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Isaac Koomson
ikoomson@myune.edu.au / koomsonisaac@gmail.com

James Atta Peprah
jpeprah@ucc.edu.gh

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Isaac Koomson[1] [b c]
Email: ikoomson@myune.edu.au or koomsonisaac@gmail.com

James Atta Peprah [a]
Email: jpeprah@ucc.edu.gh

[a] UNE Business School, Faculty of Science, Agriculture, Business and Law, University of New England, Armidale, NSW, Australia
[b] Department of Economics, University of Cape Coast, Cape Coast, Ghana
[c] Network for Socioeconomic Research and Advancement (NESRA), Accra, Ghana

Abstract

This paper sets out to provide a detailed transmission mechanism between multiple borrowing and over-indebtedness and to link over-indebtedness to microcredit addiction using desktop review and a focus group discussion with microfinance practitioners from Ghana. We find that addiction to microcredit has both supply- and demand-side causes. Some of the supply-side causes include MFIs' upscaling intentions, unhealthy competition among MFIs, group lending methodology, compulsory savings, and high interest rates and transactions costs. On the demand side, we found factors such as clients' inability to save for the future, clients' satisfaction with MFI products and services and multiple borrowing behaviour. If MFIs do not fail in the delivery of their core mandate regarding poverty reduction, clients' addiction to micro-credit will be reduced substantially.

JEL Classification: *A14, G21, O16*
Key words: *over-indebtedness; multiple borrowing; microfinance; addiction*

1. Introduction and motivation

The uptake of microcredit by poor households has been documented as having many positive benefits including poverty reduction (Dunford, 2006), financial development (Shaw, 2011); improvement in the social and economic situation of women (Littlefield, Morduch, & Hashemi, 2003), women's empowerment and reduction in the incidence of domestic violence (Peprah & Koomson, 2014); giving and improving self-respect and dignity (Chowdhury, 2009) and many more. The opposing side to this argument is the myriad of studies that have also shown that advancing loans to the poor could cause more harm than good, as the accumulated debt that must be repaid would lead this already-poor people into further impoverishment, creating a possible cycle of debt (Yang & Stanley, 2012) and over-indebtedness resulting from multiple borrowing (Alam, 2012).

[1] Corresponding author: ikoomson@myune.edu.au or koomsonisaac@gmail.com

The link between multiple borrowing and over-indebtedness has been well documented (Mpogole, Mwaungulu, Mlasu, & Lubawa, 2012; Schicks, 2014) but how these two lead clients of microfinance institutions (MFIs) to remain with them for longer periods than expected (microcredit addiction syndrome) has not been the main focus of many microfinance studies. Our focus is to first, provide a detailed transmission mechanism between multiple borrowing and over-indebtedness and to also explain the demand- and supply-side drivers of microcredit addiction using evidence from some African countries.

2. Multiple borrowing and over-indebtedness

Multiple borrowing[2], which has a higher potency to result in over-indebtedness, stitches clients to MFIs for a longer period of time than expected. Of the two microfinance crisis in Africa (Nigeria and Morocco), that of Morocco was characterized by multiple borrowers as high as 40% and this, coupled with other factors, eventually led to "repayment crisis" in the microfinance industry in 2008 (Chen, Rasmussen, & Reille, 2010; Haldar & Stiglitz, 2014). Schicks (2014) also found 30% of MFI borrowers in Ghana to be over-indebted. Due to the proliferation of MFIs and how they make credit easily accessible to the poor, the recipients are mostly not able to resist the temptation and divert the funds to purchase a fridge or a television or non-explicit needs (Reiter & Peprah, 2015). It may be a smooth affair for a while but problems begin when an emergency like sickness or lack of employment arises. To pay such loans, recipients mostly fall on other MFIs to pay previous debts which amounts to multiple borrowing and can expose the household to over-indebtedness. Multiple borrowings to repay the past loans or rescheduling of loans to adjust the over-dues do not overcome the problem; the poor borrowers just get some reprieve (Alam, 2012). The conditions explained above puts clients in a situation of vicious cycle of repeated borrowing (Figure 1). Over-indebtedness results in staying with the MFIs to make sure loans are repaid in full.

Figure 1 shows that a client has three options regarding the use of microcredit. The client can do business with the loan, divert the fund (i.e. for other activities or other investments) or split the loan into two (part for business and divert the other). The business entity can succeed or fail. If the business succeeds, the assumption is that the client is able to repay the loan and when it fails, he/she has to find means of repaying the loan. The failed entrepreneur has two options at his/her disposal — either to sell off assets or borrow from friends/relatives to repay or to borrow from another MFI to repay the loan, just like others who diverted the funds. Those who decide to borrow together with others who divert the funds go to MFI_2 for loans. MFI_2 also gives the loans to the client/household that now owes loans and interests to MFI_1 and MFI_2. Amounts to be paid to MFI_1 and MFI_2 will end up with the MFI sector in general. This means that the desire of the household to borrow to solve financial problem(s) rather cause them to engage in multiple borrowing hence, the vicious cycle of multiple borrowing. According to Yang and Stanley (2012), the poorest of the poor use loans advanced to them to meet basic needs first and do not invest into self-employment that has the possibility to increase their income levels and haul them out of poverty. In this instance, loan repayments are not a guarantee of poverty reduction but rather a possible plunging of the poor into further debt with another creditor (Yang & Stanley, 2012). The vicious cycle of multiple borrowing is shown in Figure 1 below.

[2] Multiple borrowing refers to a situation where clients borrow from different institutions at the same time or at regular interval and has the possibility of keeping the clients with the MFIs for a longer time (microcredit addition

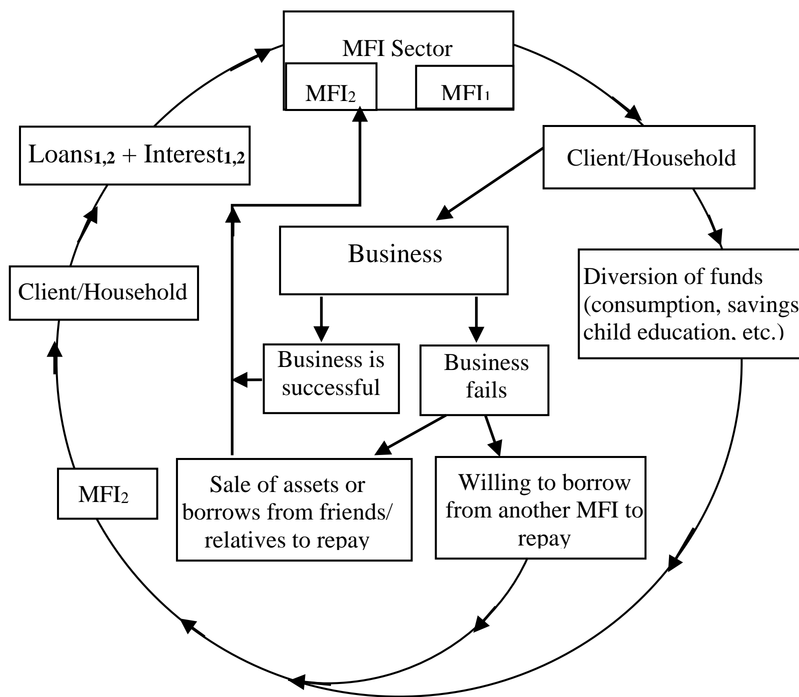

Figure 1: Vicious cycle of repeated borrowing
Authors' Construct, 2013

3. Addiction to microcredit

Considering credit as a normal good or any other physical commodity, we apply the theory of addiction to the analysis of why poor people/households become addicted to microcredit. The refined food addiction model explains addiction as emanating from consumption of foods with high concentrations of caffeine, sugar, fats, carbohydrates, flour, salt and others. Similar to drugs, the potential addictive powers of such goods are enhanced after they have been extracted and concentrated by modern industrial processes (Corsica & Pelchat, 2010). Relating microcredit addiction to the refined food addiction model helps to tentatively state that interest rates and specific loan packages may be the cause of loan beneficiaries' addiction to microcredit. Again, we can add that just as modern industrial and extractive processes enhance the potential addictive powers of goods, so does the recent developments and profit-seeking tendencies of MFIs have the potency of making clients more addicted to microcredit. There are both supply- and demand-side factors behind microcredit addition and some of these have been explained in the subsequent paragraphs.

3.1 Supply side causes of microcredit addiction

3.11 Upscaling intentions of MFIs

Upscaling is the development in the microfinance sector where non-governmental organisations upgrade their status from NGO to bank or non-bank financial institution to be able to make use of different sources of funding (e.g. take deposits) and distribute profits (Terberger, 2003). We find the case of FINCA Uganda, which started with a village banking methodology in 1992; became a microfinance deposit-taking institution 12 years after (2004); introduced newer technologies in 2010 and by 2014, was dealing in savings, loans and money transfers (FINCA Uganda, 2017). A similar story can be said of FINCA Tanzania which was into the provision of credit to small entrepreneurs, mainly in rural areas, and later became the first Microfinance Bank to be licensed by the Bank of Tanzania — enabling it to accept

deposits from the public and to carry out banking services as an MFI (FINCA Tanzania, 2017).

In Ghana one route to upscaling is where an institution starts as a microfinance company, upgrades to savings and loans and finally becomes a universal or commercial bank. This is dependent upon meeting the minimum capital requirement by the Bank of Ghana. Once an MFI intends to upscale, it does all it can to retain its clients so that they move to the next scale with them than starting all over. In a focus group discussion, some Ghanaian microfinance practitioners had this to say:

> *We picked these very poor people who had barely any assets (business skills and education) and gave them financial training and all that they needed to make their businesses flourish. If their businesses have grown and they are able to deposit bigger sums with us to increase our loanable funds and money creating process, why must we let them go?*

One implication of this situation is that the MFIs grow bigger, reduce their operation cost but charge high interest rates on loans advanced to their retained clients. Another implication is that until the MFIs achieve their aim of upscaling, the loan beneficiaries would also not realize their dream of upward financial mobility.

3.12 Unhealthy competition among MFIs

In microeconomic theory, increased competition, expectedly, drives prices downward but this is not the situation in all microfinance sectors and especially when the microfinance sector reaches the consolidation phase in its growth and expansion (Porteous, 2006). According to Srinivasan (2009), intense competition among MFIs is considered among the root causes of poor people's addiction to microcredit, especially the kind of competition which lowers borrower selection standards, weakens relationships with customers and leads to multiple borrowing and high defaults. Evidence from Tanzania shows that while increased competition presents clients with wider choices regarding where to seek to credit, anecdotal evidence, coupled with observation, has shown that increase in the number of MFIs has resulted in increased multiple-borrowing (incidences of one client with five different loans at the same time were not uncommon) and is likely to result in over-indebtedness (Mpogole et al., 2012). An increase in the number of defaulters implies that such clients must, in their future quest to get out of default, stay with MFIs which amounts to both social and financial immobility.

3.13 Group lending methodology

Lending to groups has both positive and negative impact on loan beneficiaries. On the positive side, especially on women, members of a group develop social ties, have joint liability and learn the skills of other group members. In Ghana, women jointly attend social gatherings (such as funerals, marriage and naming ceremonies) which gives them a sense of belonging. In Kenya, results from loan repayments of joint liability borrowers is reported to be well above 97% (Kiiru & Kenia, 2007). Although group lending is characterized with relatively low default rates and has been implemented across the African continent, (Kodongo & Kendi, 2013), the default by one person means that the other members must remain with the MFI until the defaulted amount is repaid. This period of stay until loan is repaid is another dimension of the microcredit addiction syndrome.

3.14 Compulsory savings

According to Rosenberg, Gonzalez and Narain (2010), some MFIs require borrowers to make compulsory deposits before they can benefit from a loan. Usually, borrowers must maintain these deposits during the life of the loan. From a study in Ghana, Koomson, Annim and Peprah (2016) found that savings is more likely to cause loan refusal than the income of

the borrower. With the Ugandan experience, group lending clients are usually required to make 25% pre-paid security deposits before accessing credit (Wolfsgruber, 2014).

In Ghana, for instance, Adjei, Arun, and Hossain (2009) studied the Sinapi Aba Trust (SAT) and found that almost all loan beneficiaries must have had at least 10% of such loan amount in the form of savings deposits prior to the disbursement of their loans. Low income people are characterized as having very low savings ability so they are compelled to borrow from family and friends just to satisfy a loan disbursement requirement. The worsening debt problem gets them stuck to MFIs.

3.15 High interest rates and transactions costs

Apart from interest rates, transaction costs can be substantial including, for instance, the time borrowers have to spend away from their businesses, their transportation costs, and the negative impact of delays in receiving loan funds. More time away from business leads to a dent in business profit and growth of firm size. In Kenya, the main fees include application and loan insurance fees (Smith, 2015). Since interest charges can be quantified easily, they tend to receive much more attention than borrowers' transaction costs. In fact, these transaction costs often represent a greater expense for the borrower than the interest being charged on the loan (Robinson, 2001). As regards interest rates, some MFIs are alleged to charge usurious interest rates and engage in forced loan recovery practices which are considered unethical (Shylendra, 2006). Reiter and Peprah's (2015) study in Ghana indicated that some MFIs charge as much as 40% interest per annum. In Uganda, the Kamwokya Christian Caring Community (SACCO) was noted to charge 40% per annum (Wolfsgruber, 2014).

3.2 Demand side causes of microcredit addiction

3.21 Clients' inability to save for the future

A myriad of studies have been carried out to indicate the numerous positive effects of microcredit on clients' income and savings. Conversely, in Ghana, Stewart et al. (2012) stated that the relationship between microcredit and income is positive in some areas and negative in others. For some areas, in particular, it became evident that those who had borrowed for longer periods had lower incomes. Those who experience these negative effects will also experience decreased savings. According to Armendariz and Morduch (2000), despite the higher transaction costs associated with more frequent repayment, borrowers who lack savings options may actually prefer microfinance loans when they are in need of money, increasing the addiction of clients to microcredit. Clients are addicted to microcredit due to their inability to save for the future. This may particularly relate to women who have difficulty in keeping funds away from spouses or individuals who face repeated requests for assistance from family and friends.

3.22 Clients' satisfaction with MFI products and services

When an MFI's product and services do not meet clients' needs, it results in high dropout rate (Wright, 2001). In Tanzania, the major reasons for clients' dropout rate have been found to include competition, rigidity and narrow range of products and services, time-consuming weekly meetings and others (Maximambali, Lwoga, & Rutherford, 1999). By implication, MFIs that are able to provide tailor-made services to meet the needs of their clients (see Reiter & Peprah, 2015) will have their clients being very satisfied. Also, MFIs with the aim of reducing loan default, in the absence of collateral, credit histories and restrictive agreements, provide incentives such as guaranteed access to larger loans with better terms for one-time repayments. This also entices clients to stay longer than usual so as to access relatively larger loans that come with better terms so long as they are able to

properly service the previous debt. It is worthy to note that MFI clients benefit from loan rescheduling when they default or delay in repaying their loans. These unique characteristics of microfinance and microfinance products make microcredit tantamount to food that has high concentration of sugar, salt or fats which cause clients to crave for more microloans.

4. Conclusion

This study sought to explore the reasons why MFI clients become addicted to microcredit, and also draws on the linkage between multiple borrowing and over-indebtedness. From the extant literature, it became evident that the reasons for this addiction could emanate from both supply- and demand-side factors. Some of the supply-side factors include MFIs' upscaling intentions, unhealthy competition among MFIs, group lending methodology, high compulsory savings, and high interest rates and transactions costs. On the demand side, we came across factors such as clients' inability to save for the future, clients' satisfaction with MFI products and services and multiple borrowing behaviour. We advocate that as microfinance institutions scale up and reduce their cost of operations, they should have the welfare of their clients and their business growth by providing them with affordable credit in the midst of commercialization. To reduce multiple borrowing, MFIs in a particular region or district, can publish and disseminate names of clients among themselves. This way, a client seen appearing on the list of two or more MFIs is monitored closely and made to choose one MFI after paying his/her loans (the approach of Vision Finance Company (VFC) and Urwego Opportunity Bank (UOB) in Rwanda.

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