The Challenges of Group-Based Microfinance and Suggestions for Improvement

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The significance of group-based microfinance
- The areas studied
Trade-offs between the group’s financial sustainability and organisational sustainability
Why is the forming of groups so difficult?
The art of group interactions
Sanctions that hurt the poor disproportionately
How to make things better
Group-based microfinance

- Formation of groups
- Learning period
- Critical period
- Consolidation period
Why is the forming of groups so difficult?

Main findings:
- Fragmented and heterogeneous groups
- Information about members’ default risk is imperfect
- Initial knowledge about household management and exposure to risk is particularly low

Why?
- Little time allocated to the formation process
- Increasing market competition
- People’s eligibility criteria do not necessarily coincide with MFI eligibility criteria
The art of group interactions

Main findings:

- Extent of peer monitoring is low and the quality of auditing deteriorates over time
- Monitoring is very costly
- Information derived from monitoring is distorted, hidden, or simply not volunteered

Why?

- Deep-seated power structures rule
- Institutional ambivalence about valid loan usage
- Communication structures are limited and decision-making is centralised
“ I told group members about our neighbours’ comings and goings and that I’d seen that they had just bought a big truck with their loans to take their maize to [the market at] Puno. Two weeks later, someone stole my pigs from my little patch of land. I know that it is that family taking revenge on me. They think they can do anything in the group and no-one should say anything.”

(Transcription from fieldwork in Huayllabamba, Cusco, 2000-2001)
Sanctions that hurt the poor disproportionately

Main findings:
- Sanctions intensify over time
- Joint-liability system is gradually abandoned
- The poorest get excluded from any given group, negative impacts arise producing deeper poverty

Why?
- Clashes and convergences of vested interests
- Insufficient protection of group savings
- Increasing incentives to default strategically
- Traditional coping strategies are reinforced
The poorest get excluded

<table>
<thead>
<tr>
<th>Group's maturity</th>
<th>Less than 1 year</th>
<th>1-2 years</th>
<th>2-3 years</th>
<th>More than 3 years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very poor</td>
<td>24</td>
<td>17</td>
<td>60</td>
<td>15</td>
<td>116</td>
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<td>100%</td>
<td>41%</td>
<td>81%</td>
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<td>52</td>
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<tr>
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<td>53%</td>
<td>19%</td>
<td>48%</td>
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<td>30%</td>
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<td>Less poor</td>
<td>2</td>
<td></td>
<td>2</td>
<td></td>
<td>4</td>
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<td>6%</td>
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<td>4%</td>
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<td>41</td>
<td>75</td>
<td>32</td>
<td>172</td>
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</table>

*Pearson Chi-Square significance value = 0, i.e. highly significant*
How to make things better

- Re-balancing the institutional objectives
- Improving information and communication systems
- Re-engineering staff performance incentives
- Introducing social performance indicators
- Examining behavioural strategies that are being encouraged in group members and officers