Analysis of strategic defaults in the Moroccan microfinance sector

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Drawing on extensive field research conducted in rural and urban Morocco, the authors analyze the causes of delinquency in the microfinance sector. They show that reasons for delinquency go beyond issues of competition or over-indebtedness, and have more to do with local appropriation of microfinance institutions (MFIs) and perceptions of debt. The decision to default on a payment depends on both local characteristics (social norms surrounding debt, past credit policies, etc.) and actors both inside and outside an institution: loan officers and local leaders. Delinquency rates and collection practices can be significantly improved if the notion of appropriation and local perceptions of debt are considered in loan disbursement and recovery strategies.

Despite its reputation as a model microfinance sector, Morocco has been dealing with delinquency crises since 2008. The first victim was Zakoura Foundation, one of the three main players in the Moroccan microfinance sector. In 1999, Zakoura had a PAR30 of 30%, leading it to be liquidated and absorbed by the Fondation Banque Populaire pour le Microcrédit in May 2009. Al Amana, another major player started facing delinquency issues in 2008. Rural areas were particularly affected, with PAR30 71% higher than PAR 30 in urban areas (personal communication, Al Almana, 2011).
Most analyses suggest that these crises are primarily due to excessively rapid growth, that resulted in increased competition and multiple borrowing. However, our own observations from client interviews of one Moroccan MFI suggest that the analogy made between delinquency, competition and cross indebtedness does not capture the complexity of the phenomenon. One element that emerges from interviews involves the incentive to repay. Repayment does not depend solely on borrowers capacity to repay; it is strongly related to the MFI's legitimacy vis à vis its clients, and the extent to which clients appropriate the institution. Appropriation depends on two main factors, both which strongly influence whether the clients deem repayment important or not: the role of debt in borrowers’ financial strategies and the perception of sanctions. Both factors are instrumental in shaping the degree of trust or, conversely, distrust vis-à-vis the institution.

The role of debt

In rural areas where delinquency is more common, people have a low propensity to borrow. Credit is not a key component of financial management strategies. Instead, savings in various forms (grain storage, livestock) play a central role. Microcredit is seen as an opportunity at a given moment. In this context, being denied access to credit due to default is not considered an insurmountable problem. The incentive of getting a fresh loan to encourage repayment is rarely observed in rural Morocco, compared to other regions, like West Africa and India. Moreover, a majority of loans are unsecured loans. As elsewhere, we observed that group solidarity was fragile. Groups are mostly formed by the MFI and do not exist outside the credit process. At the slightest difficulty, solidarity dissolves, and one member's failure to repay can lead the entire group to default. In urban areas, the most common reason for default was the non-payment of one of the group members, and the unwillingness of the others to pay for that member (40% of the cases). Borrowers agree to fulfill their own debt, but are opposed to notion of group liability.

The perception of sanctions

Widespread default is directly related to the clients’ perspectives of a MFI's strength, sustainability and legitimacy to apply sanctions. In several villages studied, microcredit is perceived as a non-repayable debt, because microcredit programs are perceived as coming from the state (Maghzen), resulting in both massive
participation and strategic default. Because the microcredit provider is considered an outsider to the community, providing a service that is considered their due, HH do not hesitate to borrow as they do not fear sanctions in case of non-payment. The sense of impunity is reinforced when leaders instrumentalize microcredit, and call for non-repayment in a bid to win over popular opinion.

Moreover, our observations in urban areas show that legal sanctions are not effective. While surprise visits from loan officers may intimidate delinquent borrowers, few actually fear legal prosecution due to a slow judiciary and the small sums involved.

Taken together, these factors explain low levels of client appropriation of MFIs, and contribute to the reasons for strategic defaults in the Moroccan MF sector.

**Policy implications**

Strategic defaults are often underestimated by microfinance institutions. The client’s perception of the MFI can play a far more important role in repayment behaviour than is typically assumed. MFIs must focus on this aspect to prevent or reduce individual and/or collective strategic defaults.

More research is needed to assess to what extent strategic defaults contribute to total defaults. However we can draw some policy implications and we are convinced that achieving good repayment strongly depends on loan officers’ capacity to build close relationships with clients, which itself has to do with their integration in the local community. Recruiting local staff (native from the region) is a good way to reduce the distance between the "foreign" MFI and the client, which reflects the distance between the supply of credit and the financial habits of the population. But it is not enough. Achieving appropriation and legitimacy in a community takes time, and efforts to do so must be integrated into the institution's strategy. It is also crucial to closely monitor field staff and ensure a constant flow of information between branches and headquarters, as appropriation and legitimacy is the result of a constant exchange at all levels of the organization.

The history of credit policies (including the experiences of massive debt forgiveness) also contributes to creating “local cultures” that legitimize non-repayment. As a result, it is only over time, with constant efforts and in developing a climate of trust that delinquency trends can be reversed.

Finally, our research further reinforces the conclusion that savings, although prohibited by regulation for Moroccan MFIs, could play a key role, not only by
“topping up” credit offers that are too small or inflexible, but by reinforcing the link and loyalty between the MFI and its clients.