

Repayment Behavior under Joint Liability Loan Contracts in a Competitive Environment

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Key Words

Microlending, Joint Liability, Competition

Abstract

In this paper we empirically examine the impact of competition between Microfinance Institutions (MFIs) on the efficacy of loan contracts when the MFIs make use of joint liability loan contracts. More specifically, we aim to find out whether competition will reduce the power of the self-selection process between the groups of borrowers, whether the peer measures within the groups of borrowers are different in an environment of competing MFIs and to what extent changes in the intra group behaviour have an impact on the repayment performance of the borrowers. We show that in a competing environment borrowers do not match anymore in groups of homogenous risks. We further show that the missing self-selection is compensated by a more intense and effective monitoring process and by a higher willingness of the group to repay the loans of delinquent borrowers. We conclude that the main advantage of competition between MFIs – namely lower direct borrowing cost due to lower interest rates – may be overcompensated by higher indirect costs which specifically arise when using joint liability contracts.