subject is here: 38. Finance and Guarantees in Rural Development FinanceRuaralDevelopment.doc http://www.coopgalor.com/i_publications.html

I still remember, many years ago, when serving as a treasurer of a young Moshav, going to the bank, holding in my hand a long sheet containing all names of the 80 members of the Moshav and their signatures, the mutual guarantee of the members, to serve as part of the guarantees needed by the bank.

I would like to propose a different angle to look at the Micro-Finance projects and their achievements.

1. The Micro-Finance enterprise is a different entity than the MFI. MFE belongs to its members, and provides them the best possible service at the lowest possible cost. MFE is the last stage between the existing MFIs and the clients.

2. The Micro-Finance enterprise allows its members-owners to save their money at a Competitive Rate of Interest (CRI), the highest possible one. A rate of interest which takes into consideration the rate of annual inflation in the given country where this enterprise exists, as well as to be higher than that offered by any other financial institution for fixed deposits. It allows them to obtain credit when necessary, at a Competitive Rate of Interest (CRI), the lowest possible one.

3. The Micro-Finance enterprise exists to serve its members at the best possible way. This means, no profit, no surplus. The enterprise would function on the basis that its total income would cover its operational expenses plus the interest paid to members on their deposits.

4. The Micro-Finance enterprise is aimed at the provision of credit to income generating projects (not exclusively, but mainly). This credit is part of the Essential Triangle of Production (EPT), where the production process is inside a triangle. The triangle is composed of the Savings and Credit side, the Supply of Inputs side and the Marketing side. The connection existing on the angle between the Marketing side and the Credit Supply side determines the rate of success of the Income Generating Project.

It is important to note here that Group Lending is essential when dealing with very poor population. But when speaking about group lending we ought to remember that only the allocation of credit, be it via group lending or via individual lending, is not sufficient and in most cases would not bring about a sustainable development. Credit should be accompanied with other components as explained above.

Best regards, Zvi

Zvi Galor
www.coopgalor.com

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

Zvi,

Thank you for your contribution. Perhaps for the benefit of the group you would like to distill your description into a comment on the role group liability played here, and whether you think the outcome could have been possible under individual liability.

Okay let's take one issue at a time.

First issue: what is everybody's experience with clients screening out poorer clients in group-liability programs? Do you think this is a problem?

-Nathanael

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Pamela Jakiela

Hi everybody,

My name is Pam Jakiela, and I am a PhD candidate in development economics at UC Berkeley. As such, my comments are likely to fall on the theoretical side of the debate, but I am very interested in hearing from those working in the field about the connections between theory and the real world.

It appears to me that a largely neglected aspect of the debate about the relative merits of individual and joint liability is the extent to which individual decisions about both project choice and repayment are impacted by psychological factors which result from the group component of microfinance lending – specifically, bringing borrowers together for meetings, where individual interactions with loan officers can be observed by the entire group. Economic theorists have focused on the potential social costs to default in group settings: individuals may choose low-risk projects and repay their loans because they want to avoid social sanctions from group members. However, there is another social cost of default in group settings which does not hinge on the actual terms of the loan contract. Individuals may repay their loans because they don't want their MFI peers to think poorly of them. Similarly, bringing people together, whether or not they are linked through joint liability, may lead to homogeneity in investment choice among borrowers. Borrowers may run their project ideas by each other, or it might be the case that innately risky (or safe) types have a desire to conform to the group norm. It also might be the case that group discussion leads to a sort of collective rationalization of the use of loans for purposes, like consumption-smoothing, which are not related to the financing of micro-enterprises.

I would be interested to hear from the practitioners in the room on this issue. Does bringing people together lead to social pressures toward conformity in loan use, whether or not borrowers are linked through contract liability?

Cheers,

Pam

Pamela Jakiela
PhD Candidate
Department of Economics
University of California, Berkeley

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

Thanks, Pam, those are very interesting questions. I know we'd all like to hear from practitioners on their experiences with this and I know we have several registered for the discussion.

Practitioners - How important is the shame factor of group lending relative to joint liability itself?

And what about this idea of conformity in loan use - has anybody noticed this?

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Linda Mayoux

I find Patricia's points very interesting.

Regarding homogeneity of investment decisions, from my consultancy with various MFIs and NGOs in different contexts there does not seem to be any noticeable homogeneity when I have collected data on loan use. But that does not mean that there would not be pressures to avoid risk - whether or not there is group liability there is still considerable social pressure against default and considerable shame involved. So women in particular tend not to try and branch out into unknown areas, but cluster in a fairly narrow range of activities.

At the same time the group mechanism does give considerable potential for cost-effective training/mutual learning between members which could progressively explore possibilities for economic diversification. One methodology which is being piloted in Uganda and Sudan is Participatory Action Learning System which is based on people examining their livelihoods through use of diagram methodologies and then using these as a basis for discussion and brainstorming areas of innovation. These methods are self-replicating in that groups can teach each other and conduct the discussions without external facilitation beyond initial training of key persons and then some follow-up in the form of feed back from the groups at events like AGMs.

Still in the process of development, but if you are interested further information can be found at http://www.lindaswebs.org.uk/Page3_Orglearning/PALS/PALSIntro.htm

But group liability has been abandoned by most organisations I work with, if they ever tried it, because it did not seem effective. Repayment incentives built into the loan product, e.g. declining balance and repeat loans were found to be more effective, particularly in areas where there are unstable populations like flood-prone areas of Bangladesh.

It would also be interesting to see what influence gender has on these issues—are all-women or all-men groups different from mixed sex groups? Or differences between groups in homogenous and tight-knit communities e.g. different caste areas in India from more heterogeneous groups.

Linda

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

Thank you, Linda. I am surprised to hear that so many MFIs have made the switch. I would be interested to hear from you or others of prominent examples besides Grameen that have switched to individual liability.

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

We have at least a couple experts on Grameen II among us (Asif Dowla wrote the book on it, *The Poor Always Pay Back*, and you will find Stuart Rutherford's article on Grameen II among the background materials on the web page for this discussion).

I have a question for them or people who are very familiar with Grameen II or with ASA (or any individual-liability MFI with near perfect repayment), which I think would be useful for everyone: How does it work?

Grameen and ASA have very high repayment rates, and we measured empirically in the Philippines that clients really pay back even without group liability, so we know it can work - the question is why.

Earlier Pam identified the social factor of public repayments and Linda mentioned repayment incentives such as repeat loans. Are these the most important strategies, or is it something else? Are fellow group members pressured to repay even without joint liability?

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Asif Dowla

I want to begin my post by going back to the introductory comments. The preamble sort of suggested that ASA switch to individual lending has little to do with group lending. ASA would not have been able to be successful with individual lending if the norm of repayment was not well established in Bangladesh. I would argue that group lending was the catalyst for the establishment of the norm of repayment. During its experimental stage, Grameen Bank was collecting repayment daily (in the mid 70s), but found out that record keeping was difficult and there was a lot of conflict between the agent collecting the repayment and the borrowers. Hence the idea of group meeting once a week where repayment will be made a public affair. So, the intent of group lending was to minimize cost of loan collecting and a public repayment. In business jargon this is know as point of service idea. Group liability which is misinterpreted by some practitioners and misused by theoreticians as a form of social collateral was not the original intent. Once Grameen Bank was successful and the norm of repayment rate got well established, anybody in Bangladesh could start a microfinance operation. The bottom line is group lending is a good organizing principle for establishing a microcredit culture. Once the industry is established, it is possible to switch to individual lending as ASA and Grameen has done. I know of no example where a microcredit industry was established based on individual lending (if you exclude money lenders).

Grameen and ASA's progression to individual lending was anticipated by the theoretical literature. Malgosia Madajewicz, currently of Columbia University economics department, showed in her PhD dissertation that borrowers prefer individual lending over group lending when their economic condition improves. Research based on Grameen shows that borrowers move out of poverty after five years. Grameen Bank switched to individual lending after 25 years in operation.

Now back to Nathanael's original question as to why repayment rate is high in ASA and Grameen? I believe it is the self-interest of the poor that keeps the repayment rate high. This is the only credible and cheaper source of finance available to them and they do not want to burn this bridge. That does not mean that some do not default intentionally and other get in trouble for situation beyond their control. Grameen Bank deal with the first issue by never forgiving loan and even collect loan that has been written off the book ((bad debt). It deals with the second issue by introducing flexibility in the contract whereby the borrower can reschedule an unpaid loan with a price. It is important to mention that even though Grameen switched to individual lending, it still maintains the group structure, i.e., group and center meeting. More details about these issues can be found in my book co-authored with Dipal Barua of Grameen Bank titled, *The Poor Always Pay Back*. The book is published by Kumarian Press.

Asif Dowla
Professor of Economics
St. Mary's College of Maryland

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY
Post by: Hamdan Goumaa

Before going into Grameen I would like to make few remarks on the group vs individual liability.

The empirical data collected in this kind of research will always be of interest to a practitioner; whose objective is to empower communities through lending, to the point where they are capable of accessing the banking system (individual liability). There has always been the argument that you don't want to isolate the poor from other national economic institutions by setting up the "poor only banks" (Grameen is a case in point). There is also this idea of you upgrade by graduating the poor from the stage of ultimate poverty and destitution- especially in contexts or situations of post wars / disaster- to a level whereby they could meet their basic needs and start accumulating own capital/assets. You may equally ask the banks to downgrade or lower their level of requirements to enable the poor to have access to their services. This graduation approach implies an evolving model and such model can only be possible when based on group lending/ group liability. Also in context such as the ones described above the group facilitates realization of other important social and developmental objectives, hence becomes imperative to work through the groups. The group becomes a focal point for delivering services that will lead to the empowerment of the poor families. Literacy, and other trainings aim at addressing such needs would be impossible without group based lending.

RE: DAY ONE: EXAMINING THE CASE FOR INDIVIDUAL LIABILITY

Post by: Stuart Rutherford

Hello.
Two brief comments:

1. Grameen II and ASA have high repayment rates largely for the reasons Asif mentions plus one other very important one, perhaps the most important. That is the breaking up of repayment into tiny frequent amounts that can be found from regular household cash-flow even if the loan is not 'productively' used.

2. Grameen II still uses what I call 'meeting day joint liability': that is, the worker will use the group in every way s/he can to get that week's payments in - for example by keeping members waiting around until they pay, or by pressuring those due to get a loan that day to repay on behalf of others. My observation is that this does help to ensure many repayments are made on time, though its effect on overall repayment is less clear, since most members find such techniques distasteful.

Stuart

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DAY ONE SUMMARY

Post by: Nathanael Goldberg

Yesterday was a quiet day. Those of you who posted had truly valuable insight and commentary to share, so I am hopeful we can hear from more of you today and tomorrow.

Some of the interesting points from yesterday's discussion:

Pam reminded us that in addition to the social sanctions of group liability, the shame factor of group lending can be a social cost of default. And she asked whether bringing people together leads to social pressures toward conformity in loan use, whether or not borrowers are linked through contract liability. Linda said that while she hasn't found this pattern in her data on loan uses she agrees that group lending creates social pressure to avoid risky activities and has noticed that women in particular tend not to branch out into unknown areas, but cluster in a fairly narrow range of activities.

Linda also said group liability has already been abandoned by most of the groups she works with, and finds that typical repayment incentives such as repeat loans are more effective. Interestingly she thought this was especially true for unstable populations such as flood-prone areas.

Asif made a very interesting and provocative comment that ASA's success with individual liability was made possible by the culture of repayment already created by the Grameen Bank. He suggested that Grameen started with group liability for the efficiency of group lending and not for the social collateral of group liability. Asif believes repayment is kept high under Grameen II because it is the only cheap and reliable source of credit for the poor, and this agrees with Linda's point about repeat loans. Asif also cited the importance of the flexibility in Grameen II which allows borrowers to reschedule unpaid loans.

Finally, Hamdan reminded us that group lending can be important for furthering other social goals, such as empowerment and literacy training.

DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Nathanael Goldberg

The topic for today is Switching to Individual Liability. Presumably some of the people signed up for this discussion are considering making the switch for their institution, and I would like to tap our collective wisdom to help them with their decision. And if they decide to go for it, to provide some pointers to guide them along. Below are some specific points you might discuss, but feel free to add your own! Where MFIs have made the switch, what were their experiences?

- did repayment rates change? what steps were taken to maintain high repayment?

- did client retention improve?

- any regrets?

Have any of you received outside training on this (e.g., from ASA)?

- what were the most valuable points learned from the training?

- what would you add?

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Amy Davis Kruize

Dear Colleagues,

I would like to insert the issue of poverty levels of both group and individual loans, which I did not see mentioned so far. My question is--are MFIs moving away from the poorer when they begin to implement individual loan products? It seems to me that group lending "used to be" a very effective way to serve the poorest in both semi-rural and rural areas, especially as an entry point. Groups were used to efficiently organize, train and assess poorer clients. My observation is that as EITHER clients evolve into larger loan amounts, OR as MFIs drift away from the poorer clients, that individual loan products are introduced. The first scenario seems a logical flow--poorer clients are successfully using larger amounts and eventually "graduate" to larger loans. Group liability truly becomes risky when members have loan amounts on opposite ends of the spectrum, etc.

However, the second scenario is when the MFI decides that the poorer are too risky or non-profitable and move to "less poor" or "non-poor" and offer a larger individual loan product (if they actually are measuring poverty levels and not just repayment rates linked to average loan sizes).

Do we have data on whether the group liability works better for the poorer/poorest and/or if individual liability works better for better-off clients?

All the best,

Amy

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RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Zvi Galor

I appreciate very much your mail and the points you raised. I have some observations to make.

On 13/12/2006, at 18:37, Amy Davis Kruize wrote: “It seems to me that group lending ‘used to be’ a very effective way to serve the poorest in both semi-rural and rural areas, especially as an entry point. Groups were used to efficiently organize, train and assess poorer clients.”

I don't think that group lending or individual lending were and are effective way to serve the poorest, and this is by the essence of the understanding of the MFI.

If I understand well, MFI is coming to provide, mainly and almost only, finance to poor persons, which are getting this finance via group or individually, in order to enable them to be uplifted from poverty.

MicroCredit exists already more than 25 years and MFI, the more "politically correct" term exist already enough years, and according to the various figures they have approach only very small minority among poor in our world.

In their nature they are not efficient. It is not because poor are not in need of finance. It is because poor needs much more than only finance, and I have detailed it in previous mails to the conference. The basic paradigm of MFI is that if we shall be able to provide to the Poor finance the poor would be able to utilize this finance in order to create a small enterprise or a small business, which will bring the poor out of poverty.

We know from our Western world that most people are not business savvy. Only minority, women and men are able to create to run and to succeed in this endeavor. Why should it be different in the world of the Poor.

Most people, if not all, women and men, want to get out of poverty. Most people are unable to do it even if we shall supply them with the necessary finance.

Only short example: Poor farmers would be very happy to get finance which would enable them to improve productivity. But, if to the provision of finance, there would be no provisions for cheap inputs and rewarding marketing, the poor farmer would fall once again in the hands of the middlemen and the trader who will subtract from this farmer any possible positive results.

Regards, Zvi

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Getaneh Gobezie

Dear colleagues,

I think there can be stages where both group and individual liabilities may be appropriate. For those aiming at reaching poor people, and really poor people who have been isolated or marginalized from any development in the past, the individual approach would be much less appropriate. For people under such contexts, it is not just that they don't have good business ideas of their own, it is also that they may not have any previous 'contacts' with the external development interventions (government, NGO, etc prorammes), and it would be much more convenient for them to 'test' such new programmes 'jointly' than individually. Think of very poor communities, poor people in isolated villages, and women there! Group liability would certainly ensure mutual learning and peer monitoring, thus ensuring better repayment records.

However with repeated loan cycles, members would have better contacts with the external world, not just with the microfinance programmes, but also with other BDS and skill programmes, marketing, etc, and their individual enterprise (and thus the loan size taken) would grow. Taking liabilities for 'bigger loans' would not be taken as easily as for smaller loans by members. And such growth may not occur at the same rate for all group members. Enterprise growth (and hence loan size taken) would be faster for some, and not for others. This would tend to weaken homogeneity of the group. While at the same time some members would have already developed 'assets' which might be sufficient for a collateral (alternative, non-traditional 'collaterals' may also need to be developed and adopted -- the 'warehouse receipt' system, for instance). Thus many would opt for 'individual' liability. This may be the time to start the individual liability, individual lending, programme. Repayment would not face many problems since clients' history is well known by the MFO, since they have been with the programme, and the 'trust' factor has already been developed. We have passed through such stages already.

Getane
tution (ACSI)
ETHIOPIA

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Diego Fernandez Concha

My name is Diego Fernandez Concha from PRISMA - Peru. Thank you for invite me to participate.

PRISMA has both methodologies. In our case in problematic areas (coca production areas and terrorism areas) were grouping is dangerous, individual lending is the methodology. In this case, because we have connections with the communities we can ask leaders if these individuals are good or bad payer o good persons! In small towns every one knows everybody.

Group lending required from the confident of the all group members and the loan officer has to work in strengthening the village banking as an organization. If the group is not strong enough all the group can default. Additionally if there are problems in the management of the internal account you will have 20 defaults. But if the loan officer can management well its delinquency rate it's almost 0%. But we have to take care of exceeds of familiarity between loan officer and the clients, because they can think that they received a credit because of the loan officer and not because of the institution.

Both methodologies have good and bad things. The institution has to be confident in management one or both. One problem we had was when we tried that one loan officer management both. The problem was that the loan officer developed clients in the methodology he o she filled more comfortable and change all the clients in one, but not necessarily was the methodology for the target population.

I will invite Iris Lanao from FINCA Peru because they are in a very interesting process to start using instead urban FINCA village banking methodology a rural hybrid individual grouping methodology. I think she will enriched the discussion.

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Zvi Galor

Hello,

I think that it is important to note that when discussing the issue, in my experience, group lending and liability is more suitable to very poor population, to which no previous experience has been gained. Individual liability can work with population which has already experience, not only with cycling previous loans, but also who were able to start and create their own, micro-business or micro-enterprise.

But, I think that another aspect should be considered when dealing with the issue of group liability. The point which was not discussed and was not raised, not only in this conference but also in other occasions, is the issue of to which direction goes the loan and what accompanied the loan.

I'll try to explain:

Group lending, to which attached the issue of group liability, may goes towards:

- to a group which get a loan on behalf of group members, then the loan is divided among the members of the group. Another variant is that the loan goes to one of the members of the group and the group liable to this loan.

- to a group which is getting the loan on behalf of the members and with their liability to create an enterprise or a business from where they may get employment and income.

Another point which is rarely discussed is the issue of giving loans or more than loans. In other words, is lending money, even to those who have recycled their loans already, only, is sufficient to help poor people to be able to get out of poverty.

My answer is that this is not enough. More and more views of this character are appearing on the net. In the Western world, when one is getting loan to create a business, in most cases, this person is required to present a business plan which comprises, first of all, the ability to run the business, the know how. This person should present the ways the inputs to the business would be available, and which outlets and marketing would be available to the person to enable the person to get the highest possible results from the business.

The marketing outlets are a way and a technique to create a form of liability to those benefiting from loans, especially when it is on a group basis.

Regards

Zvi

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY
Post by: Nathanael Goldberg

Thanks to Stuart and Diego for their comments this morning. Apologies that I was unable to incorporate them into the summary from yesterday. However, let's use this to our advantage and try to kick off today's discussion by following up on their points.

Diego mentioned using village leaders to help screen individual-liability clients, and potential problems with using the same loan officers to manage both group and individual clients.

Stuart mentioned tiny frequent payments and "meeting day joint liability," whereby loan officers will take such measures as keeping clients waiting around until they pay or pressuring those that get a loan that day to repay for others.

Such tactics would likely keep default down, but one of the key reasons for individual liability is clients prefer it, and this type of practice would surely diminish their satisfaction with the product.

-What do you think: can individual liability be implemented successfully without this type of tactic? Are there other solutions clients find less distasteful?

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Stuart Rutherford

Hello, this is Stuart Rutherford. On the question of the transition from joint to individual liability and the examples of ASA and Grameen II, remember that in their cases the transition was gradual and is incomplete. Moreover, neither of them ever enforced joint liability as rigorously and harshly as I have seen it done in, for example, East Africa. In Bangladeshi microfinance much is left to the discretion of the front-line workers, who have great freedom in interpreting rules: clients are rarely given clear printed up-to-date statements of product rules. So you will still find some workers trying to enforce some aspects of joint liability - perhaps by levying a tax of a few pence on each newly issued loan until a loss incurred by an absconding borrower is made up.

I am also interested in the discussion of joint versus individual liability for the very poor. In the Bangladesh case I am in no doubt of the following:

1. that conventional microcredit through groups was not good at reaching the very poor because of self exclusion and exclusion by workers and current members

2. that the more flexible recent versions of Bangladesh microcredit, such as Grameen II, are more successful at reaching the very poor because their products can be conveniently used for everyday money management as well as for microenterprises, and

3. in the experiment we are running in SafeSave, which deals only with individuals and never uses groups, many of our poorest clients tell us that not having to be exposed to the pressures of the group is one of the reasons (though by no means the most important) for their choice of SafeSave as their provider.

Best wishes, Stuart

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Linda Mayoux

In response to Stuart and Getaneh's points:

1) Getaneh, it is important not to assume that joint liability leads to any sharing of experience. The sharing of experience comes if there are people who are already experienced in business and want to share their experiences (which cannot be assumed in a competitive market situation) and/or if the programme has some useful methodology for stimulating sharing of ideas and experience (eg the PALS methodology I mentioned in my first E-mail) and/or a training programme. Otherwise experience suggests that no one wants to sit around in groups when they have better things to do - especially busy women.

2) My experience talking to women and men in different programmes is also like Stuart's that people prefer to be responsible for their own finances. Not tied up with other people through group liability and all the potential for ruining social relations that this entails either for those who have problems and cannot repay, or those who repay and have to badger other people for their repayment.

3) Some groups have explicit rules not to admit people who have either problems within the household or the very poor. Very sensible if you are struggling to make ends meet yourself and don't want the burden of accounting for others.

It is however very possible, as Grameen is now doing and what I have been advising for a long time, to have individual liability reinforced by loan conditions to encourage repayment with groups to help programmes identify potential clients and also help with physical delivery of credit and repayments eg in rural areas where this can be very expensive.

People I speak to do not enjoy boring savings and credit meetings, but many do enjoy social gatherings and there is a big demand for training, particularly from women. But programmes need to have more cost-effective and sustainable training/mutual learning methodologies.

Programmes I am working with have also been using a Tool called the poverty diamond to identify people in the community who are extremely poor, but outside the group and design methodologies to help them in eg giving a starting loan so they can contribute savings or lowering the entry savings requirement.

So it is perfectly possible to have the cake and eat it – individual liability with the benefits of groups. But we need to stop making assumptions about any automatic connection whatsoever between group liability and any sort of empowerment.

The main point of my first message was that there needs to be much more innovation in participatory methodologies to enable groups to develop their own learning and action strategies to develop income-generation and enterprise strategies which really improve livelihoods and help to diversify the local economy.

Linda

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Getaneh Gobezie

Hello again from Getaneh,

Linda, I don't think you have read what I said carefully. You assumed what you think I meant! I didn't say that poor clients do share 'skill' in group. It is very clear that they don't have this, and this is also 'competition', and skills cannot be easily shared to a competitor. My intention was to emphasize the courage that poor people would have when they come in 'group' [than individually] when they first face the external world: I mean any development intervention from Gov't, NGOs, etc. That is why they are living in groups in the first place, and there are several forms of informal, mutual support, groups which survived many years.

Secondly, although poor people don't have immediate "marketable" skills that can be shared, it doesn't mean that they don't have anything at all that can be shared. Some are more able to easily communicate with external people [microfinance people, other experts, etc] than others. This ability will greatly support the others who might not have that-- shy people, I mean.

I would be happy to hear more.

Getaneh
ACSI/ETHIOPIA

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Linda Mayoux

Hello again from Linda.

Yes my experience also is that extremely poor women and men have a lot to share and to teach. And sometimes courage does come through numbers and knowledge is shared easily. My experience also is that for many poor people groups formed by micro-finance programmes have been extremely valuable, providing staff are respectful of peoples' time and not patronising in assuming people are not already meeting and networking. And take the time and trouble to find out about the context and local culture - even local staff from the same village often make assumptions about people from different backgrounds, about women etc.

My worry is that this process can be blocked by the mutual liability for loans - people may be less open if access to a loan depends on the information they give because others are dependent on their repayment.

For this sharing and learning process to make a real difference -over and above what women and men are doing anyway in their ROSCAs, village meetings or gossip networks - requires better skills and methodology to build on the groups as a basis for collective action to change things which can be changed. Otherwise people get tired of meetings because they do not lead anywhere.

In particular within communities the less shy often need to learn skills to encourage others to speak. This is particularly true where women and men are in the same group, but also between women and between men.

Linda

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Ole Dahl Rasmussen

Dear All,

Thanks for an interesting discussion. I'm Ole Dahl Rasmussen, Denmark. I am not sure whether the specific debate below is now out-dated, but I'll try with a couple of questions in any case:

If group liability generally is a bad idea because people wants to manage their own finances, and if knowledge sharing in groups does not necessarily occur then I wonder:

1) Why does the Grameen II keep the social part of the group principle? And...
2) How do you make people pay back when there is no guarantee? I have just done field work in Benin, and here the entire sector had an "either material security or group"-approach. Would monitoring and training alone do the trick, or is this question to context dependent to have a general answer?

Although I've never studied Grameen firsthand, I had the impressing that the groups here helped putting a symbolic, but effective, moral pressure on the borrowers thereby reducing voluntary default. If the groups do not perform this function, then what does?

Ole

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Hamdan Goumaa

I believe individual liability still exists in group lending. Unless this term (individual liability) is created/invented to mean abolishing group based lending in favor of market oriented i.e. free market and privatization of Micro-finance. This will eventually - as many participants in this discussion indicated- lead to neglecting other important developmental objectives served by groups.

Another important aspect is related to the fact that now micro-loans become a tool for enabling programs directed towards helping communities emerging from conflicts or war and constitute perfect entry point to address other needs.

Hamdan Goumaa

RE: DAY TWO: SWITCHING TO INDIVIDUAL LIABILITY

Post by: Amy Davis Kruize

In my experience, sharing, learning and solidarity of groups needs to be intentional and provide value to the members. Many MFIs have forgotten that the facilitation of the group to use the time, and each other, effectively can be a solid foundation for lots of things, including guarantees, mutual support and empowerment. When meetings turn into a cashier's window then these aspects are eliminated. However, one challenge is to not waste member's valuable time. I agree that just convoking a meeting will not enable groups to benefit from being together; rather it is the intentional facilitation and creation of a productive relationship among the members, either by the MFI staff or leaders in the group. Additional interventions or services must also be vetted with the group and can be provided through strategic alliances or directly by the MFI.

All the best,

Amy

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DAY TWO SUMMARY

Post by: Nathanael Goldberg

Yesterday we were fortunate to have Zvi and Amy keep us on mission by reminding us to consider poverty levels and not just repayment rates. Amy noted that individual lending products can be introduced either when successful clients graduated into individual loans or as MFIs drift away from serving poorer clients. She asked whether we have data that group liability works better for poorer clients or individual liability works better for better-off clients. Zvi thought group liability is more suitable for poor populations though he doesn't believe microfinance by itself in any form is suitable for the poorest.

Getaneh argued group liability is more suitable for poorer clients because it allows marginalized populations to share risk. Linda countered, however, that it is important not to assume that joint liability leads to any sharing of experience.

Regarding the transition from group to individual liability Stuart noted that in the case of ASA and Grameen II the transition was gradual and even incomplete. Following up on his point from Tuesday's discussion he noted that much discretion is left to the loan officers who use various methods to ensure repayment. Regarding serving the very poor Stuart argued that, at least in Bangladesh, group liability indeed led to exclusion of the very poor, both through being screened out by other clients and loan officers, as well as through self exclusion. He said the individual-liability products are more successful at reaching the very poor because the products can be conveniently used for everyday money management as well as for microenterprises. In the case of SafeSave he said often their poorest clients tell them that not having to be exposed to the pressures of the group is one of the reasons for their choice of SafeSave as their provider, and Linda's experiences agree. She called for more innovation in participatory methodologies; one example she provided is a system to identify people in the community who are extremely poor, but outside the group, and to design methodologies to help them, such as giving a starting loan so they can contribute savings.

And that leads us to today's discussion where we will talk about innovations in liability.

DAY THREE: ARE THERE ALTERNATIVE OPTIONS?

Post by: Nathanael Goldberg

For the final day of the e-conference we would like to discuss what alternative options to traditional group or individual liability may exist. Some of the various possibilities are listed below. I have thrown in some potential discussion questions below each topic. Feel free to suggest more questions, and if you have any innovations around liability options please share them with the group!

1. Structure of liability:

a. Group/Center liability - making group members liable only up to a point, above which the center is responsible

b. Proportional liability - making clients liable only for the proportion of their loan in the total group loan

- Are there advantages to spreading liability over a greater number of borrowers (i.e., the center rather than the group, as in village banking)

- What division of liability between the group and center works best?

- Can proportional liability help poorer clients to participate in group liability by limiting their responsibility for covering fellow group members' larger loans? Has this been tried?

2. Collateral substitutes: items of collateral (e.g., household assets) which have value to the borrower but have limited resale value

- Can collateral substitutes ensure high repayment in an individual-liability setting without screening out the poor?

3. Graduating clients: transitioning successful clients from group lending to individual lending

- What is the appropriate point to move clients out of group lending into an individual loan product?

- How does this affect the efficiency of the program?

DAY THREE SUMMARY

Post by: Nathanael Goldberg and Dean Karlan

Because of a few last-minute posts this morning we let the meeting run on a bit but now it is time to bring the Speaker's Corner on Group vs. Individual Liability in Microfinance to a close. I think Amy's comments will serve well as the last post, arguing that group sharing, learning and solidarity needs to be intentional and provide value to the members but MFIs must also not waste members' valuable time.

Linda, agreeing with Getaneh, finds that the very poor have a lot to share and teach, but she worried that the sharing process can be blocked by joint liability. I should add that in the Philippines we found that under individual liability new entrants to the program had closer ties to prior members, which suggests that under group liability, clients' fear of peer pressure kept them from bringing people into the program.

While you were a relatively quiet bunch I do believe we favored quality over quantity. We were lucky to have among us experts with a wealth of experience in microfinance, and my hope is the relatively small number of posts allowed participants plenty of time to appreciate what each of us had to say. I hope the rest of you found the discussion useful.

Dean and I would like to thank each of you for participating. If any of you would be interested in testing out group vs. individual liability with your institution, in a manner similar to what we described on day one, please be in touch.

Sincerely,

Nathanael and Dean

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