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Peer Monitoring and Enforcement:

Long Term Evidence from Microcredit Lending Groups with and without Group Liability*

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ABSTRACT

The group liability contract feature is often named as key to the growth in lending markets for the poor. Group liability purports to improve repayment rates by providing incentives for peers to screen, monitor and enforce each other's loans. However, group liability may create excessive pressure and discourage good clients from borrowing, jeopardizing both growth and sustainability. A Philippine bank removed group liability from randomly selected group-screened lending groups. After three years, we find no increase in default and larger groups, thus showing that banks can do just as well as peers at monitoring and enforcing loans and generating high repayment rates.

JEL: C93, D71, D82, D91, G21, O12, O16, O17

Keywords: microfinance, group lending, group liability, joint liability, social capital, micro-enterprises, informal economies, access to finance

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