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Group Credit: Recent Evidence from the Philippines

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Philippine Institute for Development Studies

Group Credit: Recent Evidence From the Philippines

Teodoro S. Untalan

DISCUSSION PAPER SERIES NO. 94-24

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December 1994

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from the Philippines**

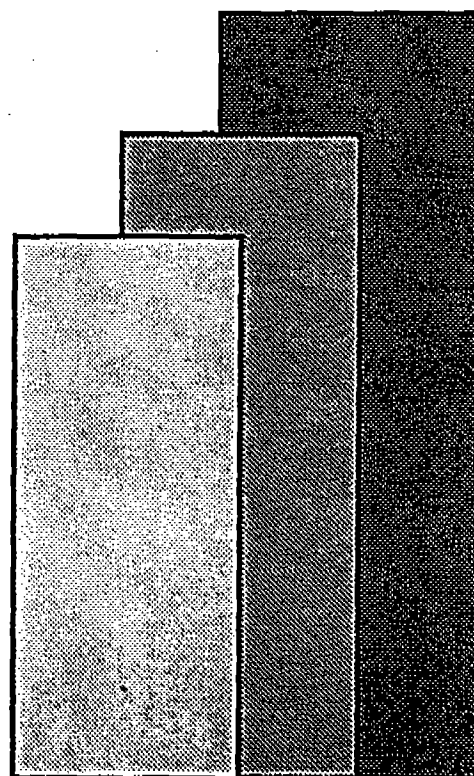
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**GROUP CREDIT: RECENT EVIDENCE
FROM THE PHILIPPINES***

Teodoro S. Untalan

December 1994

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Preliminary Paper

Group Credit: Recent Evidence From The Philippines

Teodoro S. Untalan

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Group Credit: Recent Evidence From The Philippines

Teodoro S. Untalan

1. Introduction

An alternative lending scheme to ease credit market rationing due to information asymmetry is to provide lenders an alternative risk-sharing arrangement in the form of group credit. In the Philippines, this mode of lending is relatively at its early stage. Some lending institutions are believed to maintain a credit relationship with a group of borrowers to offset or partly solve informational problems about such borrowers. Distinguished from the usual lender-single borrower relationship, this three-tier lending set-up involves the lending institution which channels the funds to a so-called *conduit* which in turn re-lends the fund to the ultimate user.

The remarkable success of this group credit program, measured by the relatively high repayment rates, has attracted the interest of lenders not only in the Philippines but in other countries as well particularly those that have elected to adopt it. There is an implied benefit of group credit that is appealing to lenders given the burden of borrower risk that comes with lending. It surprises no one that most of the assessments done on this lending program have concentrated on the effect of group credit to the lending institutions. On one hand, the attention to the effect of this lending on borrower welfare provides a different social orientation. Little is known, however, about the group process that provides the backdrop for this type of lending. In other words, are there really enforcement mechanisms within an organization? Is there a valid claim about the so-called peer pressure within the group? What are the forms of peer pressure?

The main task of this paper is to document the interactions among borrowers that make up a group under conditions that there is joint-liability. Among the objectives are (a) to be able to provide a description of the loan beneficiaries that participate in group credit, (b) to find out their reasons for borrowing with the group, and (c) to be able to obtain a first knowledge of how the condition of joint-liability influences borrower behavior. Is the need to gain access to credit worth the added risk-taking on the part of borrowers when they have to be liable of others loan as well?

2. Group Credit as a Form of Lending

The customary practice among lenders to deal with their borrowers could be considered a form of risk-taking. In the lender-single borrower relationship, the lender entrusts his funds to a borrower who is expected to pay him back with the amount plus some remuneration at

some future date. Considering the lapse of time between the receipt and the payment for the good in the exchange, this form of transaction is open to non-compliance of an agreement by one party involved in the exchange - normally the borrower. Credit markets are distinguished from other markets in that there is non-simultaneity of exchange of the good transacted. The lender's problem may be compounded further if, one notes, that the lender deals with borrowers of various character. Oftentimes, there is scarce information for him to distinguish among his set of borrowers. When such information is costly, the lender is handicapped to deal with each individual borrower.

Usually, lenders could be compensated for their risk by a higher interest rate for the funds they lend. But it has been suggested that there is a limit to how high the interest could be raised to compensate lenders. At higher interest rates, borrowers also become risk-takers as a way to compensate them for the higher cost of the funds they borrow. It has even been pointed out that a form of self-selection among borrowers ensues with some of the good borrowers, who no longer consider their projects viable, staying out entirely from the credit market.¹

This inability of the lender to deal separately with each type of borrower forces him to offer a single loan contract to all borrowers. In effect, the lender charges a premium for the added risk of carrying in his portfolio the indistinguishable dishonest borrowers. The premium is uniformly applied to all borrowers regardless of type. If higher interest rates become a way by which dishonest borrowers are subsidized by the honest borrowers then the latter would prefer a contract with a smaller loan size and a smaller interest rate. The reason is that smaller loan size means fewer defaults and this implies that the honest borrowers don't have to subsidize the dishonest borrowers even if with this loan contract credit rationing ensues. (Jaffee and Russell, 1976).

There is an obvious need for any potential borrower to gain the trust of the owner of the fund for him to part with it. This arises because the lender may not have all pertinent information to himself to tell one type of borrower from another. To tell which borrower is creditworthy or not is an information problem that is costly to collect and undertake. There is also a limit to how far one can really verify all the actions of the borrower. Under this circumstances, raising interest rates may not be a solution. The reason is that the returns to the lender is not a linear function of the rate of interest.

As a way to extricate the lender of his dilemma, the lender entrusts his funds to one who has a comparative advantage in lending. By comparative advantage one means that the so-called conduit for the fund has the information available that the lender lacks. Consider a lending arrangement where a bank lends to a group of borrowers. The group may be referred to as an *intermediary* or a conduit for the fund. The intermediary may be a group or any formal organization made-up of member borrowers such as a cooperative or any private organization. The advantage of the organization over that of the bank is that individuals in the group are accustomed to each other either because they belong to the same trade or occupation or simply because they live in the same community. This setup breeds familiarity among the members of the group. Under this setup, the lender will provide a

¹ The twin proposition of adverse selection and moral hazard has been advanced by Stiglitz (1980).

loan but will share or pass the bulk of the borrower risk to the organization. The organization will then assume the collective task of monitoring the actions pertaining to the loan of its members.

Evidently, the size of the group is an important consideration in this lending. Bigger groups encourage typical *free-riders* and reduce monitoring efforts by each individual member-borrowers. It also acts as a disincentive to member-borrowers given that it spreads the cost of a default thinly across members. Fairly homogenous groups should appear to do a better job of monitoring. Information about each member is efficiently and conveniently conveyed if members know each other better. This is particularly true if they can observe each others' actions given any geographic setting or because they are engaged in the same trade or have similar occupation.

Among the attractive features of the group credit is that the lender gains from the arrangement by presumably lowering his risk from lending, represented by the variability of returns, in dealing with numerous individual borrowers. The lender, likewise, reduces his transaction costs, known to be independent of loan size, as well as the cost of gathering information from lending to different borrowers.² Between the creditor such as a bank and the ultimate user of funds are considerations of both implicit and explicit costs of a loan transaction. The bank as a lender incurs transaction costs in loan handling such as loan processing and collection as well as bookkeeping. These are presumed independent of loan size. The bank also incurs risk-reducing costs. It incurs information costs in screening loan applicants and in monitoring its borrowers. For each loan that it spends on loan insurance and guarantees it also becomes part of its risk-reducing costs not to mention its legal expenses in case of a default. These are all borrower-specific. Thus, the bank's costs are compounded given the number of different borrower characteristics it must deal with. In lending to a group its transaction and risk-reducing costs ceases to be borrower-specific so that it can reduce its costs to the extent that it deals with a group instead of separate individual borrowers. A greater part of this reduction in cost is associated with the bank monitoring individual borrowers but has now become a responsibility of the group. There is incentive for the group (i.e., an organization) to participate given arbitrage opportunities. Assuming the gains of the lender are passed on to the organization in terms of a relatively lower cost of funds, then if the organization is profit-making it earns some profit by lending at a slightly higher rate to its member-borrowers. If the organization is not profit-seeking, it can be assumed that its objective is to maximize the welfare of its member-borrowers.

There are advantages for the borrower. Assume the bank imposes a joint-liability on the group's loan requiring each borrower to guarantee other borrowers' loan. In exchange the bank would waive the need for collateral from each borrower. Given that the group (a designated representative) will transact the loan with the bank for all the borrowers, the borrower would save part of his transaction costs in borrowing. His savings include follow-up expenses such as visits to the bank, as well as the legal and documentation fees given that he will share this cost with the others in the group. These are his explicit costs.

² The bank may have to incur some initial set-up cost for the group such as member instruction and education. The bank would also have to incur some bookkeeping costs during the course of its lending relationship with the group in order to maintain individual borrower records for its reference.

There are reduction in his implicit costs as well given that he need not raise a collateral. This comes from any imputed costs on the mortgage of a property, and the need of a compensating balance (e.g., bank deposit). Further, he would eliminate his search cost for a collateral. However, due to the nature of the present lending arrangement, the borrower would have to shoulder some screening and monitoring costs in enforcing contracts. This screening cost arises because now, as a guarantor, he would want to obtain the loan only with individuals he is familiar with and worthy of his trust.³ This clearly mean some information and search cost. This will have a direct bearing on his monitoring cost during the period of the loan. An effective screening reduces the necessity of following-up on any borrower through reminders, notices, visits, and group meetings which subsequently reduces the cost of monitoring.

Is borrower welfare increased given that he would have to assume most of the risk of lending? Obviously, there are some immediate benefits to the borrower such as the reduction in his borrower transaction costs and the possibility of not to provide collateral for a loan. As to an increase in his risk-reducing costs (e.g., information costs), these are considered minimal given that much of the information he needs is an outright result of his association with other members. In this arrangement the borrower could stand to gain if, as a result of assuming part of the lending risk, the lender is willing to reduce or eliminate rationing, such that the borrower can gain access to credit (or a bigger loan). Thus, when the rationing is due to asymmetric information, and if the lender by shifting a major part of the information problem to the group would be willing to increase credit then, the supply of credit shifts outward (Figure 1). Given any initial rationing contract below the market-clearing rate (i.e., contract s) the distance between the demand curve (Ld) and the supply for credit (Ls) is lessened, and rationing is reduced to Ls' . The extent of the reduction depends on how much the lender can transfer and the extent by which the group is willing to assume the information problems for the lender so as to alleviate his risk from lending. This reduction in rationing shows up in the increase loan size from the lender that ends up in an increase in borrower welfare (note the iso-utility curve III touching the new supply curve). The borrower has made a trade: assuming part of the risk from the lender in exchange for credit. Here, the borrower is compensated with the increase risk-bearing by the increase in L .

Signalling becomes an important device that an individual can use to group themselves with other creditworthy members in the population. Stiglitz (1990) calls the process *assortative mating*.

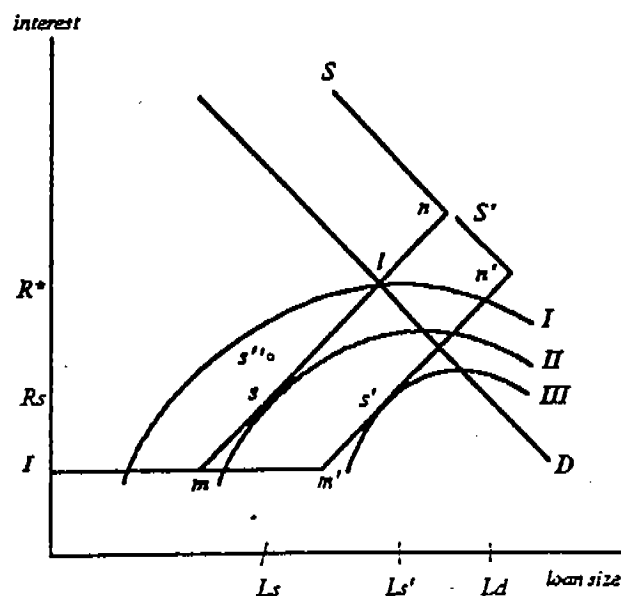


FIGURE 1. The lender's backward-bending supply curve is given by $ImnS$. An outward shift represented by $Im'n'S'$ is brought about by less rationing on the part of the lender. The borrower gets a larger loan size Ls' at contract s' than originally at s . Thus, the amount of rationing represented by the distance $Ls-Ld$ is lessened when the borrower obtains the loan Ls' . The difference between R^* and Rs is the lender's premium. R = loan rate. I = cost of funds (deposit rate).

3. Group Credit in the Philippines

3.1 Some Group Credit Programs

The study looked into three major group credit programs. Despite the type of lending common to these group credit programs, these programs differ in the type of organization they lend to, the intended beneficiaries, mode of group lending (e.g., group size, term and size of loan), and the reach and scope of the program.

Gramscen Bank Replication Program

This is a lending project undertaken by the Department of Agriculture through the Agricultural Credit Policy Council (ACPC) in an effort to assess the impact in the Philippines of a rural-based credit delivery to the marginally poor. The program here is a replication of

the original concept which is the delivery of credit services at the village level where the term *grameen* was derived. In the Philippines, it first became very popular with non-government organizations since it was first introduced in the country in 1989.

ACPC's replication program which started in 1990 services 23 so-called replicators or conduits and caters to a total of more than five thousand borrowers almost all women. There are currently 3 cooperative rural banks (CRBs), 6 cooperatives, and 14 foundations or people's organizations in the fold of the program. One of the achievement of the program is its remarkable overall repayment rate of 94% attributed to concept of partnership-in-credit among the borrowers.

A distinguishable feature of the program is that re-lending is done to individuals bundled into five borrowers each one liable for the loan of the others. Loan size averages P2,500 and carries a term of usually a year. A savings generation program is also incorporated to complement the lending.

Tulong Sa Tao

This is a group lending program administered by the Department of Trade and Industry (DTI) for small non-agricultural producers. It was established in the early 1987 with the primary objective of providing capital to small but promising non-farm, non-agricultural enterprises. The program funds are coursed through cooperatives, CRBs, foundations and other civic organizations for re-lending to the targeted beneficiaries. The beneficiaries considered should be in the low-income group and considered to have no effective access to credit. The projects assisted are in the areas of agro-processing, small manufacturing, trade, and service. Preferably, it must be labor intensive.

The group credit component, sometimes referred to as TSTANGO Microcredit, lends funds to the conduits which re-lends the funds to individual beneficiaries and self-help groups. Loans range from P25,000 to P200,000 per group beneficiary. The program has assisted about 300 conduit organizations and an estimated 19,363 entrepreneurs.

The program encourages capital build-up for the conduits served by its funds and to encourage self-sustainability. It also incorporates graduation of the conduit to other funding sources such as banks in order that these would have continued access to credit.

LBP Group Lending

The Land Bank of the Philippines' (LBP) group lending program was started in the late 1987. The program was conceived to cater to agricultural farmers and producers as well as fishermen. This group lending program is open to farmers and fishermen's cooperatives or associations. The other component of the lending program is coursed through rural banks, private development banks and savings association for the purposes of re-lending the funds to rural beneficiaries. The shift from retail lending to group lending was necessitated by the

need to service more farmer beneficiaries, provide extensive financing for agricultural endeavors (e.g., warehouses) not possible in individual lending, encourage farmer beneficiaries to go into countryside microenterprises, and to implement efficiency in the bank through group lending.

The program currently serves 5,198 cooperatives nationwide through the group credit. The latest figure indicates about 886,000 farmer-beneficiaries served including those from the rural financial intermediary (RFI) component of the program.

3.2 Group Credit: The Case of the Philippines

The term group credit refers to a loan made to a collection of individual-borrowers. The term group may refer to any formally organized group of individuals such as a cooperative, or any private profit or non-profit organization such as a cooperative rural bank (CRB), a people's organization (PO) or a foundation that represents a group of individuals seeking credit. For cooperatives, the individual borrowers are its members. It would then be proper to refer to these individuals as member-borrowers. Other types of organization such as CRBs, POs, or foundations have no formal membership to speak of. However, these organizations are represented by a set of officers and the aggrupation of individual borrowers that they seek to serve. Here, the individuals referred to are simply the borrowers. Both cooperatives or the other types of organization will be referred to as the *conduit* because these are recipients of loan from a lending institution with the intention of re-lending these funds. In the Philippines, the lending institution is not necessarily a bank. Currently, other government agencies with funds may also offer this type of lending program.

Reckoned in terms of borrowers these conduits may have as small as twenty to more than a thousand member-borrowers for a cooperative, or borrowers in the case of a cooperative rural bank, a foundation or a people's foundation. Invariably, the loan to any conduit carries the condition of joint-liability for the borrowers making up the group. Thus, for the cooperative there as many jointly-liable members as there are member-borrowers. For the CRBs, POs, and the foundations re-lending to their borrowers is done into smaller groups, usually of five to seven members. One member of the sub-group is elected as group leader or chairman who acts as the coordinator and collector for the group, another as group secretary who keeps the records of the group, and the rest are members. The loan of one member is guaranteed by the remaining members of the group regardless of position. CRBs and the other type of conduits unlike cooperatives have no formal memberships but simply composed of borrowers. Without membership, there is less hold by these types of organization on their respective borrowers. A smaller sub-group is the most effective way to enforce loan contracts especially when the loans are unsecured. The condition of joint-liability among borrowers has a stronger effect when the size of the group is small which makes it easier to observe each member.

In providing a loan, the lending institution considers the group credit request of the conduit as a single loan application. A one-time evaluation is made on a fully completed loan application by the conduit. No individual borrower is allowed to represent himself. For all

the lending institutions the foremost consideration to grant the loan request would be the lending performance of the conduit. This serves to emphasize that in this type of lending the recipient organization is responsible for each of the individual loans it subsequently makes. In other words, the conduit not the lending institution must be able to enforce individual loan contracts with the ultimate user of the fund. The lending institution is more interested in re-couping its loan to the conduit than from individual borrowers. Thus, the performance of the conduit is more important from the point of view of the lending institution than the credit record of each individual borrowers. The lending institution relegates itself to maintaining a good lending relationship with the organization and not with individual borrowers.

There are two ways in which a group loan is granted. The lending institution earmarks a fund to the conduit and, in the case of a CRB, PO or a foundation, give these a free-hand in re-lending the amount to any of its prospective borrowers. The only condition it requires is that all potential borrowers must undergo a seven-day credit education and instruction, which the recipient organization will undertake for the lending institution.⁴ Only upon completion of this seminar will a prospective borrower qualify for the loan. Usually, the cost of such borrower education is shared between the lending institution and the conduit.

The other way is the conduit submits a group loan application to the lending institution for group credit consideration that includes the type and the amount of loan applied for by each prospective borrower. The lending institution sees to it that the individual loans applied for is in accordance with the policies of its lending program before it releases the loan to the organization. This practice applies to cooperatives because these have pre-determined borrowers from among its members. Most of these cooperative are credit cooperatives or multi-purpose cooperatives, hence the lending institution assumes that its roster of member-borrowers had earlier undergone credit education thus no further education of the borrowers is required. In both cases, the lending institution relegates the screening of borrowers to the recipient organization.

Loan proceeds are re-lent to individual borrowers when the fund is made available from the lending institution and depending on the loan amount applied for by the borrowers. Loan sizes range from P1,000 to P265,000 (Table 1). The CRBs, POs and the foundations give smaller unsecured loan (e.g., P1,000-10,000) to its borrowers re-grouped in five to seven borrowers each group. The loan of one group member is, however, guaranteed by other remaining members. To further encourage others to meet their loan obligations, these CRBs, POs and foundations require a staggered release for the loan to each prospective borrower. The method is called *two-two-one*. The last two members get a loan first and after a lapse of time normally four to six weeks the next two members draws a loan. The last would be the group leader or chairman. This procedure is suppose to encourage the group members who draws last in the list to encourage the first loaners to repay and enables them chance for a loan. This group of five borrowers can also avail of further loans only if all members have subsequently repaid all previous loans.

⁴ The loan beneficiaries of the replication program of ACPC are required to pass an income requirement above which a potential borrower would not qualify for the program. This is to ensure that the beneficiaries served are the poor but deserving of credit.

On the other hand, depending on the purpose and size of the cooperative, loans range from a small P4,000 to a large P265,000. The largest loans given to individual borrowers are, however, given by the cooperatives. The smaller cooperatives giving smaller loans (e.g., P15,000) require one or two guarantors for the loan of a member. Members are normally allowed by some cooperatives to guarantee the loans of as many as three members-borrowers. The larger loans (e.g., P60,000) require a combination of both guarantees and collateral. There is no procedure of staggered disbursement similar to that of the CRBs or the other organizations. Loan amounts are disbursed to individual members according to the amount of the loan applied for.

Borrowers make their individual loan payments to the organization through a designated representative. Normally, the smaller loans made by the CRBs and the foundations are paid on a weekly basis. The designated representative collects the weekly amortization at a designated place in the area where the borrowers have their residence. This normally coincides with the meeting of the members. These loans normally carry a term of six to twelve months. The larger loans given to member-borrowers of the cooperatives are usually paid monthly, quarterly and at times seasonally in the case of the agricultural loans. Usually, the loan accounts of these member-borrowers are usually settled at the office of the cooperative. Records of payment by the individual borrowers are kept by the conduit. What the lending institution keeps is the record of payment made by the each organization it has loaned the total amount. There are instances, however, when individual records of payment

Table 1. Loan Size

<i>Size of Loan (pesos)</i>	<i>Frequency</i>	<i>Percent</i>
<i>2,000 and below</i>	<i>27</i>	<i>13.5</i>
<i>2,500 to 5,000</i>	<i>78</i>	<i>39</i>
<i>6,000 to 10,000</i>	<i>24</i>	<i>12</i>
<i>11,000 to 15,000</i>	<i>18</i>	<i>9</i>
<i>16,000 to 20,000</i>	<i>10</i>	<i>5</i>
<i>21,000 to 25,000</i>	<i>15</i>	<i>7.5</i>
<i>26,000 to 30,000</i>	<i>10</i>	<i>5</i>
<i>31,000 and above</i>	<i>18</i>	<i>9</i>
<i>minimum = 1000</i>		
<i>maximum = 265,000</i>		

Source: DRD Survey on Group Credit, 1994.

by the borrowers may be submitted by the conduit to the lending institution upon request of the latter.

The ways by which the conduit enforces loan contracts with its individual borrowers varies according to the type of organization. CRBs, POs or foundations require a substantial role from the guarantors of individual loans. This the reason why these organizations disperse their borrowers into smaller sub-groups. The concept of joint-liability is strictly enforced where the other individuals in the group are required to help collect a loan. Members are forced to remind others of their obligations. Others get from the group's fund, which is the savings of the group, to settle a member's obligation. Sometimes, it comes to the extent that the remaining members would advance the amount to enable the group to get another loan. Groups with good credit records can avail of increasingly larger loans as an incentive.

Cooperatives that require guarantors for individual loans also urges guarantors to help in the collection of the loans. There is, however, no strict rule that guarantors are answerable for the loans that they guarantee. The cooperative with substantial savings and capital may opt to get the any unpaid balance of a borrower from the savings or from the share in the cooperative of the borrower. This is possible given that majority of these cooperatives have capital build-ups or share capital by each of the members which these can draw from. For cooperatives that also require collateral, the cooperative may also opt to get the collateral as a last recourse. Larger loans already require the collateral as additional guarantee since a loan default may impose a heavy burden and unnecessarily penalize the guarantor if he is made to assume the unpaid balance. Here the role of the guarantor is transformed to one who could encourage payment but not assumption of the balance. It is also observed that for cooperatives having large members guarantors play a minimal role. In most cases, it is the set of officers of the cooperative that puts pressure on the member-borrower to pay his loan. For all these various types of organization, no current borrower can avail of any further loans until he settles his current obligations.

The conduit settles its loan with the lending institution separate from the payments made by its respective borrowers. Its payments depend on the terms of its loan with the lending institution as contained in the loan agreement. To be able to meet its obligations, it must be able to keep a good collection of its loans with its individual borrowers. Since the lending institution only collects from the conduit the former also frees itself from the task of running after each individual borrower.

If the organization has difficulty meeting its loan obligations with the lending institution because it has difficulty raising the required collection to service its loans, the bank classifies the conduit's record with a delinquency. In this case, the lending institution has two options. One, to restrict the amount of loan forthcoming to the organization or to cancel its borrowing privileges until the total loan amount is repaid. The grant of future loans to the organization depends on an assessment of its payment record to the lending institution as well as its collection record from its borrowers. As an incentive, favorable assessments would qualify the conduit for larger loans from the lending institution.

There is normally a valid reason why the organization would want to continue its credit relationship with the lending institution. Borrowers normally find the organization to be a convenient access to credit. But only their collective effort can assure them future access to credit given that loans from the lending institution will be forthcoming only when the organization can settle its loan obligations. Here, the relationship among members is key to pursue their working relationship with the lending institution. Thus, there is the usual incentive for the organization to be strict with its borrowers. Given this type of lending where the members are required to be liable for others' loan obligations group peer pressure is the normal result.

Peer monitoring becomes an effective device to deter borrower misbehavior as long as individuals are willing to make long-term commitments. Theories of agency and the design of incentives in an organization portray the members of the organization as players in a *cooperative game*. Under cooperative game theory, repeated relationship such as in the case of a long-lasting credit relationship between the conduit and its borrowers encourages cooperative behavior, and the tendency of members to signal their intentions to penalize non-cooperative members. The motivation on the part of each member is due to the fact that future access to credit is one way by which members, particularly for marginal borrowers, can maximize their own objective function through credit from the group. Given that this is true for each individual borrower that makes up a group then there will be an implied interdependence among individuals enough to make the credit relationship to work (Untalan, 1994).

4. The Sample Data

The study requires respondent-borrowers from conduit organizations known to be involved in group credit. In investigating borrower characteristics of group credit programs the beneficiaries of the three major group credit programs were interviewed. A sample of 200 respondents representing beneficiaries of these programs from different provinces were interviewed. The type of organization sampled are cooperatives, CRBs, POs and foundations all currently participating as conduits for the different lending programs. These various organizations are in the provinces of Quezon, Laguna, Aklan, Iloilo, Negros Occidental, Bulacan, Pangasinan and Metro Manila.

All in all, there were a total of 3 CRBs, 10 cooperatives and 5 foundations or people's organization visited for the study. Of these eighteen organizations 7 are from the Grameen Bank replication program of ACPC, 9 from the Tulong Sa Tao program of DTI, and 2 from LBP's own group lending program. All of these programs mandates lending to conduits. However, these differ in terms of the targeted beneficiaries, the size and composition of the respective organizations the lending institution lend their funds, the term and size of the loanable amount as well as the requirements for potential borrowers.

5. Group Credit: Some Recent Evidence

Despite the most recent interest generated by this form of lending, there is little knowledge about this form of credit delivery from the aspect of the borrower. There remains an enigma of the group process that distinguishes this lending from the usual lending practice that most are familiar of. The dearth of information may have contributed to the usual skepticism on the effectiveness of the group as a collateral substitute. What is known and oftentimes claimed, however, is that this lending has brought the benefits of credit to the least bankable of borrowers, those who live in the rural areas. The welfare implications of this lending on the part of the borrowers may be two-fold. The supposed increase in the well-being of those who have benefited from credit balanced by the additional risk-bearing on the part of the borrower who guarantees the loan of the others in his group. The issues on borrower welfare are taken in other research works and it is not the intention of this study to duplicate their findings.

Instead, this study intends to document the working of such a lending program by looking into the group process that this type lending is supposedly to revolve. The only and best way to accomplish this task is to go within the group itself and look into its borrowers, their character, behavioral modifications, and preferences. This study gives a first hand look of a group involved in this type of borrowing.

Respondent Profile

Majority of the respondents were female (Table 2). This was not intentional but rather dictated by circumstances given that one of the lending programs looked into, the Grameen Bank replication program, caters only to women. There is no particular age group more involved in this type of borrowing. In fact, the ages of survey respondents ranges from twenty-one to seventy-one. Most borrowers have minimal schooling at most having primary education. This is expected given that the target beneficiaries of the programs are the marginally poor. Normally, income is highly correlated with educational attainment. Further, a general education such as most of the respondents had leads to less specialized jobs mostly self-employment and in the services. Note that most of the borrowers are vendors and small traders of various items. The farmer and those involved in farm-related work, on the other hand, are loan beneficiaries of the agricultural program of the LBP. Only a negligible portion of those surveyed are enterprising individuals being both wage earners or employed while at the same time doing small business on the side.

Almost all of those surveyed are the main breadwinner for the household. As for most of the women respondents, their earnings could not be considered a supplemental income since the spouse, if he has a livelihood, has an irregular income. Thus, for most of the respondents their income is a primary source of support for the members of the household. The magnitude of this responsibility is given by the fact that about seventy percent of those surveyed have at least three family members dependent of them for support. Some even have as many as eight to twelve members of the household being supported. Credit appears to be a limiting factor for almost all respondents to maintain a livelihood. The major reason why almost all of the respondents seek credit is to be able to raise the necessary capital for their small business.

The Respondent As Borrower In General

Close to half of those surveyed had no previous experience with any other lenders (Table 3). For the other fifty-one percent who have previously availed of loans, about one third or thirty-three percent has a credit experience with an informal lender known more locally as the *five-six*.⁵ Among those surveyed a rural bank is the second most popular source of credit. Usually, those who have borrowed from a rural bank are those who were able to

Table 3. Respondent-Borrower Experience With A Lender.

<i>Type of Lender</i>	<i>Frequency</i>	<i>Percent</i>
<i>five-six</i>	45	32.8
<i>trader</i>	15	10.9
<i>landlord</i>	2	1.5
<i>other cooperatives</i>	12	8.7
<i>other organizations/associations</i>	15	10.9
<i>rural or savings bank</i>	27	19.7
<i>commercial bank</i>	6	4.4
<i>private development bank</i>	10	7.3
<i>government bank</i>	5	3.6
<i>with previous borrowing experience</i>	102	51
<i>without</i>	98	49

Source: DRD Survey on Group Credit, 1994.

⁵ Five-Six is an indigenous term referring to a form of lending where for every five pesos lent an equivalent of six pesos is the expected repayment. These are very short-term loans requiring daily or weekly payments. It is considered a usurious lending practice because when computed the interest shouldered by the borrower is 20% during the term of the loan.

Table 2. Respondent-Borrower Profile.

<i>Attribute</i>	<i>Male</i>	<i>Female</i>
<i>Age</i>		
<i>minimum</i>	<i>28 yrs.</i>	<i>21 yrs.</i>
<i>maximum</i>	<i>71 yrs.</i>	<i>67 yrs.</i>
<i>mean (both sexes) = 43 yrs.</i>		
<i>Education</i>		
<i>6 years or less (primary)</i>	<i>4</i>	<i>59</i>
<i>7 to 10 years (secondary)</i>	<i>20</i>	<i>53</i>
<i>11 years or more (tertiary)</i>	<i>20</i>	<i>44</i>
<i>Livelihood or Sources of Income</i>		
<i>farmer</i>	<i>12</i>	<i>7</i>
<i>trader</i>	<i>-</i>	<i>6</i>
<i>operator</i>	<i>2</i>	<i>2</i>
<i>wage-earner/employee</i>	<i>3</i>	<i>13</i>
<i>vendor/small business</i>	<i>13</i>	<i>19</i>
<i>small manufactures</i>	<i>7</i>	<i>6</i>
<i>housewife</i>	<i>-</i>	<i>3</i>
<i>others</i>	<i>3</i>	<i>11</i>
<i>Mean Number of Children Per Household = 4</i>		
<i>Mean Years of Residence (both sexes) = 29.8</i>		

Source: DRD Survey on Group Credit, 1994.

offer an acceptable collateral for their loan. The trader is one popular source of credit given that some of those surveyed such as the farmers and a few vendors get their supplies or inputs from the trader. In one credit cooperative visited, all the member-borrowers entrust their produce to the trader who lends them money for other off-season crops. To some respondents, the *other* associations/organizations or cooperatives (e.g., church or school cooperatives), usually located in their communities, is also a good source of a loan.

For those who have some experience borrowing from an informal lender such as the five-six the attraction to the latter only underscores the sad fact that most of these borrowers hardly know of other lenders, having remained in their respective area of residence for years some even since birth. The average years of residence in their respective communities for all the respondents is about thirty years (Table 2). Many of the respondents believe they have very few opportunities away from home which is the reason why they opt to stay. Opportunities come sparingly to those with less years of education. In the process, not only are their chances to look for other livelihood stifled but also their awareness of other sources of credit is almost nil. The need for credit usually comes after any opportunity to invest. This explains why to most borrowers, their appreciation of the role of credit is also very minimal. In fact, the common reason for those who chose not to borrow from any type of lender at all is the fear to be in debt or that the amount they need is negligible for them to seek credit (Table 4). The usual recourse is to borrow from relatives because of convenience. Most fear the high cost of the fund from moneylenders.

Table 4. Typical Reasons For Not Borrowing

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>no experience/fear of borrowing</i>	34	43.6
<i>no security/collateral</i>	10	12.8
<i>no reason to borrow/amount negligible</i>	20	25.6
<i>no knowledge of other lenders</i>	6	7.7
<i>borrowed from relatives/friends</i>	8	10.3

Source: DRD Survey on Group Credit, 1994.

If this type of sedentary behavior on the part of the borrower indirectly affects his ability to prosper it may, however, prove to be a benefit to the lending institution implementing these group credit programs. The longer the borrower resides in a certain community the more familiar he becomes with the area and its people. This is a positive aspect for purposes of monitoring the actions of the residents of a certain area. This is why lenders would find it to their advantage to cultivate a credit relationship with local organizations to ease their lack of knowledge about local borrowers. There is no better evidence of this view given that the member-borrowers of all the conduit organizations are local residents who are also

neighbors. Further, most of these borrowers also conduct their daily business or livelihood in the community where they reside.

There are reasons why some borrowers opt to deal with some lenders. Forty percent of the respondents are attracted to the expeditious loan approval by a lender. It is a known fact that informal lenders usually do not require loan papers (Table 5). One need not be a previous borrower of a moneylender to be knowledgeable of his operations. The fact that there is an efficient exchange of information among local residents also contributes to this knowledge. The moneylender can provide a loan on the same day that a potential borrower applies for the loan. For the conduits surveyed in the study it takes an average of two and a half weeks to release the proceeds of a loan.

Table 5. Reasons For Borrowing From A Particular Lender.

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
1 <i>affordable periodic payment</i>	8	5.8
2 <i>low interest</i>	17	12.2
3 <i>larger loan amount</i>	8	5.8
4 <i>longer term of loan</i>	6	4.3
5 <i>good system of lender</i>	6	4.3
6 <i>no alternative lender/first lender to offer</i>	32	23.0
7 <i>no security or collateral needed</i>	3	2.2
8 <i>no paperwork needed</i>	1	0.7
9 <i>no follow-up needed</i>	-	-
10 <i>immediate loan approval</i>	55	40.0
11 <i>allows saving</i>	2	1.4
12 <i>none in particular</i>	1	0.7

Source: DRD Survey on Group Credit, 1994.

About twenty-three percent of those responding expressed their lament for having no other alternative lenders as the reason why they opted to deal with a particular borrower. If an immediate need presents itself for them to borrow, they could easily be swayed to commit to the first lender that offers them credit usually the very ambulant moneylenders. Rural communities are hardly serviced by formal lenders such as banks. Being captive borrowers is also due to the tendency for local lenders to be particular about their borrowers. Borrower-specific loan transactions arise out of the nature of the purpose for the loan one that would normally conform to the business interest of the lender (e.g., trader) (Esguerra, 1993).

Only a small portion of the respondents has personally dealt with a formal lender such as a commercial bank or a government bank. First, there are hardly any branches of commercial or government bank in the rural areas. If there are these are in bigger towns or in the cities where few of these borrowers hardly venture. Rural banks are more common but at some distance from the residences of the borrowers. For some borrowing from *other* associations/organizations or the rural bank is the best option yet to informal lenders. These lenders normally offer relatively lower interest rates than the informal lenders.

It is notable that the need for security or collateral for a loan is not one of the strong reasons given by those surveyed for borrowing from a particular lender. This is because even moneylenders also require a form of security (e.g., household items) for the loans they provide.

The Respondent As Member-Borrower

Among those surveyed, about eighty-two have borrowed at most four times from their present organization. About thirty-one percent of the respondents have availed of a loan twice.

There is less doubt that current borrowers are attracted to group lending because it offers them a window to credit they have not experienced before. Group lending also promises to be an innovative approach to whatever lending practice, indigenous or otherwise, it intends to replace. Borrowers find the issue of interest rate and/or affordable periodic payment as well as the system of re-lending by conduits as the main reasons that attracted them to seek credit with their respective association or organization (Table 6). There is little reference by those surveyed about the issues on the requirement of collateral by a lender, and of the need for loan papers or follow-ups. Some borrowers find the requirement of collateral by a lender as something inevitable if they have to gain the trust of the lender that they will act in good faith. Borrowers have become indifferent about this practice since even moneylenders require a security for a loan. Surprisingly, even the small borrowers are not averse to coming up with a loan security such as some house appliance or any valuable house item just to enable them to gain access to credit. Less paperwork or the need for follow-ups is not a main reason why they borrow with the organization, since the latter can not claim any advantage over informal lenders who provide immediate loans without any supporting papers or promissory notes. That moneylenders give a larger amount of loan than some conduits is also the reason why the loan size can not be an attractive feature to some borrowers of the organizations especially those lending programs giving smaller loans.

It is easy to explain, however, why majority of borrowers are sensitive to the issue of interest rate the same way that they are attracted to the affordable periodic payments. Of those surveyed low interest for a loan is synonymous to affordable debt service. Lower

Table 6. Typical Reasons For Borrowing With The Association

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
1 <i>affordable periodic payment</i>	78	26.1
2 <i>low interest</i>	97	32.6
3 <i>larger loan amount</i>	2	0.7
4 <i>longer term of loan</i>	12	4.0
5 <i>good system of lender</i>	61	20.5
6 <i>no alternative lender/first lender to offer</i>	4	1.3
7 <i>no security or collateral needed</i>	22	7.4
8 <i>no paperwork needed</i>	4	1.3
9 <i>no follow-up needed</i>	3	1.0
10 <i>immediate loan approval</i>	5	1.7
11 <i>allows saving</i>	10	3.4
12 <i>none in particular</i>	1	0.5

Source: DRD Survey on Group Credit, 1994.

interest rate to most would also mean lower amortization for their loan. Most of the respondents are members of single-income households thus affordability is an important consideration. For the borrowers with small loans such as the vendors it becomes even easier for them if they amortize the loan on a weekly rather than on monthly basis. Most of these have daily income that they can source their payments.

There seem to be an attraction of those surveyed to the system of re-lending by the conduit organizations involved in the program. What is being referred to is the type of a lending approach by the conduits that motivates rather than coerce the borrower into paying his loan. The mode of motivating borrowers is through regular meetings and other activities designed to explain the importance of the group to each individual member and encourage cooperation among members. In fact, some of the conduits especially those re-lending under the replication program (e.g., foundations or people's organizations) incorporate the value of a partnership in a group to foster rapport among members. This approach is not surprising given that one of the key factors in any group undertaking is the participation of the other individuals in the group. Borrower motivation and education seems to be the most important ingredient for the success of this type of lending program. This can only be explained by the fact that good borrower behavior can be contagious on others in the group. Group peer pressure works best on the individual to the extent of his attraction to the group - its members, ideals, and practices. It also works well given the importance of an individual to the other members in his group (Cartwright and Zander, 1953).

The extent of borrower consciousness on individual responsibilities for this lending program is discernible when many of the borrowers make it their responsibility to meet their loan obligations voluntarily. All of those surveyed personally agree that paying one's loan obligation provides an example to others to similarly meet their loan obligations. Part of this attitude also stems from the need to maintain credibility with their peers in the group. On the aspect of joint-liability, exactly ninety-three percent of those surveyed are aware that they are responsible for others in their group who can not pay a loan. Likewise, ninety-six percent are aware that the organization will not be granted a loan unless it could first pay its current loan. Respondents were also asked about their awareness of the forms of enforcement mechanisms in their organization for delinquent borrowers. Verbal reminders are the most common form of enforcement mainly because it is easy to implement especially among group mates (Table 7). On one hand, penalties, whether interest or in some peso amount, on an erring member are the most common mechanism for enforcement on paper exactly because these are oftentimes stated in promissory notes of these borrowers with the organization. If these are the remarkable attributes of this type of lending program then it is reflected in the number of borrowers who voluntarily keep a good credit record by avoiding any form of delinquency on their loans. Of all those surveyed fifty-five percent have paid their loans on time.

Table 7. Enforcement Mechanisms Within The Organization.

<i>Response</i>	<i>Verbal</i>		<i>Written</i>	
	<i>Frequency</i>	<i>Percent</i>	<i>Frequency</i>	<i>Percent</i>
<i>regular meeting</i>	42	24.9	1	0.9
<i>verbal notice</i>	54	30.0	-	-
<i>written notice</i>	-	-	22	20.0
<i>house visit</i>	30	17.3	2	1.8
<i>interest penalty</i>	18	10.4	81	72.3
<i>warning</i>	6	3.5	0	0
<i>get from group fund</i>	10	5.8	5	4.5
<i>group pays amount</i>	13	7.5	1	0.9

Source: DRD Survey on Group Credit, 1994.

Attendance on meetings is also a popular method to enforce discipline on members. This method is an effective way to keep members informed. To the organizations in the replication program meetings also become a forum by which borrowers explain any

shortcomings about their loan in the presence of their peers. Some of the conduits relate attendance in meetings to the attraction of the borrower with the lending program. It is, therefore, not uncommon to observe a practice that associates borrower's attendance with the loanable amount. For some of these organizations even the other members of a group can not borrow when a member has a poor record payment coupled with the borrower's attendance record.

For most of the conduits there is also a system of rewards for the creditworthy borrowers. These rewards are either in the form of a gift or cash. The incentive to obtain another loan is what drives some members to pay their loans on time. But what is interesting is that some members consider prompt payment as a form of recognition of being a creditworthy member by their peers in the organization (Table 8). To others, being creditworthy is self-fulfilling.

Table 8. Borrower Incentives For Meeting Loan Obligations.

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>recognition/self-fulfillment</i>	25	12.5
<i>faster re-loan</i>	12	6.0
<i>gift/cash prize</i>	17	8.5
<i>nothing</i>	134	67.0
<i>lower interest on loan</i>	9	4.5

Source: DRD Survey on Group Credit, 1994..

About forty-five percent of those surveyed have reported that they have been delinquent on the payment on their loans at one time or another. Majority of those who have experienced delays in payment is due to their inability to meet their loan obligations because of disruption in earnings from their business (Table 9). For those who failed to meet their obligations thirty-six percent have received reminders, verbal or otherwise, from their peers (Table 10). However, a large majority also reported receiving nothing. The reason, as some members explained, is that often members may get the reprieve when the explanation is valid such as health reasons or when the cause is beyond the control of a borrower such when one is befallen by calamities. Often the member affected, knowing the procedures of the group,

Table 9. Typical Reasons For Failing To Meet Loan Obligations

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>personal (health, family needs)</i>	36	18.0
<i>negligence</i>	9	4.5
<i>poor sales/income shortfall</i>	43	21.5
<i>no group discipline</i>	2	1.0
<i>always paid</i>	110	55.0

Source: DRD Survey on Group Credit, 1994.

Table 10. Typical Group Pressure On Delinquent Borrower

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>reminded</i>	41	36.3
<i>visited at home</i>	8	7.1
<i>penalized</i>	18	16.0
<i>group advance amount</i>	4	3.5
<i>talked together as group</i>	8	7.1
<i>nothing</i>	34	31.0

Source: DRD Survey on Group Credit, 1994.

preempt the actions of the latter by making a promise to pay twice the amount for the next period (Table 11). Members at times also opt to settle the amount by temporarily dipping from the group fund, or from the shares of the member affected. For smaller loans with smaller amortization some members advance the payment. It is, however, understandable that most members can not really assume others' loan obligations. This is because they can not afford to given their meager earnings.

Table 11. Typical Borrower Response To Group Pressure.

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>paid twice the amount</i>	51	63.0
<i>paid other group members</i>	3	3.7
<i>paid association any amount</i>	24	29.7
<i>nothing</i>	3	3.7

As to the preference of borrowers regarding the method of encouraging others to meet their loan obligations, about half of those surveyed personally prefer regular group meetings (Table 12). Perhaps one of the reasons why borrowers prefer group meetings is that it is

Table 12. Borrower Preference On Enforcement Mechanisms

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
<i>regular meeting</i>	99	49.5
<i>verbal notice</i>	42	21.0
<i>written notice</i>	9	4.5
<i>house visit</i>	15	7.5
<i>penalty</i>	7	3.5
<i>warning</i>	27	13.5
<i>legal action/confiscate property</i>	1	0.5

easier to encourage others to pay in the presence of one's peers. It is effective given that he is being observed and his promise to pay is noted by the other members. Member meetings is also a way to diffuse the responsibility of having to remind a member of his obligations and avoid to single-handedly confront a borrower. Further, given that it is effective, it proves to be less costly as one need not have to be forced to assume any amount payable by the delinquent member. The fact that penalties are less popular is that most members consider it sometimes to be harsh and an additional burden on the borrower with meager earnings. Giving members a verbal reminder or a warning is a more acceptable form of enforcement because not all delinquent borrowers intentionally renege on their obligations. Reminders or warnings give the borrower some time to make up for whatever loan deficiencies it may have.

How attracted are the current borrowers to this type of lending? About ninety-five percent of those who responded to the questionnaire intend to borrow again from the organization mainly for raising the necessary capital for their small businesses. When asked about how long they foresee themselves to be borrowers the typical respondent answers, which may also be indicative of the attachment of the borrower to the organization, are provided in Table 13.

Table 13. Respondent Desire To Remain Borrower

<i>Response</i>	<i>Frequency</i>	<i>Percent</i>
1 as long as possible (indefinitely)	17	8.5
2 as long as the system is good	4	2
3 as long as the need arises	44	22
4 as long as organization lends	28	14
5 as long as member is creditworthy	72	36
6 as long as group exist	22	11
7 borrow not with group anymore	4	2
8 postpone	9	4.5

Source: DRD Survey on Group Credit, 1994.

6. Summary and Conclusion.

1. There is a consistent pattern of the lack of good livelihood opportunities among those surveyed. This is mainly the result of low educational attainment. The lack of opportunities leads to less appreciation of credit. But, the scarcity of credit itself limits their opportunities to earn a living. The introduction of group credit may be the best opportunity to break this cycle.

2. There is a perceptible appeal of this lending process to the individual borrowers. It is mainly brought about by the subservience to or the lack of, for these borrowers, other alternative forms of credit. There are possibly two indications for these. First, their being sensitive to the interest rate reflects the scorn to the practice of most local informal lenders. Second, their attraction to this ingenious form of lending (e.g., the value of partnership).

3. There are enforcement mechanisms, both explicit and implicit, in this type of lending perpetuated by the condition of joint-liability. These mechanisms need not be demonstrated by individual members. The mere knowledge of the existence of these mechanisms within the organization is sufficient to encourage the borrower to meet his obligations.

4. These enforcement mechanisms may vary in degree and form according to the type of organization. The bigger the group the less influence members have on other members. The effectiveness of peer pressure is strengthened by the attachment of the individual to the group. However, collateral as a form of security for the loan may substitute for peer pressure.

5. There is a tenuous cord around the concept of peer pressure as an enforcement mechanism. The group process could work bothways. It is observed that when organizations are strict in implementing the enforcement mechanisms within the group, these have exceptional success in enforcing loan contracts. However, it is also likely that when the group process weakens there is a damaging effect. Cooperative behavior may be contagious and so is uncooperative behavior.

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