

Group versus Individual Liability: A Field Experiment in the Philippines*

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May, 2007

ABSTRACT

Group liability is often portrayed as the key innovation that led to the explosion of the microcredit movement, which grew with the Grameen Bank in the 1970s and continues on today with hundreds of institutions around the world. Group liability claims to improve repayment rates and lower transaction costs when lending to the poor by providing incentives for peers to screen, monitor and enforce each other's loans. However, some argue that group liability creates excessive pressure and discourages good clients from borrowing, jeopardizing both growth and sustainability. Therefore, it remains unclear whether group liability improves the lender's overall profitability and the poor's access to financial markets. We worked with a bank in the Philippines to conduct a field experiment to examine these issues. Working with 169 previously formed group liability centers of approximately twenty women, we converted half to individual-liability centers (treatment) and kept the other half as-is with group liability (control). The weekly group meetings still occurred; only the group liability is removed. After one year, we find no increase in default and we find higher outreach due to more new clients joining the treatment groups.

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

Keywords: microfinance, group lending, group liability, joint liability, social capital, micro-enterprises, informal economies, outreach

*Contact information: xgine@worldbank.org, dean.karlan@yale.edu. We are grateful to the World Bank Research Committee and the National Science Foundation CAREER SES-0547898 for funding this research. We thank Tessa Bold, Jim Engle-Warwick, Karla Hoff, Kate Johnson, Jonathan Morduch, Mark Schreiner, Chris Udry, Bruce Wydick, Dean Yang, and seminar and conference participants at Berkeley, BREAD-AIID, Center for Global Development, Chicago-GSB, Economic Science Association, George Washington, Georgetown, Paris-Jourdan, UC-Santa Cruz, Stanford, Toulouse, Tufts, University of Washington, World Bank and Yale for comments. We thank John Owens and the USAID/Philippines Microenterprise Access to Banking Services Program team for helping us coordinate the project and the Office of Population Studies at University of San Carlos for collaborating on the field work. We also thank Tomoko Harigaya and Melissa Scudo for superb research assistance. We thank Omar Andaya, Gerald Guillen, Zaldy Mantilla, Monette Perez, and the field staff of Green Bank for implementing the experimental protocols.

I. Introduction

Microfinance is seen by many as a promising and cost-effective tool in the fight against global poverty (Morduch 1999; Armendariz de Aghion and Morduch 2005; Microcredit Summit Campaign 2005). Group liability, a contract feature found in many programs, is a common component in many microfinance programs. Many believe that this feature, because of its purported ability to overcome adverse selection and moral hazard problems, is a key innovation responsible for the rapid growth of the microcredit movement in credit markets for the poor. Its popularity can be linked to numerous perceived advantages. By making a group of clients liable for each other's loans, the lender can exploit local information to improve the screening, monitoring and enforcement. Under group liability, clients have an incentive to screen other clients so that only trustworthy individuals are allowed into the program. In addition, clients will make sure that funds are invested in profitable enterprises. Finally, enforcement is enhanced because clients face peer pressure, not just legal pressure, to repay their loans. Thus, by effectively shifting the responsibility of certain tasks from the lender to the clients, group liability claims to overcome information asymmetries typically found in credit markets, especially for households without collateral.

In recent years, however, some micro-lenders, such as the Association for Social Advancement (ASA) in Bangladesh or the Bank Rakyat Indonesia (BRI), have expanded rapidly using individual liability loans. Others, like BancoSol in Bolivia, have converted a large share of its group liability portfolio into individual liability lending. Even the Grameen Bank in Bangladesh, whose founder Mr. Yunus won the 2006 Nobel Peace Prize, has recently relaxed the group liability clause in the Grameen II program by allowing defaulters to renegotiate their loans without invoking group pressure. Many of these groups (e.g., ASA) have made this shift while still

keeping the “group” intact. Thus, while *liability* is individualized, the group process helps lenders lower their transaction costs (by consolidating and simplifying loan disbursement and collection logistics) while possibly maintaining some but not all of the peer screening, monitoring or enforcement elements due to reputation and shame. The shift to individual liability is not merely the Grameen Bank and a few other large, well-known lenders, but many lenders around the world are following the lead of the large, well-known lenders. Many policymakers have been advising lenders who seek to expand more rapidly (such as the Green Bank of Caraga, with whom we conducted this field experiment) to engage in individual lending rather than group lending.

This shift from group liability to individual liability loans has accelerated as the microfinance community learns about some of the pitfalls of group liability lending. First, clients dislike the tension caused by group liability. Excessive tension among members is not only responsible for voluntary dropouts but worse still, can also harm social capital among members, which is particularly important for the existence of safety nets. Second, bad clients can “free ride” off of good clients causing default rates to rise. In other words, a client does not repay the loan because she believes that another client will pay it for her, and the bank is near indifferent because it still gets its money back. Third, group liability is more costly for clients that are good risks because they are often required to repay the loans of their peers. This may lead to higher dropout and more difficulty in attracting new clients. Finally, as groups mature, clients typically diverge in their demand for credit. Heterogeneity in loan sizes can result in tension within the group as clients with smaller loans are reluctant to serve as a guarantor for those with larger loans. In sum, while repayment may improve under group liability, the client base may be smaller, so it remains unclear whether group liability improves the lender’s overall profitability and the poor’s access to financial markets.

Despite being a question of first-order importance, empirical research on group versus individual liability lending has not provided policymakers and institutions the clean evidence needed to determine the relative merits of the two methodologies. The empirical literature instead has focused on related questions: which group characteristics, such as social capital, lead to higher repayment (Wydick 1999; Ahlin and Townsend 2007; Karlan 2007), or which program design do individuals choose (Ahlin and Townsend 2006). The basic question of the relative merits of group versus individual liability has remained unanswered because lenders typically chose the credit contract based on the context in which they operate. Since in practice most microlenders use one type of loan, it is hard to identify impacts from a cross-section of loan contracts if the different contexts have unobserved characteristics that influence its choice. Morduch (1999) and Armendariz de Aghion and Morduch (2005) point out in their microfinance reviews that the performance of group liability contracts in developing countries indeed has been very diverse.¹ Thus far, however, since most claims are supported with anecdotes, we still lack good evidence on the relative importance of group liability *vis a vis* the other mechanisms, such as dynamic incentives, regular public repayments, etc. found in “group lending” schemes. Quoting Armendariz de Aghion and Morduch (2005),

“The best evidence would come from well-designed, deliberate experiments in which loan contracts are varied but everything else is kept the same.”

¹ See also Adams and Ladman Adams, D. W. and J. R. Ladman (1979). "Lending to rural poor through informal groups: A promising financial innovation?" Savings and Development 2(3): 85-94. and Desai Desai, B. M. (1983). Group lending in rural areas. Rural financial markets in developing countries: Their use and abuse. J. D. von Pischke, D. W. Adams and G. Donald. Baltimore, Md., U.S.A., Johns Hopkins University Press: 284-288.. On anecdotal evidence on the limits to joint liability, see Matin Matin, I. (1997). "Repayment performance of Grameen Bank borrowers: The 'unzipped' state." Savings and Development 4., Woolcock Woolcock, M. (1999). "Learning from failures in microfinance: What unsuccessful cases tell us about how group-based programs work." The American Journal of Economics and Sociology 58: 17-42. Montgomery Montgomery, R. (1996). "Disciplining or protecting the poor? Avoiding the social costs of peer pressure in micro-credit schemes." Journal of International Development 8(2): 289-306. and Rahman Rahman, A. (1999). "Microcredit Initiatives for Equitable and Sustainable Development Who Pays?" World Development 27(1)..

This is precisely the goal of the paper. We use a randomized-led control trial conducted by the Green Bank of Caraga in the Philippines to evaluate the relative impact of group versus individual liability on client repayment and its overall profitability. Half of Green Bank's existing group-lending centers in Leyte, an island in central Philippines, were randomly converted to individual liability in three waves between August 2004 and May 2005. Using this conversion methodology, we are able to assess whether group liability (relative to individual liability with group meetings) is better at overcoming information asymmetries and has differential impact on access and use of credit.

The separation of adverse selection from moral hazard is one of the most difficult empirical challenges when studying information asymmetries in credit markets.² In this paper, we isolate the effects from moral hazard by "surprising" existing group liability member, already peer-screened under group liability. We therefore address the question of whether the shift to individual liability exacerbates moral hazard by focusing on existing clients. This allows for a cleaner test of theory, which is useful both academically and practically in the design of products. However, it also limits the immediate policy prescriptions since the treatment conducted here is not a viable long-term product for a lender. Individuals selected under group liability may be different (e.g., safer) than those selected under individual liability. Thus, while our study cleanly isolates moral hazard effects of group liability, it employs a sample of individuals selected through a group liability contract. We discuss this more in the conclusion.

Throughout this paper we maintain an important distinction between "group liability" and "group lending." "Group liability" refers to the terms of the actual contract, whereby individuals are both borrowers and simultaneously guarantors of other clients' loans. "Group lending" merely

² See Karlan and Zinman Karlan, D. S. and J. D. Zinman (2006). "Observing Unobservables: Identifying Information Asymmetries with a Consumer Credit Field Experiment." Yale University Economic Growth Center Discussion Paper 911. for a similar separation of adverse selection from moral hazard in credit markets.

means there is some group aspect to the process or program, perhaps only logistical, like the sharing of a common meeting time and place to make payments. The heart of this paper is testing whether the removal of group liability from a “merely logistical” group lending program leads to higher or lower repayment rates, client retention and to changes in group cohesion.

Whereas the literature has focused almost exclusively on the superiority of group liability in ensuring repayment, we find no change in repayment for those centers converted to individual liability. Yet, we find higher client growth in converted centers, and weak evidence (statistically) that it is due both to fewer dropouts and more new clients. We find direct evidence that individual liability leads to less monitoring of each other’s loan performance (although as noted, this lowered monitoring does not lead to higher default). Lastly, we find that those with weaker social networks prior to the conversion are more likely to experience default problems after conversion to individual liability, relative to those who remain under group liability. In sum, as conversions from group to individual liability become more commonplace, we take an important step towards understanding whether and how such conversions work.

The rest of the paper is organized as follows. Section II reviews the literature on group versus individual liability lending. Section III presents the experimental design and the administrative and survey data we collected. Section IV presents the empirical strategy and primary results on the impact of group versus individual lending on center and individual performance. Then, section V presents results from three surveys conducted one year after the initial conversion in order to learn more about the mechanism through which changes did or did not occur. Section VI concludes.

II. Literature Review

In a survey article, Ghatak and Guinnane (1999) summarize the literature by identifying four channels through which group liability can help institutions improve repayment: (i) *adverse selection*: ascertaining the riskiness of borrowers (Ghatak (1999; 2000), N'Guessan and Laffont (2000), and Sadoulet (2000)) or by the insurance effect that results from diversification even if borrowers do not know each other well (Armendariz de Aghion and Gollier (2000)), (ii) *ex-ante moral hazard*: ensuring that the funds will be used properly (Stiglitz (1990) and Laffont and Rey (2000)), (iii) *monitoring*: ensuring that the borrower tells the truth in case of default about her ability to pay, (iv) *voluntary default, or ex-post moral hazard*: enforcing repayment if the borrower is reluctant to pay (Besley and Coate (1995)). Group liability contracts in theory can lead to higher repayment because borrowers have better information about each other's types, can better monitor each other's investment, and may be able to impose powerful non-pecuniary social sanctions at low cost..

However, there are other stories that suggest that group liability may instead jeopardize repayment. For example, Besley and Coate (1995) point out that borrowers who would repay under individual liability may not do so under group liability. This situation may arise if members realize that they cannot repay as a group. In this situation, since (if rules are adhered to) no further loans will be granted, members that could otherwise repay decide to default because the incentive of future credit is not longer present. This model also demonstrates that social collateral can help make joint liability work better than individual liability (barring the strategic default situation mentioned above). However, Sadoulet (2000) argues that "social collateral" induced by group liability is not sufficient to ensure high repayment rates.

Even if group liability does not jeopardize repayment, theory also suggests it may do no better than individual liability. Rai and Sjostrom (2004) show that both individual and group liability alone can be dominated by a contract that elicits truthful revelation about the success of the peers' project. In their setup, high repayment is triggered by the ability of banks to impose non-pecuniary punishments to members according to their reports about their success and that of others. More importantly, if borrowers have the ability to write contracts with one another (i.e., side-contract), group liability contracts can be excessively burdensome.

Despite being the focus of much of the theoretical literature on group liability, repayment is only one outcome of interest to the lender, because its ability to retain good borrowers and attract new ones is equally important to assess the overall profitability. Indeed, an institution with perfect repayment may be more profitable with lower repayment but a larger client base. Madajewicz (2005) argues for instance that group liability is only desirable for poorer borrowers. In her model, all loans are backed by wealth but group liability loans create an incentive for choosing riskier projects. Lenders respond by limiting the loan size, and since the loan size is related to the wealth that can be pledged as collateral, below a certain level of wealth, group liability dominates individual liability. But above a certain wealth, individual lending will be preferred by customers. One implication is that better-off clients tend to seek individual loans as they move forward and indeed, many institutions that offer group liability loans are now offering new individual-liability contracts for successful clients. In a related paper, Conning (2005) uses another principal-agent model to explore when monitoring is best done by the lender and when it is best left to the peers. He also finds that wealthier clients prefer individual liability loans.

In this field experiment, however, neither group nor individual liability loans are backed by any form of physical collateral, so that the same borrowers can be subject to one or the other form of liability.

III. Experimental Design and Data Collected

A. Experimental Design

The Green Bank of Caraga, a for-profit, family-owned rural bank operating in central Philippines, conducted a field experiment in which they removed the group liability component of their Grameen-style³ group liability program, called BULAK.⁴ Typically a center starts with 15-30 individuals residing in the same barangay (community). Centers grow in size as demand increases, without predetermined maximum sizes. Within each center, members divide into groups of five. Under the normal group liability system, those in the group of five are the first layer of liability for any default. Only if those five fail to pay the arrearage of an individual is the center as a whole responsible for an individual.⁵ New members joining an existing center are also assigned into groups after mutual agreement is reached. If at one point in time there are enough new members to form a new group of five, they may do so. Across the central Philippines, Green Bank has over 12,000 clients in over 400 BULAK centers in 27 branches. This study was conducted on the island of Leyte, and all 169 centers on the island were included in the sample frame.

³ This is a Grameen “style” program since the bank conducts some basic credit evaluation, and does not rely entirely on peer selection. The bank’s evaluation steps include essentially two components: physically visiting the business or home to verify the presence of the enterprise and its size, and an assessment of the repayment capacity of borrowers based on the client-reported cash-flows of their enterprise.

⁴ Bulak means flower in Tagalog, but is also the acronym for Bangong Ug Lihok Alang sa Kalambuan, which means “Strive for Progress.”

⁵ Although many institutions that have this two-tier structure on paper do not enforce it in practice, Green Bank does enforce it. The payment of all members in a group is collected by the credit officer from group officials at the meetings. In addition, group members sign as co-makers for the rest of group members, thereby becoming the first to be liable if another group member is in default.

All loans under the BULAK program are given to microentrepreneurial women for their business expansion. The initial loan is between 1,000 - 5,000 pesos (roughly \$18 - \$90).⁶ The increase in loan size depends on repayment of their last loan, attendance at meetings, business growth, and contribution to their personal savings. The interest rate is 2.5 percent per month, calculated over the original balance of the loan. The client has between 8-25 weeks to repay the loan, but payments must be made on a weekly basis during the center meeting.

As part of the BULAK program, clients are also required to make mandatory savings deposits at each meeting. At loan disbursement, each member deposits 100 pesos plus two percent of the loan amount into savings. In addition, each member must pay an additional ten percent of their weekly due amount (principal plus interest) into their individual savings account. Member savings may be used to repay debts and also act as collateral, although in this last case there are no fixed rules. Finally, 10 pesos (\$0.18) per meeting are required for the group and center collective savings account. The center savings cover mostly the construction of the center meeting building (a small house or hut in the village) and other center activities, or as a last resort to repay member loans if the center is being dissolved and default remains.⁷ The group savings is held as collateral to cover arrearage within each group.

In the experiment, the Green Bank randomly converted *existing* centers with group liability loans to individual liability loans. All other aspects of the program remain the same (including attendance at center meetings and weekly payment made in groups).⁸ Hence, the only two features that changed are the group liability and the savings rules.⁹ By removing the group liability, no

⁶ Based on exchange rate of 56 Philippine Pesos = 1 US Dollar.

⁷ In our observation, this never occurred.

⁸ It is useful to note that although the choice was effectively voluntary (a group could, if they wanted, complain about the switch and remain with group liability), not a single group complained. Quite to the contrary, researchers typically observed groups clapping when the announcement was made.

⁹ All other loan terms remained the same in both treatment and control groups, including the dynamic incentives, the interest rates, the lack of collateral, the length of the loan, the frequency of the payment, etc.

member is held liable for another member's default. Thus, members are no longer forced to contribute towards the repayment of other members in default and they are no longer required to sign as co-maker of loans for other group members. If Green Bank had enforced a stricter group liability rule, the change to individual liability would also have entailed the issuing of new loans when other clients were in default. In practice, however, loans were already being issued to clients in good standing even when other individuals were in default.

It is important to note that although this change removed the group liability rules, it did not remove all social influences on repayment. Group payments were still done at the weekly meeting. Although after the conversion group meetings did not include a discussion or review of who was in default, the fact that all were at the meeting provided ample opportunity for people to learn of each other's status. Thus, many clients may still repay not out of social pressure, but rather out of concern for their social reputation. One's reputation is important, for instance, in order to secure informal loans in the future from their peers, outside the scope of the lending program.

The second component of the treatment involved the savings policy. The group and center savings were dissolved and shifted into individual savings accounts. The total required savings deposits remained the same.¹⁰ With the conversion of group and center savings into individual savings, there no longer were funds set aside to pay for center activities. Thus, all center activities in treatment groups were to be paid for out of individual accounts on a per-activity basis.

Critical to the design is the fact that treatment centers were converted from existing centers, and not newly created. By comparing the repayment behavior of *existing* clients in group-liability

¹⁰ The new Personal Savings quota will be the previous amount of Personal Savings (based on the loan amount), plus P20, the amount previously given for Center and Group savings.

centers and converted centers, we are able to isolate the impact of peer pressure imposed through group liability.¹¹

Our sample includes 169 BULAK centers in Leyte, handled by 11 credit officers in 6 branches. Among these, 161 had been created before August 2004, when the experiment started. Green Bank's main competitors are NGOs (such as TSKI) which mostly offer group-liability loans and cooperatives (such as OCCCI) which offer individual liability loans. At the time of the first conversion, about 28 percent of the existing centers were located in barangays with no other competitor, 53 percent of the centers were in barangays with at least one NGO and 47 percent of the barangays with Green Bank presence had at least one individual liability lender.¹²

Figure 1 shows the timeline of the experiment and data collected. In August 2004, we implemented the first wave of conversions in 11 randomly selected centers (1 center per field officer). Three months later, in November 2004, we randomly selected 24 more centers to be converted to individual-liability (wave 2). In the sample frame for this randomization, we included 8 additional centers formed after August 2004. Finally, nine months after wave 1, in May 2005 we randomly selected 45 more centers from the 125 remaining (wave 3). As of January 2006, the final month for which we have administrative data, there are 78 converted centers and 86 original (group-liability) centers (2 converted and 4 original centers were dissolved in the past 12 months). Conversions were done in these three waves because of operational and repayment concerns. Credit officers were initially unwilling to be responsible for more than one individual-liability center until successful repayment was observed. In order to minimize the pressure on the credit

¹¹ We also analyzed the impact of selection by comparing the performance of clients who joined three months before conversion to those that joined three months after. We found no significant differences in repayment, savings and loan size. Because the sample size of new entrants is rather small, and because the analysis is less clean as it relies a before versus after comparison (not an experimental comparison), we do not report these results.

¹² We run separate regressions for barangays with individual liability lenders and barangays with group liability lenders. The results do not differ significantly from those of Table 5 using all barangays and thus are not reported.

officers, and to assess early results to ensure default did not rise substantially, the conversion was completed in three waves.¹³ We stratified the randomization by credit officer in order to ensure all credit officers had the same proportion of treatment (converted) and control centers. Since there were only 11 credit officers, the stratification was done both to ensure a fair implementation across credit officers in terms of potential workload and risk and also orthogonality with respect to credit officer characteristics. In addition, we periodically checked with credit officers and conducted surprise visits to center meetings and clients' homes to confirm that converted centers had individual liability and that control centers had group liability.

B. Data Collected

We use data from five sources. First and most importantly, we use the Green Bank's full administrative data on repayment and savings, loan sizes and client retention rates for all 3,272 clients who were active members of the 161 centers at the time of the first randomization in August 2004, as well as the 8 new centers opened after August 2004. We have data from one year prior to the first wave of the experiment and 9 months after the last wave of experiment, thus enabling us to incorporate center-level fixed effects in our analysis. Second, we use data from an activity-based costing exercise that credit officers conducted, where for a given week, they had to keep a log of how they allocated their time across the different tasks they typically perform (e.g., attending meetings, assessing new clients, enforcing repayments, etc). Third, we use a baseline survey conducted in November 2004 regarding the social relationships in the treatment groups as well as control groups. Fourth, we use data from a follow-up survey on social networks, conducted in January 2006. Finally, we use a survey of clients conducted in November 2005 (over one year after the start of the experiment) designed to understand the observed differences between converted and control centers. We employed stratified random sampling from 1) baseline clients,

¹³ Note that increased default is not necessarily bad for the bank, since the bank cares about profits not merely default.

2) new clients who joined the program over the three months prior to the survey, and 3) clients who dropped out within the three months prior to the survey.

Table 1 presents summary statistics and some orthogonality checks that show that the randomization yielded observably similar treatment and control groups, when looking at the pooled treatment group. This holds when we examine group-level measures (Panel A) as well as individual level measures (Panel B).¹⁴

IV. Empirical Strategy and Primary Results

The experimental design described in Section III allows us to test several hypotheses that emerged above in the discussion of the relative merits of group versus individual liability. The primary goal is to measure the change in key variables that affect bank profitability, such as repayment, savings deposits held at the Green Bank by borrowers, loan size, and client retention and success attracting new clients. We conduct the analysis on the institutional outcomes at the cycle level and the center level. Our analysis uses the definition of the “treated” cycle as a loan cycle which matures after the conversion from group to individual liability. In other words, we consider loans that have any exposure to individual liability as treated cycles.¹⁵ In the next section we examine further hypotheses about specific mechanisms such as selection and monitoring, and changes in social networks.

Table 2 presents the primary results. Our empirical strategy takes into account the fact that not all centers were converted at the same time and that fifty percent remain in a control group throughout the study, and that we have administrative data from both before and after the

¹⁴ The orthogonality check verifies that the null hypothesis that there are no significant differences between the aggregated treatment and control groups cannot be rejected. When disaggregated, the F-stat in the last row of Panel B suggests that treatment centers across waves have average loans of different size as compared to control centers. The primary specification controls for center-level fixed effects, so as long as this difference is not indicative of a difference in trends rather than levels, this imbalance is resolved in the fixed effect estimation model.

¹⁵ Alternatively, the treated cycle could be defined as all loans released after the conversion. We have run regressions in Table 2 with this alternative treatment variable; however, the results do not vary significantly.

conversion. The primary specifications use individual level data, with standard errors clustered at the center level. The sample frame includes only clients that were borrowers at the time of each wave of the randomization. This allows us to focus analytically on the *ex-post* changes in behavior generated by group versus individual liability, holding constant a sample frame of individuals chosen under a group liability regime. We present the results of the three waves as if each were its own separate experiment (albeit sharing similar control groups¹⁶). This is done as such in order to account cleanly for any timing effects.

Specifically, we estimate a difference-in-difference (using pre-post and treatment-control data) model using OLS:

$$y_{igt} = \alpha + \beta T_{gt} + \delta_t + \theta_g + \varepsilon_{igt},$$

where the subscript i refers to the individual, g the group, and t the time period, T is an indicator variable if center g is under an individual liability regime at time t , δ_t are time fixed effects and θ_g are center fixed effects. Thus, β is the coefficient of interest.

Table 2 Columns 1, 2 and 3 show that the conversion to individual liability had no adverse effect on client repayment. Given that the default rate is very low, the impact of conversion can be seen as a one-sided test, where at best there is no increase in default. Not only is the point estimate close to zero, but most economically significant effects can be ruled out: the 95 percent confidence bound on default at the time of maturity (Column 2) is +/- 1.5% and 30 days after maturity (Column 3) is +/- 0.6%. Thus, we do not find strong enough evidence to support the “social collateral” story of Besley and Coate (1995) that predicts higher repayment for group liability loans

¹⁶ They only differ if membership in the center changes between waves, if for instance individuals leave or join after one wave and before another.

on average.¹⁷ However, as noted elsewhere, the “conversion” to individual liability does not remove all “social collateral” since repayment is still public, and someone may repay in order to protect their reputation in the community. Table 2 Column 4 shows that the savings behavior does not change after the conversion. One may have expected higher savings in individual liability since the savings deposits were not held as collateral for other people’s loans, the expected return on savings is higher under individual liability (assuming there is some default in expectation under group liability).¹⁸

Of course, the conversion to individual liability does imply both a reduction in peer pressure and a potential increase in bank pressure to repay. The empirical analysis addressed above concludes that the net effect is nil.¹⁹ To confirm that in fact the conversion was adhered to and group liability was not imposed in the treatment centers, we ask current members the reason why others dropped out. Appendix Table 1 shows these results. Under individual liability, individuals are less likely to be forced out of the center in net (column 1), but importantly Column 2 shows that individuals are less likely to be forced out by their peers and more likely by the credit officer.

We observe a (weak) reduction in loan size (Table 2, Column 5), significant statistically only for the second wave of the experiment although the point estimates for the other waves are similar in magnitude. The decrease is significant economically: an 894 peso reduction is 14.2% of the average loan size of 6,380. The bank reported to us that this drop is due to mainly two reasons. First, individuals were withdrawing their individual savings (since they are no longer held in “communal” savings accounts as joint collateral) rather than borrowing in order to obtain the

¹⁷ Below, we will examine heterogeneous treatment effects where we will find evidence for social collateral mattering for those with stronger levels of social networks. On average, however, the net effect is that repayment is not higher under individual rather than group liability.

¹⁸ This assumes the substitution effect is larger than any income effect in terms of the elasticity of savings with respect to return.

¹⁹ In results not shown, we further tested whether centers with less experienced credit officers performed worse under the conversion to individual liability. We found no differential effects based on the tenure of the credit officer. Results are available from the authors.

needed cash for their enterprise. Second, credit officers were stricter on loan sizes under the individual liability in order to protect the repayment performance of their centers.²⁰

Table 3 shows the results for Table 2, but pooled in one regression. The results mimic those of Table 2, showing no effect on default and savings, and lower loan sizes. Note that these specifications include new entrants to the program and separate estimates of their treatment effects. We do not find any consistent patterns on differential effects between preexisting and new clients.

Table 4 uses a Cox proportional hazard model to estimate the likelihood of dropout in each given time period. We find a statistically significant effect for the first wave of experiment. This effect, however, is not consistent across three stages of the experiments. When we examine heterogeneous treatment effects we find that those with a prior history of missing payments and those with larger loan sizes are less likely to drop out. This implies that while on average individual liability lowers drop out, it does so by changing the composition of the clients in the program. We will discuss the net effect on profitability below.

Table 5 examines the main outcomes at the center level. We estimate the following specifications using OLS:

$$(1) y_{gt} = \alpha + \beta T_{gt} + \delta_t + \theta_g + \varepsilon_{gt},$$

where y_{gt} is either the proportion of missed weeks, center size, retention rate,²¹ new accounts, number of dropouts or center dissolution for center g at time t , δ_t is an indicator variable equal to one for time period t (time fixed effect), θ_g is a center fixed effect, and T_{gt} is an indicator variable equal to one if group g at time t had been converted to individual liability. The time fixed effects refer to three-month time periods. Since loans begin at different times, there is no obvious time

²⁰ Unfortunately, data are not available on savings withdrawals in order to test the first hypothesis empirically. In support of the second reason, credit officers confirmed in interviews conducted in January 2006 that they were being more careful when determining loan sizes of clients in converted centers.

²¹ The retention rate between t and $t+1$ is defined as the percentage of clients at t that are still clients at $t+1$.

period to use. The coefficient of interest is β . We test whether the liability rule matters by examining whether the coefficient β is significantly different from zero. Notice that we use information from *all* clients who belonged at some point to the center between August 2004 and January 2006.

We find that individual liability is much better at attracting new clients (Column 4), leading to larger centers (Column 2) and that individual liability makes existing centers 10% points less likely to be dissolved (Column 6).

V. Additional Results on Specific Mechanisms

We now turn to three sets of auxiliary data. First, we examine the results of two activity-based costing exercises completed by the credit officers in order to measure the change in their allocation of their time across centers. Second, we examine the results of a client follow-up survey conducted in November 2005 (over one year after the initial conversion) on clients in both the treatment and control groups. This survey includes several questions intended to tell us more about three possible mechanisms that could be influenced by the liability structure: center activities, selection and the flow of information (monitoring). The survey was conducted during center meetings and was administered to a sample of active members, including individuals who were members at the time of the conversion as well as new clients who entered afterwards.²² Third, we use social network data collected before the intervention and again one year later to examine the impact on social networks, as well as heterogeneous treatment effects for groups with different preexisting levels of social networks.

A. Lender Costs: Activity-Based Costing Exercise

²² Since meeting attendance is compulsory, we should not be concerned with having a bias sample of survey respondents. In any event, we compared past repayment between respondents and non-respondents in converted and control centers and found no statistical differences across samples (largest t-stat is 0.82).

