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How Good Repayment Performances Can Harm Borrowers: Evidence from the Dominican Republic

Solène Morvant-Roux
Joana Afonso
Davide Forcella
Isabelle Guérin

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Microfinance in Crisis Project
UMR 201 Développement et sociétés
Paris 1 Sorbonne University/Institute of Research for Development
45 bis avenue de la Belle Gabrielle
94736 Nogent-sur-Marne
Tel: 00 33 (0) 6 72 06 52 66

How Good Repayment Performances Can Harm Borrowers: Evidence from the Dominican Republic

Solène Morvant-Roux*
Joana Afonso**
Forcella Davide***
Isabelle Guérin****

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Abstract

High-standard MF service provision within a regulated and expanding industry, with low PAR and widely used credit bureaus, does not necessarily bring about positive social outcomes for clients. In the context of a highly dynamic MF industry, it can contribute to clients' financial fragility. Here we give evidence from the Dominican Republic.

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* Institut de démographie et Socioéconomie-IDESO, University of Geneva, Switzerland
** Independent Consultant, Portugal
*** Université Libre de Bruxelles, Center for European Research in Microfinance, Belgium.
**** Cessma-IRD, Université Paris Diderot, France

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1. Introduction

Recent delinquency microcredit crises have raised awareness as to the excesses and abuses of the microcredit system. They have drawn attention to household over-indebtedness and how microcredit can do more harm than good (Guérin, Morvant-Roux & Villarreal 2013). They have also pointed out the dangers of excessive, uncontrolled growth (Chen *et al.* 2010). This has helped reinforce the legitimacy and need for initiatives to better protect clients, such as the Smart Campaign for client protection (which started in 2009) and financial education programs. In the 2012 *Microfinance banana skin survey* for instance (Lascelles & Mendelson 2012)[1], practitioners, investors, regulators and observers ranked over-indebtedness as a top risk.

We however believe that lessons have still not been learnt, and that the case of the Dominican Republic is a good illustration of this. While indicators and practices point to the stability of the current situation, there are reasons to believe that some clientele, including some "good" clients[2], are struggling to make repayments and that microcredit is one of the explanatory factors.

As Gonzalez and Servet (2014) have discussed, various seemingly solid indicators of sound and prudent microcredit supply management are in evidence on all levels: growth and competition, screening procedures and risk management.[3] The sector has seen steady, but not massive growth (less than 18%/year on average from 2007 to 2012 for the five main MFIs in terms of portfolio volume, and around 21% in clients from 2008 to 2011)[4].

The market leaders pay particular attention to the macroeconomic environment, arguing that microcredit growth is perfectly sustainable given relatively strong GDP growth (5% on average from 2008 to 2012). As is often the case, the market is highly concentrated (Banco Adopem and Banco Ademi make up more than 50% of the supply) but the competition seems to be fair and cooperative. For instance, Adopem organizes training sessions that are open to (and followed by) other MFIs. The average loan amounts issued by the leaders suggest that

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1 The microfinance banana skin survey has been carried out annually since 2008 to identify risks in the microfinance industry from the perspective of an international sample of practitioners, investors, regulators and observers. The 2012 survey was done with 360 microfinance stakeholders from 79 countries.

2 From MFIs' perspectives, good clients are those who regularly pay instalments, if perhaps sometimes with some small delays.

3 What follows draws heavily on Gonzalez and Servet (2014).

4 Figures calculated from Gonzalez and Servet (2014) data, drawing on the mix market. The numbers for 2013 are not available for all the indicators and MFIs, but the two larger MFIs notably saw portfolio growth rates of 7.4% and 13.4%.

they operate among different segments of the population. There are two established private credit bureaus, which are widely used, including by some informal lenders who usually report to one of the bureaus (Gonzalez and Servet, 2014). For the largest MFIs at least, policies and procedures on the lending process (and particularly the screening process) adhere to international 'best practices'. This includes sophisticated techniques for assessing clients' indebtedness (including their informal indebtedness), repayment capacities and willingness to repay (Afonso 2013)[5]. This cautious sector management has kept portfolio risk under control, if not perfectly (PAR_{30} was 5% in 2013)[6].

But our field observations on the basis of a sample of microfinance clients contrast with this positive picture. We have found that many clients in competitive areas of the country endure great financial hardship: they have relatively high debt/income ratios, regularly make sacrifices to keep up repayments, increase their numbers of loans and have poor prospects of getting out from under high levels of debt in the near future. In the light of this, we might wonder why and how they manage to repay. Firstly, they have little choice but to do so, given the powerful incentive role of the credit bureau (which, from what we have seen, works well for lenders but does little to protect borrowers). They secondly juggle a variety of loan sources (including informal ones) to sustain their creditworthiness (but for how long?).

Although microcredit is far from the only factor, it certainly contributes to household financial fragility. Loan officers in competitive areas, constrained by high performance targets (which many cannot meet), are left with no choice but to focus on specific segments of clients (those who are creditworthy on paper), sometimes encouraging them to take on excessive risk. Our findings are based on qualitative analysis and make no claim for representativeness, but they do point out worrying trends that should be a matter of concern for the future of the sector.

2. Context

With a GNI per capita of 5470 US$, the Dominican Republic is classified as a middle-income country, with the largest economy in Central America and the Caribbean. It has been through rapid economic growth, with average GDP growth of 5.8% from 1991 to 2012 (with a 2014 forecast of around 3.6%). This growth has however been job-weak, and the relatively few

[5] Afonso draws on an in-depth analysis of Adopem practices, one of the two market leaders.

[6] Data from REDCAMIF Portfolio Quality Report December 2013 available at http://www.redcamif.org/uploads/media/Presentacion_Calidad_de_Cartera_Diciembre_2013.pdf

jobs created have mainly been low-skill or in the informal sector. As the World Bank has reported, real wages have declined by 27% over the last ten years.

37% of the labour force is viewed as vulnerable and lives without any social protection[7]. Despite recent efforts to tackle this, out-of-pocket health expenditure accounts for 38.7% of total health expenses. Infrastructures are still highly inadequate (in 2012 for instance, there were 17.7 electrical outages in an average month, in contrast to 2.5 for the subcontinent). Poverty is higher today (40%) than in 2000 (32%), although this is declining from a 50% peak in the immediate aftermath of local economic and financial crisis in 2003.[8] Growth has equally slowed down in the wake of the global economic crisis in 2008, in reflection of its strong dependency on the United States economy.

Over the same period, urbanization increased and almost half the population (45%) now lives in the two biggest cities (Santo Domingo and Santiago de los Caballeros). Consumerism also increased, as is reflected in the percentage of households with a mobile phone subscription (88%), an Internet connection (45%) or a motor vehicle (13.2%)[9]. These figures are lower than the average for the sub-continent, but much higher than that of middle-income countries.

As far as financial supply is concerned, 12 MFIs with a variety of legal statuses providing financial services to around 314,000 clients reported to the MixMarket[10]. As the introduction discussed, two institutions dominate the market – Ademi and Adopem. Both started out as NGOs and then turned into banks in 1997 and 2004, respectively.[11]

The microfinance landscape is much larger and diversified, however. There are firstly public programs with the declared aim of improving poor households' financial inclusion. These include Promipyme and Banca Solidaria, which are both partners with BanReservas (a public bank), and provide credit at lower interest rates than the private sector. Standard banks willing to downscale their activities (especially through credit cards) to low-income populations also work with microfinance clients. BHD and ScotiaBank are particularly active on this level and have set up separate microcredit units – "Crédito Amigo" and "Scotia Soluciones".

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7 ILO Key Indicators of the Labour Market database available at World DataBank – World Development Indicators (http://databank.worldbank.org/). Vulnerable is defined as 'unpaid family workers and own-account workers as a percentage of total employment'.

8 World DataBank – World Development Indicators: Poverty headcount ratio at national poverty line (% of population) available at http://databank.worldbank.org/

9 World DataBank – World Development Indicators available at http://databank.worldbank.org/

10 Penetration rate (2009): 16.7% as compared to Nicaragua (47.7%), Costa Rica (17.7%), Panama (4%) and Brazil (5%) (Pedrosa 2010). The sector growth rate over more recent years gives to think that the penetration rate is also growing.

11 Other institutions are following this transformation pattern is: ASPIRE became a cooperative in 2013 and FONDESA, the third biggest MFI, is in the process of becoming a credit and savings bank.

There are various other formal and semi-formal providers of credit to low-income households, including local cooperatives, non-profit organizations, and many small to medium sized companies. They usually offer credit at a higher interest rate[12] than MFIs, and have shorter terms and frequent instalments.

Beyond semi-formal and formal credit providers, various recent studies have shown that looking at informal financial landscapes can help to understand how people perceive and use different formal financial services such as microcredit (Morvant 2006; Collins *et al.*, 2009; Guérin *et al*., 2011). The linkages between microcredit and informal credit sources will be discussed further below, but here we will highlight some salient features of the financial landscape in these regards.

The Dominican Republic's informal financial sector is highly developed and dynamic. Ortiz and Garcia (2012) point out that 30% of the loans taken out by low-income populations in 2009 came from informal providers (Ortiz and Garcia, 2012). Lending money is perceived as a lucrative activity and many microcredit officers accordingly start their own moneylending businesses (after leaving their MFIs), while as we will see later, some microcredit borrowers are themselves moneylenders[13]. The informal sector also includes pawnbrokers, roscas, informal loans from relatives, friends or neighbours, and credit purchases for durable goods.

MFIs are thus part of a highly dynamic and interrelated financial landscape.

Box 1. Research method

This research uses qualitative analysis, which is best suited to unravel the cognitive and social processes underlying observed effects, i.e. how a given intervention sets off events that ultimately lead to an observed outcome. 85 interviews with diverse actors were conducted, with the aim of better understanding demand and the role of microcredit in clients' trajectories. We focused on specific neighbourhoods[14] in the two largest cities, Santo Domingo and Santiago, where competition is greatest and which account for around 40% of

[12]Contact with clients and some moneylenders indicated a common interest rate of 20%/month for informal loans, while one of the largest microcredit banks charged between 3 and 4.6%/month for the different business loans. In some cases, the difference between interest rates was not as wide as one might expect. One private moneylender interviewed applied an average of 8%/month.

[13]The estimated number of moneylenders in the country appears to be between 8000 and 11500 (Gonzalez and Servet 2014)

[14] In Santiago we focused on Cienfuegos, while in Santo Domingo we worked in three areas: West (Los Alcarrizos, Herrera and Las Palmas), East (Villa Faro, Alma Rosa, Los Minas) and National District (Cienaga and Villa Consuelo).

the microcredit portfolio.[15] We followed the basic rigour criteria for qualitative analysis. Diversifying cases was the first principle adhered to. We met 47 clients from 6 MFIs (Ademi, Adopem, Aspire, FDD, Fime and Fondesa) and 14 non-clients. We selected for diverse client repayment behaviours (using information from MFI staff): clients who always pay on time, those who are sometimes late, and those who are regularly late, while also ensuring to include the most common types of employment. Triangulation was another basic principle and took two forms: comparing and contrasting the observations of different researchers (most interviews were done jointly by two of us), as well as observations from various sources. Clients and non-clients were our main focus, but we also met 11 loan officers, 5 branch managers, 4 heads of 6 MFIs in our sample and 4 moneylenders. As far as possible, discourses – what people say – were compared and contrasted with practices – what people really do, by asking our interviewees to be very concrete. For more in-depth analysis, we carried out 49 interviews with 45 MFI clients and 4 non-clients. The socioeconomic characteristics of our sample were as follows: 34 women (69%), of whom 14 were single (plus 2 unspecified) who accounted for 29% of the total sample. In terms of age group, younger clients were less well represented (2 were under 30); but other age groups are well represented, with 37%, 33% and 26% in their thirties, forties and over fifty respectively.

3. Over-indebtedness and household financial fragility

(a) Assessing over-indebtedness

Financial fragility and over-indebtedness can be measured in various ways, including through financial indicators such as debt/income ratios, chronic debt, and number of loans (Guérin, Morvant-Roux and Villarreal 2013) or subjective factors such as the sacrifices experienced by the borrower (Schicks 2013). We used various indicators in our study, all of which confirmed that a large proportion of our sample is highly financially vulnerable.

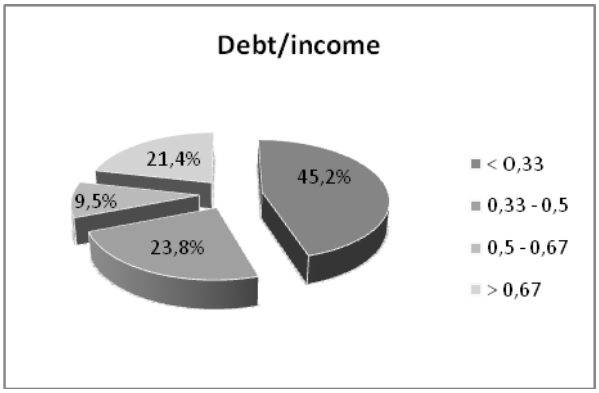
We calculated the debt/income ratio (monthly debt repayment compared to monthly income) of 42 households (Figure 1). In Europe, a common threshold for over-indebtedness is where households spend over 30% (or 1/3) of their gross monthly income on total loan repayments (secured or unsecured).[16] Repayment to debt ratios have their limitations in that they fail to take relative income disparities (higher levels of debt affect low and high-income households

[15] As of 31/12/2012, 34.4% of microcredit clients, 33.1% of portfolios and 35.7% of branches were concentrated in the Santo Domingo area (including the National District). The figures were 7.4%, 8.3% and 9.2% for the same indicators in Santiago (REDCAMIF). Note that 33.7% and 10.6% of the country's total population lived in these 2 areas in 2012 (Oficina Nacional Estadistica).

[16] There is no common European definition of household over-indebtedness. In 2008, the European Commission ordered a study entitled "Towards a common operational European definition of over-indebtedness" that further highlighted various differences between countries as regards its definition and measurement, and policies for tackling it. Some common elements and measures are however used to assess over-indebtedness. These include debt to income ratios, and arrears, number of loans and the subjective perception of debt (D'Alessio &. Iezzi 2013; European Commission 2008).

differently), and household assets into account, but these seem to be more significant limitations for high-income households, who are not microfinance institutions' focus. We therefore use this ratio as our indicator of reference, which places 23 of the 42 Dominican households as over-indebted. For nine of our cases (21%), debt repayment accounted for over two thirds of their monthly income.

Figure 1. Debt/income ratio of interviewed households



Looking at the two extreme groups (those with a debt/income ratio of below 0.33 and those over 0.67) it is key to note that only 2 out of the 19 less indebted households used microcredit to repay other debts, but this was microcredit's primary use for the most indebted (7 out of 9). By contrast, only 3 over-indebted households partly used credit for running a business, while in the other group, 7 used the whole loan to invest in a business, and another 5 partly did so. Four of the least indebted group had applied for the money in order to help others.

Financial vulnerability can also be assessed in terms of other criteria. These include short-term sacrifice (mainly on daily consumption) and long-term sacrifice (on housing and other investments), people's prospects of getting out of over-indebtedness (whether they have workable strategies for doing so over the coming years), and family support (which can be a deliberate repayment strategy, minimizing over-indebtedness).

Table 1. A broader approach to over-indebtedness

	Daily Sacrifice		Long-Term Sacrifice		Prospects of getting out of high debt		Family Support	
42 households	Yes	18	Yes	16	No	23	No	25
	No	24	No	26	Yes	19	Yes	17
9 households with debt/income > 0.67	Yes	9	Yes	8	No	9	No	5
	No	0	No	1	Yes	0	Yes	4

Table 1 shows that there are fewer households making daily or long-term sacrifices (43% and 38%, respectively) than the 55% with a debt/income ratio of over a third. This is in line with the argument that poorer and marginalized populations are highly skilled at adapting and tolerating sacrifices. For the other two criteria, the figures are very close to the debt indicator (55% have no exit prospects from high indebtedness and 60% lack family support as part of their repayment strategies). These factors further the gravity of the nine highly over-indebted households' situations, leaving them trapped a vicious cycle of debt and impoverishment. They make short and long-term sacrifices and have no prospects of breaking out of debt, despite four of them also having some form of family support.

Furthermore, it is important to stress that many households accumulate various sources of borrowing. Our 49 cases had an average of 2.85 sources of debt. 12 households (24%) had one source, 22 (45%) two or three and 12 (29%) four or more sources[17]. This went up to 4.3 for the nine most fragile households, some of which had as many as six or seven active debts. Most also resort to formal and informal financial suppliers. These borrowers constantly need informal loans to pay off formal loan instalments (or vice versa).

These various indicators allow us to see that some MFI clients are financially vulnerable. It is interesting to note that six out of the nine most indebted households (in terms of income) were introduced to us by MFIs, and that loan officers considered four of them as "normal" or "good" clients who always or often repaid on time. But these indebted clients were all open in interview that they struggled to repay their loans. One told us that he was always struggling and that he had no way out ("*siempre vivo con apuro y no hay forma de pararlo*"). Like others, he keeps struggling and "finding" the money somehow ("*cojo aquí, cojo ahí*"). But as most of them stressed, it is better to make sacrifices such as only eating rice and bananas than

17 In one case the information is missing.

to lose the asset of being a good payer. And, as another client mentioned, failing to pay is a source of shame (*verguenza*) so he always returns to the lenders even without the money to pay them. It's important to consider the origins of such financial fragility. We would argue that it stems from employment vulnerability, particular sets of household characteristics, inadequate infrastructure, and preferences for debt and easy access to it, all of which is putting some households into a very difficult situation.

(b) Key factors for financial vulnerability and over-indebtedness

As in other developing countries, the households have diverse portfolios of economic activity and sources of income. 26% of the interviewees had a single source of income, whilst 20% had four or more. Of these various sources, 11 households raised income by both renting out housing and money lending (22%), while a 3 further interviewees had plans to rent out houses in the future; 17 (35%) of the interviewees had their own or family members' wage earnings to contribute to their standard of living (35%); remittances, while essential for those receiving them, were rare (4 cases).

Men do most of the wage labour, for instance as municipal workers, security guards, drivers, factory and warehouse employees at private companies, and some in "zonas francas"[18]. Opportunities seem to be more restricted for women, who mainly work in "zonas francas" or lottery shops. It is difficult to find a job and wage jobs are low-paid so a significant proportion of the population (around 40%) is self-employed[19].

Self-employed men mostly work in one area: trade (grocery shops, esoteric and pharmaceutics, iron), craft (furniture making and renovation), and services (mechanics). Some men also sell small goods in the street, such as phone cards and various gadgets. Self-employed women often work from home, or do small-scale trade in fruits and vegetables, flowers, second hand clothes, underwear or cosmetics. Some also offer services like small restaurants, cafeterias and beauty salons. We also came across one case of handcraft (furniture renovation). Money lending is apparently quite a frequent source of income, both for men and women, and is usually done alongside other activities.

[18] In "zonas francas" (free zones) one finds garment/clothing companies but also footwear, tobacco and some machinery/equipment companies.

[19] ILO Key Indicators of the Labour Market database available at World DataBank – World Development Indicators (http://databank.worldbank.org/). It is important to note that many wage workers need to complement their low wages with other activities, and that Dominicans are pro-active and value their independence at work.

These entrepreneurs usually have low education levels. Their businesses are too small to thrive, being a poorly organised mix of domestic and professional budgets, while failing to differentiate themselves from other similar businesses, which leads to cash-flow problems, and in some cases, project failure.[20] This is epitomised in second hand clothing businesses, which usually sell on packages of clothes from the United States and were everywhere to be found in the two main cities. While being a source of income for over a quarter of our sample, it is a highly competitive and saturated market. There are few success stories, and households can at best survive on this unreliable source of income.

Jobs are no guarantee of financial stability however, as contracts are often insecure and wages very low. Wages can equally be a double-edged sword in as much as they facilitate very easy access to formal credit (to credit cards in particular), and may also encourage unrealistic aspirations (for instance for housing) and expectations among close family and friends.

A common feature of our nine highly indebted households is how they only had one or two sources of income. 1-2 members of three of the households surveyed were wage workers, but their incomes were not regular enough to solve their financial problems. None of the indebted families rented out accommodation or lent money, which are apparently the most secure income-generating activities.

Both individual and household characteristics and trajectories can also contribute to financial vulnerability. Disadvantageous situations can include disability and chronic health problems, single motherhood, and cash flow uncertainty. Households have a variety of structures, from individuals living alone, to single mothers with children from different partners, and extended families of up to eight parts. Households had four members on average, with 32 cases consisting of three to five members. The households we looked at were very diverse and levels of kinship solidarity varied a lot. A number of single mothers were struggling a great deal, but others were doing well thanks to sophisticated coping strategies, which makes it difficult to draw firm conclusions as to the impact of this factor.

It is easier to confirm the significant impact of inadequate infrastructure on various levels. Although there has been recent progress[21] in improving access to basic services and health insurance, many households still have social security and face maternity-related health

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[20] Loan officer training stresses the need for businesses to differentiate themselves from their competitors, but this is hard to do in practice with this level of competition.

21The "Tarjeta Solidariedad" programme helps poorer families meet some of their basic needs by including them in the Social Protection Net and allowing access to different programmes (food, gas, electricity, education, etc.) In February 2014, the programme was supporting 990,704 beneficiaries (with 59,462 million RD in subsidies, 52% of which for the food programme). Source: http://www.adess.gov.do/

expenses, which frequently contributes to financial vulnerability. Almost 60% of the households (29) can be considered as house owners, while 8 owned more than one (and up to four) houses. But many households have no ownership deeds, or only have one in a relative's name, while the term 'house' covers a wide range of homes, from large concrete houses to small rooms with iron roofs. The problems of absent or high-cost property deeds, as with the country's other problems, are offset by the lack of regulation. This has several drawbacks, including a lack of collateral to guarantee cheaper loans at traditional banks. It does however allow people to get hold of land at no or very low cost, and to rent houses as a business (in several cases this proved an important source of income, if not in terms of value, then in terms of regularity).

Finally, were often told that Dominicans "like" getting into debt and that they are strongly encouraged to do so by an abundant (and high-profile)22 credit supply. There seem to be little by way of saving practices, perhaps for cultural but also security reasons, which limits saving options. While some people keep savings at home (particularly those who were also lenders), most people said that they did not do so, for fear of being robbed. Safety concerns have been growing in recent years and have compounded a lack of appropriate saving solutions for poor clients, since even only some MFIs offer savings products.

The challenges of accumulating sufficiently large sums to invest, buy assets (houses, furniture, etc.), or to cope with emergencies (notably health-related costs and death), high consumption aspirations among the younger generations in particular, and the need to build a credit history (as we shall see below) are strong borrowing incentives. Though it is difficult to be admitted to traditional commercial banks, poor people have other, largely informal or semi-formal, solutions. These are usually financially costly but allow people to obtain and accumulate different types of loans. This raises the question of the capacity of households and local economies to absorb the growth of the credit supply.

As a final note on the nine highly indebted households, we can point to various typical scenarios. Some of the households plunge into debt after a specific crisis, most often owing to health problems or project failure (these may be business-related or the result of projects such as migration). Some people live with high debt for a long time, either due to very high poverty (as with an old widow we interviewed) or due to chronic cash flow problems in their

22 Many providers, whatever their status, advertize their products and information is readily available everywhere (small advertisement boards, flyers, loudspeaker cars, etc.)

business. This latter category includes wage earners who have unrealistic aspirations, and/or who face high expectations from their close family and friends.

4. Why and how do people repay?

As we have already highlighted above, both poor and non-poor segments of the population of the Dominican Republic have a strong demand for and use of credit (in contrast to Morocco for instance, see Morvant-Roux chapter in this volume). Credit sources currently serve a wide range of purposes in Dominicans' daily lives. But surprisingly, the ready availability of credit and strong cross-borrowing potential are not correlated to repayment defaults. This is firstly due to social norms on debt. Debt's central place in everyday life, and secondly results in strong commitment to maintaining creditworthiness (which is heavily reliant on a clean credit history) to keep credit options open. This feeds into the third factor: caring about a good repayment record is based on the powerful incentive role of the credit bureaus.

(a) Credit provider hierarchies, social norms and credit history

Field testimonies indicate that paying off debt is a strong social norm for Dominicans. Several interviewees regularly skip meals (including their children's) or cut down on food in order to pay what they owe (as with a mother who gave her children sugar water rather than milk to drink, or an old single lady who adjusted her meals according to what she owed). Many people talked about the social stigma of defaulting on payments. We were once told that delaying by over a week was shameful. As has been highlighted elsewhere, borrowers have their own hierarchies of credit sources, and not all debts have the same social and economic roles and meanings. We found in our fieldwork that people prioritised repaying what they referred to as the "bank" (namely formal credit providers). This held particularly true for marginalised people, as with two of our highly indebted interviewees: "the bank is sacred" or "the bank doesn't play". People allow themselves some leeway with repayments, but still observe strict limits. For those in desperate need of borrowing options, ensuring access to future loans is key: « *credit, es eso que hace uno caminar* ». Notwithstanding social norms therefore, our interviews found that their greatest motive was to secure further loans in the future. Moneylenders are also central to total indebtedness (51% of our sample borrows from informal sources) but as we will see, informal lending is frequently used to maintain

creditworthiness with formal lenders[23]. Maintaining one's creditworthiness and a clean credit history heavily depends on the power of the credit bureau.

(b) The powerful role of the credit bureau ('el diablo')

Credit reporting has recently attracted much attention from microfinance practitioners and policymakers in the face of high growth, competition and a growing risk of cross-borrowing and borrower over-indebtedness. Credit bureaus are seen as one of the most effective means to protect clients, for their role in preventing over-indebtedness caused by cross-borrowing practices.

As a recent CGAP focus note pointed out, all the lenders involved in a given market are meant to issue reports for the process to be effective (Chen et al. 2010). In recent credit bureau experience at the base of the pyramid, most have failed to do so. Not only do they fail to include all the regulated financial institutions, but they also ignore other credit sources, despite their importance in people's financial practices. Here again, the Dominican Republic is a typical case. The two privately run credit bureaus (DataCred and TransUnion) do have a large share of the credit provision for low-income populations, because they also include telecommunication companies, electricity, etc. As mentioned above, it is also interesting to note that some informal moneylenders (even if only a small percentage, estimated at around 10%) report to one of the credit bureaus (Gonzalez and Servet 2014).

Beyond the issue of coverage, the consequences of being blacklisted and how far this incentivises borrowers' repayment behaviours also matter. Our field observations suggest that credit bureaus are a very strong enforcement mechanism. They are 'el diablo', as we were once told, for various reasons. Firstly, borrowers who default are barred from future loans: borrowers are well aware of this and talk about it in interview. As they know they will regularly need credit, they are very careful to maintain a good standing. This incentive is all the greater in that the information exchanged does not just concern the credit bureaus: local lenders share information with one another (be these formal, semi-formal or sometimes even informal lenders), as well as regularly sharing information through loan officers (and possibly moneylenders) who know one another personally. A wide range of lenders may thus exclude people blacklisted by the credit bureaus, including those who don't issue reports, leaving them only have access to very small informal loans. Secondly, blacklisting can have dire

[23] People on the margins of formal financial inclusion do however build close relationships with moneylenders, as we saw with some of our interviewees.

consequences far beyond credit access: losing one's bank account, monthly mobile phone subscription, or even difficulties getting a formal job or a visa. Some large companies apparently request the credit history of job applicants, as do visa embassies (the US embassy in particular) for migration applicants. We met a security guard who had been confined to the informal economy and excluded from entering the US because he had been blacklisted.

Finally, this information remains in the credit history for several years (7 according to a branch manager). This all makes the credit bureau an extremely efficient means of enforcing repayment, while validating clients' worries and drive to maintain a clean credit history.

We will now turn to the question of how, in the face of high debt, people manage to meet repayments.

(c) Repayments: Juggling practices with informal borrowing and various temporalities

60% of the households in our sample reported having 2 or more debts, while 46% of the households borrowed from formal and informal sources at the same time (whereas 48% borrowed only from formal sources and 6% only from informal). It seemed to be common to borrow from one source to repay another. For instance more than one third (1/3) of households, as indicated above, used all or part of their microcredit to repay previous debts (this was the most frequent microcredit use after running a business).

An example of this is the case of a 47 year-old woman, "Maria". She lives alone with her 17 year-old son old. She has been trapped in a persistent debt cycle ever since the economic shock of a failed migration project for which she sold her house: she repays 12,000 pesos per week to 5 different informal lenders plus a debit card, while she earns around 50,000 per month (she owns a street food stall). According to the microfinance loan officer, she is a "good client" since she repays well, but he had not realized at the time she asked for a microcredit that she was already highly indebted. All these credits are used to finance her business, to pay the owner of her house and repay debts (S5).

The dynamism of the financial landscape allows for juggling debt between various options (formal, informal, semi-formal) and time frames. While microcredit most often lasts one year (and possibly longer for some providers), semi-formal and informal lenders offer shorter-term loans (six to fifteen weeks), with very frequent instalments (daily or weekly). They also show some flexibility. As discussed above, a wide range of informal lenders all have their own strategies, but as one told us, and as was widely confirmed by the practices we observed: it is

a “demand-driven” market, and they adjust to their clients’ needs. Our observations suggested that it is common for clients to set the frequency of instalments themselves, and moneylenders accept delays and reschedule loans without charging penalties (while MFIs charge for the slightest delay (one day) and start reporting to the credit bureau after 30 days).

Informal lenders' wide market coverage and highly flexible supply conditions allow vulnerable clients to repay formal loans, maintain their future borrowing capacity, and keeps the financial system sustainable, at least on the surface.

This partly explains why the different segments of the financial landscape (formal, semi-formal and informal credit suppliers) do not really fear competition, but instead cooperate and look for some degree of complementarity, as Gonzalez and Servet (2014) have discussed. Interviews with informal lenders confirm this: when moneylenders are approached by MFIs for information on their borrowers' creditworthiness, they do not worry about losing them. They know that if their clients take out a microcredit, they may need their own services further in the future to make the microcredit repayment.

5. The role of microcredit on household financial fragility

(a) The impact of microcredit on clients’ financial strategies

Out of the 40 cases giving information on microcredit[24], it accounts for over half of the household debt repayment of 26 households (65%), (while for 35% it is less than half), so one can fairly argue that microcredit is quite decisive in clients’ financial strategies. Table 2 shows that income generating activities are the primary use. 26 out of the 45 MFI clients (57%) used their microloan(s) (most often partly) for this purpose. We came across a number of cases where microcredit has been successfully used to maintain or consolidate a pre-existing small business (by raising or maintaining working capital, sometimes by investing in fixed equipment), and more unusually to start a new activity (often together with other sources). As indicated however, self-employed work is often small-scale and fragile, and many entrepreneurs operate in congested markets. ‘Productive’ uses are thus no guarantee of easy repayment. Furthermore, while running a business is the most frequent use; it is followed by (or combined with) debt repayment (17 cases, i.e. 37.8%), daily consumption (15 cases, i.e.

[24] Microcredit is understood here as all small loans from formal financial institutions (MFIs, public banks and standard banks).

33.3%), housing (12 cases), emergencies (which may include supporting relatives, 8 cases) and moneylending (5 cases).

Table 2. Microcredit usage

Microcredit Uses	Nº. Cases[a]	%
Business (working capital or equipment)	26	57.8%
Debt repayments	17	37.8%
Daily Consumption	15	33.3%
Housing	12	26.7%
Emergencies + Help others	8	17.8%
Money lending	5	11.1%

a : total exceeds 100% as loan usually serve various purposes

As the companion chapter on India in this volume argues, in a situation where people draw on a wide range of debt sources, it is extremely difficult to directly assess the outcomes of MFIs operations on clients' wellbeing. Moreover we do not have the right data to try to do so. What we have instead done is to analyse MFI procedures, their current implementation by loan officers and branch managers, and attitudes within them that could contribute to their clients' financial fragility.

(b) Assessing borrowers' creditworthiness in a context of strong concentration and competition

As mentioned above, and despite cases where microcredit seems to be very useful, many of the clients in our sample are financially fragile, and we found elements to indicate partial MFI responsibility for this. They have highly standardized and professional official procedures, including very detailed analysis of borrowers' creditworthiness (including informal loans), personal visits to clients' workplaces, credit bureau consultation, etc. (Afonso 2013). However, our empirical data on 6 MFIs, at least in the most competitive areas we looked at, shows up concrete practices that may contribute to clients' financial fragility.

Most of the actors we met acknowledged that there was high competition between MFIs. Though some MFIs claim that the potential market was still very large - one internal study discusses unmet (and solvent) demand from 2 million people - they stick to the same

geographical areas and activities. The two largest MFIs have very different average loan amounts (at Adopem it is around 2.5 lower than Ademi)[25]: while they do have very specific clientele at the two extremes of the spectrum, they heavily compete for the middle segment. The MFI managers we interviewed moreover regularly raised the point that specific areas of the market were saturated and that over-indebtedness was a risk. But there do not seem to be any concrete policies for preventing market saturation or over-indebtedness. While some MFIs discuss strategies for finding market niches (including private schools or zonas francas), most seem to keep competing for the same market segments.

It is difficult to give exact data on the extent of cross credits between MFIs, but our interviews indicate that they are common. A manager at on MFI's headquarters told us that on average their clients have two formal credits, while 15% have more than two. The CEO of another MFI told us that approximately 40% of its portfolio is shared with other MFIs. In two branches of another MFI, we were told that 40% to 50% of the clients are shared with others MFIs and that around 25% of them have three or more formal loans.

The loan officer of another MFI explained that it is possible for clients to have five or six active loans. The details of his portfolio are an interesting example. He had 270 active clients at that time, of which 175 were also the clients of other MFIs, and he had "stolen" 75 from other MFIs by offering a loan to refinance their previous debts. Refinancing other MFI debts seems to be commonplace. Most of the managers and loan officers we met deny it but argue that their competitors are doing it. We also met loan officers who were open about using this aggressive strategy to gain market share and meet targets.

There is also competition from government schemes, which are seen as unfair competitors and a potential risk (Gonzales & Servet 2014). Public intervention has grown quickly over the last two years with subsidized loans and, it seems, less attention to credit recovery[26]. MFIs cannot compete on price and so try to compete on service, especially for delivery speed (with the risk of lowering client selection standards). Some MFIs are afraid of losing clients because of this "unfair" competition, but our fieldwork suggests that clients combine both sorts of credit, either for different or the same purposes.

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[25] According to Mix data, the average loan in Adopem is 18322 pesos = 425 USD (2012) against 69075 = 1605 USD for Ademi (2011). (1USD = 43 DOP).

[26] Banca Solidaria offers business loans with an annual interest rate for individual loans of 12%. The program targets people on low incomes and informal business owners, people with ideas and business experience, especially women (www.promipymes.gob.do/)

Loan officers also have very specific performance targets. These relate both to portfolio growth and quality, and determine an important part of their monthly wages. In one of the two largest MFIs (the one for which we have precise data), incentives can represent around half of monthly wages for experienced loan officers, but only some are able to meet their fixed targets (Afonso 2013)[27]. It is then easy to understand why they may stray from official procedures in competitive areas, sometimes with the complicity of the branch manager who is also under a lot of pressure from performance targets.

In such a highly competitive market, it is easier to grow through existing clients than to find new one. Indeed, it is many MFI's policy to refinance clients once they have repaid without (too much) delay around three quarters of the loan.[28] They also try to offer larger amounts. Some of the interviewed loan officers told us that if 'good' clients do not ask for a second credit, they try to stimulate the demand, "creating the clients' necessities". "Creating the needs" seems almost to be an official policy at one of the MFIs we visited (at least at one branch in a competitive area). Loan officers making home visits to clients suggest possible ways to invest the credit, be it for consumption or running a business. Examples included buying a computer for the kids, buying or replacing a fridge, and home renovation. "When people tell us they don't need a loan, we try to convince them it would be useful", we were told. In this branch, a loan officer explained that all the loan officers behave like this and that they have weekly discussions on possible strategies to keep clients.

Another MFI sells appliances in its branches as a way of approaching potential clients and potentially combining the good's purchase with a consumption loan or another of the MFI's products. The client will have to regularly return to the branch for his/her instalments, which can be the opportunity to offer him/her a cash loan, as a loan officer explained to us. The MFI stores various kinds of appliances at its offices and headquarters.

6. Does the credit bureau help to prevent over-indebtedness?

The strong incentivising effect of credit bureaus has been discussed above. The maximum number of active loans registered at the credit bureau for a client to be eligible at an MFI is an

[27] Considering data from one of the MFIs for the first 6 months of 2013, out of 300 loan officers only 8 managed to meet their targets every month for loan numbers, and only 94 did so for more than 3 months. The results were better for the arrears target, with 114 managing to comply with the objectives every month.

[28] It is common policy for MFIs to renew loans, but some of them restrict this practice. One of the largest institutions encourages renewal for investment purposes but does not allow loans to be restructured in case of arrears problems.

interesting proxy for the offer and competition of the microfinance market.[29] The MFIs we met have various policies regarding the number of loans their clients are allowed to have from other lenders. Some have fixed the maximum at three, while for others the amount is flexible and depends on case-by-case evaluations, while others have no limit. Taking into account that only a small part of informal lenders report to one of the credit bureaus, the total number of loans could be much higher. We indeed found clients with five, six or more active debts quite easily during our interviews (see above).

In some MFI branches, credit bureaus are used not only to assess the level of debt of their potential clients, but also as a source of information for stealing clients from other MFIs. This is claimed to be a competitive strategy whereby loan officers try to recruit new clients by offering to refinance her/his debts from up to three competitors, while also offering additional funding to meet the new client's needs. As we were told by one loan officer, "when you see a client from another MFI, what do we do? We try to get them". The two effective credit bureaus (in the sense that credit providers use them) are supposed to guarantee the sector's security; nonetheless there are ways to get around them, as one branch manager and loan officer explained to us. Credit bureau information is not immediately updated (it can take up to a month). If a client applies for credit from more than one MFI at once, the request would not immediately register at the credit bureau and the client might then obtain more than one loan at once. We found such cases in our sample: a woman who had 20,000 and 15,000 pesos (around 465 and 350 USD, respectively) loans approved by two small MFIs, and another client who had applied for credit from three MFIs at once for 75,000, 75,000 and 50,000 pesos, and had managed to obtain a total of 200,000 pesos.

The picture we have painted in the previous sections shows that some clients with impeccable credit repayment records are in fact a very fragile position. But we found no clear MFI strategies for offsetting this issue. Moreover, some MFI head officers and branch managers claim that PAR quality can measure over-indebtedness risks because over-indebted clients could never maintain a small PAR for longer than a couple of months. The empirical data given in the previous sections challenge this claim and highlights the excessive trust put in indicators such as the PAR to measure over-indebtedness, preventing MFIs from reacting to possible non-repayment crises in a timely fashion, or from simply avoiding furthering their clients' financial fragility.

[29] It does not seem to be mandatory to check the credit bureau before every credit issue. At one MFI, we were told that it had been a year since branch managers had had to check for it in credit applications below 20,000 pesos. The branch managers nevertheless claim that to continue to look at the credit bureau for all credit.

7. Conclusion

High-standard MF service provision within a regulated, expanding industry with low PAR and widely used credit bureaus, does not necessarily bring about positive social outcomes for clients. It may instead, in a highly dynamic MF industry, contribute to clients' financial fragility.

On the supply side, the market leaders have seen very good repayment performances mainly because of the effectiveness of credit bureaus, along with borrowers' needs to maintain a clean credit history in order to access future loans. In competitive areas, it seems that the most convenient choice for the MFIs is to concentrate on similar segments and geographical areas, and that targeting underserved or excluded populations is seen to be too costly. Even if there do turn out to be large niches with a lower concentration of formal financial services, the scale of actual market demand is much more limited than repayment performances would suggest. People of course still need to access adequate financial services, but only when there is an investment opportunity or an emergency, and not all the time, as microcredit providers expect.

The anecdotal evidence from our sample suggests that it is quite different for various poor households to obtain get, but once a household obtains its first credit, the door is open for debt accumulation through MFIs and informal actors. In short, it seems that the microfinance industry has shifted its paradigm from fighting credit rationing to facilitating “too much debt” (for a specific segment of its clientele). The proportion of households able to continuously repay credits is limited, which could mean that growth targets should be revised.

As such, the notion of a “good client” (not only one who will repay but who will not be harmed by repayment) should be expanded in order to enable MFIs to fix their strategies and growth expectations in the light of the real financial needs of the target population, the saturation of certain areas in terms of credit supply, and local absorption capacities.

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