

Chapter 9

Dynamics of Group Lending Mechanism and the Role of Group Leaders in Developing Countries: Evidence from Nigeria

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ABSTRACT

Group lending mechanisms have increasingly become popular among microfinance providers in recent years. This is largely due to its ability to leverage joint liability to increase loan repayments whilst promoting an entrepreneurial spirit among borrowers. Meanwhile, a group-lending mechanism is also very important in promoting women's empowerment through cooperative engagements of all group members. However, the effectiveness of the group lending methodology in the delivery of microfinance within a de-

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veloping country context is largely under-researched. Using data from extensive focus groups interviews of women borrowers held in Nigeria among participants from 150 different groups, this article analyses the dynamics of group lending mechanism (group formation, peer monitoring, pressure and support). The article widens the current narrow literature on group leaders by providing a detailed empirical account of the activities of group leaders in a microfinance intervention. The findings showed that because group leaders are primarily held liable for loan delinquency of group members, they are more highly motivated than other members to monitor and pressure members. The results also suggest that while group leaders were found to perform vital roles, some of these group leaders abused their positions in ways that undermine group cohesion and microfinance sustainability. Lastly, the article introduces the “multiple card phenomenon” in group-based microfinance intervention.

1. INTRODUCTION

Lack of access to finance had been generally acknowledged as one of the main reasons why many poor people in developing countries are unable to departure poverty (Vanauken et al., 2016; Griffith-Jones & Brett, 2016; Griffith-Jones & Brett, 2016). The inability of the poor to provide suitable collaterals, required by conventional banks to hedge loan risk has been considered as the main rationale for excluding the poor from the formal financial system. Other cited reasons for that are the high transaction cost of screening, monitoring and enforcing loan contracts with a group of people who lack a useful form of banking history, as well as making it difficult for banks to profit from lending to that segment of the population.

However, since the successful microlending experiment of Professor Muhammad Yunus in Bangladeshi in the 1970's, the poor have increasingly gained access to microcredit through the help of microfinance institutions. The past two decades have particularly experienced an exponential increased in access to finance for the poor in many developing countries. From 1997 to 2015, the number of microfinance institutions rose from 618 in 1997 to 3725 in 2015. The number of poor people who have received finance from these microfinance institutions rose from 13.5 million to 211.1 million (157.6 million of them being women) during the same period (Microcredit Summit Campaign, 2015)

Microfinance achievements in reaching millions of poor people in a developing country are largely owed to group lending mechanism employed by many microfinance institutions. Group lending has been applauded for being able to innovatively solve the problem of lack of collaterals and high transaction cost associated with lending to the poor. It does this by grouping borrowers in ways that create incentives for peer selection, peer monitoring and peer pressure of members to fulfil loan repayments obligations. Previous studies (Besley & Coate, 1995; Ghatak, 2000) have argued that the group lending mechanism is effective at motivating group members to carry out the responsibilities mentioned above by tying future loans of each member to loan repayments of every member of the group. Most group lending models assume that all members monitor each other and that monitoring efforts of members are equal (Van Eijkel, et al., 2011). This paper argues that by depending on all group members to carry out voluntary monitoring and pressure duties, exposes the fragility of the group lending mechanism. For instance, peer-monitoring transfers risk from the bank, which is in a better position to bear the risk, to the co-signer (Stiglitz, 1990).

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