

Group Versus Individual Liability: Long-term Evidence from Philippine Microcredit Lending Groups

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Group liability purports to improve repayment rates through peer screening, monitoring, and enforcement, helping to overcome information asymmetries and reducing the lenders' risk of lending to the poor. However, group liability carries its own concerns, including decreased retention of good clients who are forced to pay when other group members default. In this paper, researchers employ two field experiments to test the overall effect of individual liability lending, as well as specific mechanisms. They find that compared to group liability, individual liability does not affect the repayment rate, despite evidence of decreased monitoring. For groups in pre-existing lending areas, there was an increase in group size and retention after three years. In previously unreached areas, individual liability led to increased client retention but fewer borrowing groups formed.

Removing Group Liability

The trial was undertaken on the island of Leyte, where the Green Bank of Caraga participated in two trials to test the impacts of a conversion to individual liability. Initially, researchers randomly reassigned half of the 169 existing bank centers (3,343 clients) to individual liability, thus removing a borrower's liability for any default other than her own. All groups in this first trial were comprised of pre-existing clients who had already agreed to borrow under the group liability methodology. By "surprising" some clients with the new individual liability model, the researchers hoped to isolate the effects of adverse selection (borrowers more likely to default choose group liability) from those of moral hazard (once in a group liability setting, default becomes more attractive). A second trial sought to evaluate the overall effects of individual liability policy on the formation and behavior of borrowers by focusing only on new borrowing areas. In this trial, new villages to which the bank was only first entering were randomly assigned to receive offers of either only individual liability, only group liability, or phased-in group liability loans.

Results

Results indicate that neither converting borrowing groups from group liability to individual liability nor offering individual liability to new groups affects repayment rates. While the conversion to individual liability implies a reduction in peer pressure (though payments were still made in a group setting), the potential increase in pressure from the bank to repay seems to net out these effects. Repayment, however, is not the only outcome of interest. In pre-

existing areas, individual liability centers were better at attracting new borrowers, leading to larger centers, and were also 13.7 percentage points less likely to be dissolved. Individuals at these centers, however, were slightly more likely to drop out. This contrasts with the behavior of borrowers in new areas, where those in individual liability centers were less likely to stop borrowing. There are differing results for pre-existing and new areas when it comes to the activities of loan officers, as well. Loan officers in pre-existing areas did not allocate their time differently for groups according to the type of liability. Loan officers in new areas, on the other hand, did spend more time on repayment activities for individual liability centers, an average of 90 minutes more per week, and were less willing to open groups in individual liability areas. For borrowers in the first experiment, conversion also impacted the social composition and behavior of groups. In groups with individual liability, new members were more likely to know prior members well, but were less likely to know each other. Borrowers were also less likely to know who in their group had missed payments, and to predict who would miss payments in the future.

Policy Implications

The results suggest that the recent microfinance trend towards expanding the offerings of individual liability lending products may help deepen outreach and provide more flexible microfinance products for the poor, without increasing the risk of default for lenders. Still, as with all empirical research, replication in other contexts will allow a fuller understanding of where these findings hold and where they do not.