

## **Over-indebtedness in the Philippines: Clients' Perceptions**



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## Research Issue

Over-indebtedness occurs when an individual takes loans beyond his/her capacity to repay. A low income individual who falls into such a situation will suffer hardships, as basic needs will have to compete with loan obligations for limited funds. For a poor microfinance client, this could mean skipping meals in favour of making a loan payment ... or defaulting on the loan. Clearly, no microfinance institutions (MFIs) would want any of their clients to be trapped in debt.

However, more and more cases of over-indebtedness are being reported. MFIs cite over-indebtedness as one of the top reasons for delinquent accounts. This is confirmed by the Centre for the Study of Financial Innovation (CFSI) which identified over-indebtedness as one of the major causes for credit risk contributing to increased delinquencies in MFIs.<sup>1</sup>

Lack of information on over-indebtedness prevents microfinance institutions from taking a more proactive response to managing the situation. *MicroSave*, in partnership with two socially-oriented financial institutions, ASKI<sup>2</sup> and ASHI<sup>3</sup> conducted market research to understand the phenomenon from the perspective of microfinance clients in the Philippines. In particular, the study discussed the following topics with clients:

1. Indicators of over-indebtedness, and strategies employed to avoid, and get out of, over-indebtedness;
2. Sources of loan payment, and household decision making processes to allocate cash between different expenditure requirements; and
3. Information to assess capacity to repay a loan.

## Research Objective

The research aimed to provide market information to financial institutions on over-indebtedness in order to help them develop client protection strategies. The information can also help financial institutions protect their biggest asset, their loan portfolio, from delinquency.

Key questions that the research sought to answer were as follows:

1. What are the indicators or factors that could lead to over-indebtedness?
2. What are measures that clients take to avoid getting into over-indebtedness?
3. If clients find themselves over burdened with debt, how do they get out of it?
4. Where do clients usually get money for loan payments?
5. How does the household decide on uses of cash to meet expenses including payment of debt liabilities?
6. What information do clients use to determine their repayment capacity when considering taking a loan?

## Participants/Sample

The study covered 123 women with outstanding loans under the group lending programmes of ASHI and ASKI. It focused on urban-based clients where the incidence of multiple lending and over-indebtedness is considered to be higher as compared to rural areas.

ASKI clients from Plaridel and San Rafael Branches in Bulacan participated in the study. Bulacan is considered a first-class province in terms of income.<sup>4</sup> Both Plaridel and San Rafael are first-class municipalities (annual income of P135 million [\$3.07 million] and P106 million [\$2.41 million], respectively) of Bulacan with the former classified as urban and the latter partially urban. The most prominent industries in the area include agribusiness and aquaculture.

ASHI clients are serviced by the Bacoor Branch in Cavite. Both provinces and municipalities are also classified as first-class income-wise. Proximity of Bacoor to Metro Manila has caused a shift of its local economy from

<sup>1</sup> CFSI/CGAP Microfinance Banana Skins Report 2011

<sup>2</sup> Alalay sa Kaunlaran, Inc. (ASKI) or 'support to progress' in English.

<sup>3</sup> Ahon sa Hiras, Inc. (ASHI) or 'rise above poverty' in English.

<sup>4</sup> Municipalities are divided into income classes according to their average annual income during the last three calendar years: 1st class-P50 million or more, 2nd class-P40 M or more but less than P50 M, 3rd class- P30 M or more but less than P40 M, 4th class- P20 M or more but less than P30 M, 5th class- P10 M or more but less than P20 M, and 6th class- below P10 M.

agriculture- and fisheries-based to a residential/commercial urban centre. Commercial activities range from wholesale to retail trading, restaurants and eateries, hardware and construction supplies and other service-related industries.

**Table 1.** Provincial Statistics of Study Sites

Institution	Province	Municipalities	Income (2008) In Pesos	Income Classification	Urban/ Rural	Prominent Industries
ASKI	Bulacan	Plaridel	135,382,505 (US\$ 3.1M)	First class	Urban	agribusiness and aquaculture
		San Rafael	105,865,750 (US\$2.4M)	First class	Partially Urban	agribusiness and aquaculture
ASHI	Cavite	Bacoor	670,349,863 US\$15.5M)	First class	Urban	wholesale to retail establishments, restaurants and eateries, hardware and construction supplies and other service-related industries

### Tools Used

Thirteen focus group sessions were conducted using Focus Group Discussion (FGD) guide or Participatory Rapid Appraisal (PRA) tools.

**Table 2.** Tools Used

Tool	# of Sessions	Focus of Discussions
FGD	5	Perception on debt burden and how clients avoid or deal with it, determining debt payment capacity
Attribute Ranking	4	Define and rank the most important factors that lead to over-indebtedness
Household Generation, Receipt and Spending of Cash Analysis	4	Determine sources of cash and understanding household cash management, determining who makes the decisions on use of cash, determining and prioritising weekly household expenses in times of financial difficulties
Total	13	

### Profile of Participants

#### Number of Years of Membership

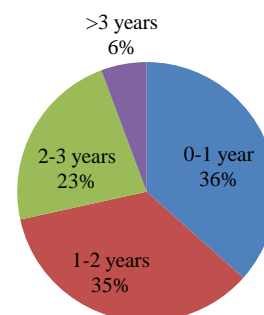
More than a third (36%) of the sample is composed of relatively new clients, who have borrowed from the MFI for one year or less. The rest (64%) have been members for one year or more. Of this figure, a small percentage of 6% have been with the MFI for more than 3 years. The sample offers adequate number of years of experience in availing microfinance.

#### Current Loans Available

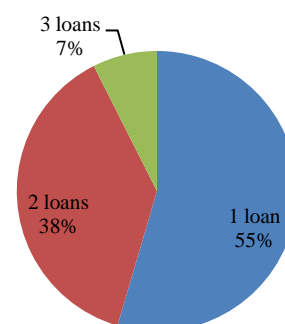
Slightly more than half of the sample manages one current loan with the MFI (55%). This is usually the micro-enterprise loan, which is the base loan product required for clients to join the programme.

In addition to micro-enterprise loans, clients who have more than 1 year of membership with good credit record become eligible to other loan products. This is the common way for MFIs to provide incentive to clients who demonstrate financial discipline, enterprise growth, and loyalty. A good number of

**Figure 1.** Number of years as MFI member



**Figure 2.** Number of current loans from the MFI



clients in the sample, 38%, took a second loan for house construction/repair, or children's education, or for emergency use such as hospitalisation. A further 7% of clients have taken three loan products at the same time from the same MFI. This shows that MFIs' systems, of themselves, can spur multiple borrowing among the clients. This validates calls for MFIs to put in place mechanisms to assess debt-carrying capacity and to avoid over-indebting their clients. This analysis does not, however, include additional loans that respondents might have taken from other MFIs, informal sector sources or family and friends. *MicroSave's* previous study of this phenomenon indicates that "multiple borrowers obtain their extra credit from non-bank financial institutions (43.94%) like MFIs, followed by family members and relatives (30.30%), and individual money lenders at 24%."<sup>5</sup>

A look at the loan amount shows that majority (63%) manage loans within the P5,000 to P15,000 (US\$ 116-345) range. At an average loan size of P10,000 (US\$233) for a loan with a 25 week term, this implies a weekly amortisation of P400 or P57 per day (US1.33). This repayment responsibility seems manageable as this comprises less than 15% of minimum wage of around P400 per day in urban centres like Metro Manila.

A smaller group of clients (14%) meet debt obligations for total loans above the P30,000 (US\$700) range. This appears to be a big amount for a low income client to manage. However, clients elaborated that loan products offering larger loan sizes, for example for house repair or construction, are structured by the MFIs with a longer repayment period to make the weekly amortisation small and more affordable. This indicates another important way for MFIs to address needs of its clients.

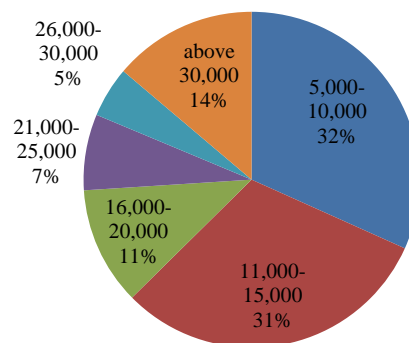
### Businesses Engaged in

Most clients manage sari-sari (community retail) stores (24%). Another most common type of enterprise at 23% is food vending, which includes selling cooked food as well as raw meat and fish. Dry goods or retailing of items such as ready-to-wear clothes and shoes accounts for 10%. These three sets of clients mainly conduct petty trading for the mass market. Entry to these types of businesses is relatively easy due to the small amount of capital required. Because of the ease of entry, many engage in these enterprises and this spreads customer base thin, resulting in limited sales, income and growth. The fierce competition can lead to bankruptcy for the less experienced.

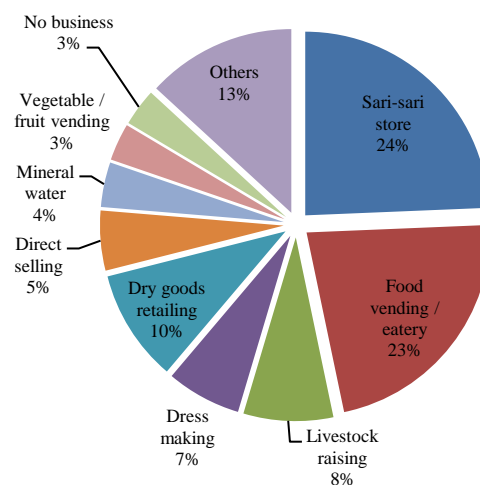
The production sector is represented by livestock raisers (8%) and dress makers (7%). Some clients acknowledge going into livestock raising in order to save. In times of emergency, hogs and chicken are sold and turned into cash.

The data shows 3% of clients having no business at the time of the research. Some are caught in a phase where the business just closed down or they were about to start a new business. Clearly, it is not enough for MFIs to track loyalty or continuing interest to borrow among clients. For repeat loans, it is crucial for MFI field personnel to know the status of client's enterprise/s. This highlights the value of close monitoring and having updated knowledge on the situation of clients and their sources of income.

**Figure 3. Total current loan principal amount borrowed from the MFI (Php.)**



**Figure 4. Participants' Businesses**



<sup>5</sup> Diaz et al., "[Multiple Borrowing in the Philippines](#)", *MicroSave*, 2011

### Perceptions on Borrowing from an MFI

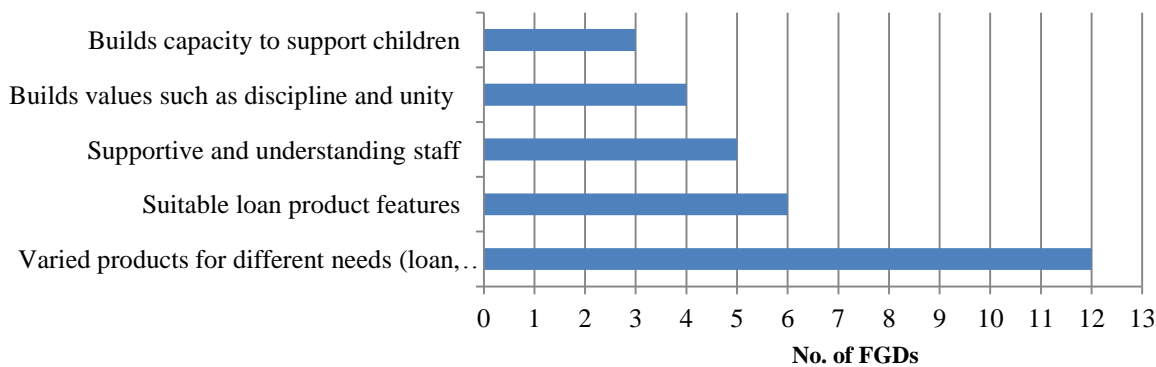


Figure 5. Top five reasons for borrowing from an MFI

The most common reason cited for borrowing from an MFI is the presence of a broad range of products to meet the varying needs of the clients (12 of 13 group discussions). These products include loan, savings and insurance. *“Maganda ang layunin ng organisasyon. Nandyang na lahat ng pagkakataon para umasenso. Marami silang mga produkto na pwede naming gamitin para umasenso sa buhay.”* (The institution has a good purpose. It gives us all the chances to succeed. They offer many products to help us become progressive.) *“Hindi ko naman sana kailangan ang utang para sa negosyo ko. Pero nung sinabi sa akin ang mga benepisyo, katulad ng insurance at nakikita mo na tumataas ang savings mo, naging interesado ako at sumali.”* (I did not really need to borrow additional capital for my business. When I was told of the benefits like insurance and savings that one can grow and monitor, I got interested and thus joined.) Another client remarked, *“maraming mapagpipiliang produkto kagaya ng housing kung magaling kang magbayad.”* (There are many products to avail such as housing loan when one can show good repayment record.)

From above client quotes, we find a variety of needs. One may need a loan, others need more than one loan, while there is another group who may not even need to borrow and would rather have access to micro insurance and savings.

The second top reason for taking a loan from an MFI relates to product features that suit the conditions of the client (6 of 13 groups). *“Mababa ang binabayaran namin bawat linggo, kompara sa 5-6.”* (We pay a smaller amount per week, compared to the amount we repay to individual money lenders like the “5-6”.<sup>6</sup>) Another client adds, *“walang collateral, basta mag-attend ka lang ng meeting.”* (No collateral is required; you just have to attend the meetings.)

Borrowing from MFIs is also seen as helping clients build values such as trust and financial discipline. They value being trusted by the MFI. This motivates them to work hard and do well, and return the favour by fully meeting financial obligations with the MFI. Orderly conduct of client meetings in the community bring in interested clients as well. *“Hindi kami mawawala sa utang. Para sa amin kasi, sumisikap talaga ang tao basta may utang.”* (Debt will not lead us astray. For us, a person perseveres as long as there is debt to repay.) *“Noon, palaging umiinom ‘yung asawa ko. Nung sumali ako dito, pinuntahan talaga ni Manager ang asawa ko at sinabihan niya na huwag nang uminom at tumulong sa akin para makabayad sa utang. Hanggang ngayon, ‘di na siya umiinom.”* (My husband used to drink alcohol a lot. When I joined the MFI, the manager visited my husband and told him to stop drinking and instead help me so I can pay the loan. Now, he does not drink alcohol.)

Helpful and understanding staff attracts clients. *“Gusto talaga namin na active ang mga tauhan. Kahit manager, umiikot talaga para kilalanin at makipagkwentuhan sa amin. Madali lang silang pakiusapan kapag may*

<sup>6</sup> “5-6” is a local term used to describe Indian individual money lenders that supposedly lend at a rate of 20%, hence lending 5 and receiving 6.

*problema sa pagbayad.*” (We like it that the staff is active. Even the manager visits and talks to us. They are also easy to talk to when we have repayment problems.)

## Client's Resource Allocation and Management

### On Household Cashflow Management

The research looked into the household cashflow management to understand where the money for loan payment comes from and who makes the decision for resource use when money is scarce.

### Sources of Cash for Loan Payment

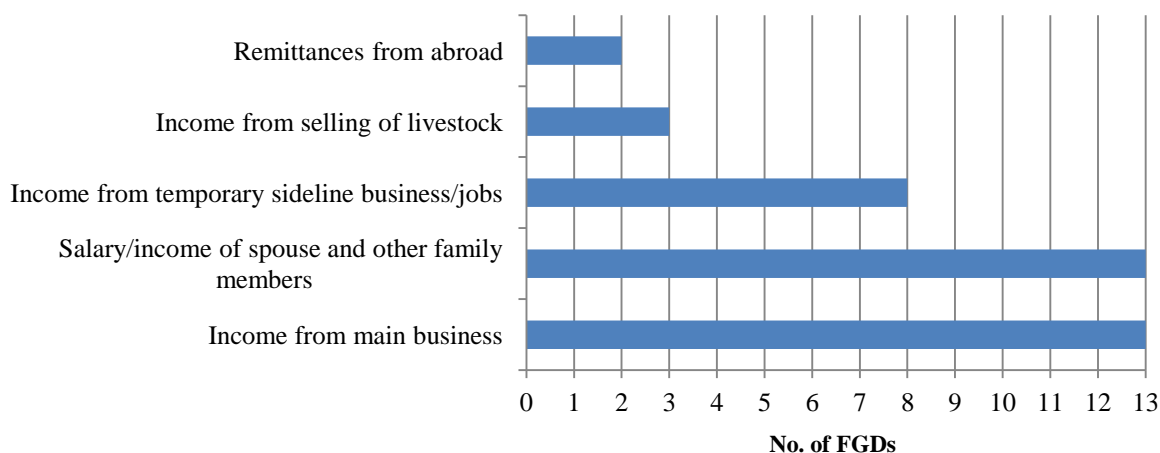


Figure 6. Common sources of cash

Figure 6 shows that having two sources of income is common among clients' households. Incomes from both client and spouse are pooled together to meet the expenses of the household. Clients with good businesses however have the confidence to say, *“Dapat hindi inaasahan ang sweldo ng asawa na gagamitin na gastusin sa bahay. Ito dapat ang tinitipid at ginagamit kapag may emergency.”* (One should not depend on the salary of the husband to cover the daily household expenses. The salary should be saved and used during emergencies.)

In some cases, children still living with the client or other family members working in other places contribute to the family cash inflow as well.

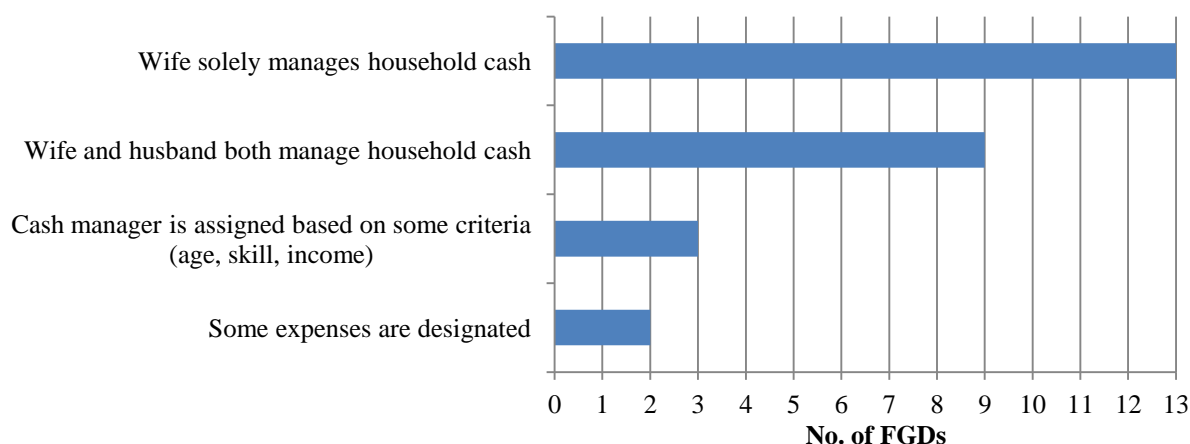
Income of the client's spouse usually comes from employment or provision of services. Among the common jobs being held by spouses are: security guard, factory worker, construction worker, company or family driver, and government employee. Among the services being provided by spouses are: tricycle driving and carpentry. Some spouses are also farmers and fishermen.

These income sources are, however, prone to seasonality and irregularity of income flows. *“Kung umuulan, walang masyadong trabaho sa construction kaya wala ring kita ang aking asawa.”* (During rainy season, there is not much construction work available so my husband is unable to earn at this time.) Even the businesses of clients experience seasonality in sales. Customers have been noted to buy more at harvest time or when there are special occasions like graduation and Christmas.

In general, loans will be paid from these income sources. *“Basta may utang, gawan talaga ng paraan para makabayad. Kapag kulang ang pambayad ko, kahit maging labandera saglit, para lang makakuha ng pambayad.”* (One who has debt will find all means to repay it. When my money is not enough for loan payment, I temporarily become a laundry woman to earn and receive cash.)



## Control of Cash



**Figure 7. Household cashflow management**

In the household, the client, who is usually the wife, mainly handles the money (13 of 13 FGDs). This arrangement works well because the wife, who is usually working at home or within the community, is more accessible to the rest of the family members. She is entrusted with budgeting and supplying the provisions for the family. *“Ang babae ang sumisikap maghanap ng pera sa pamilya kasi siya din ang may alam sa lahat ng gastusin sa bahay”* (The woman strives to find money and supplies the needs of the family because she is the one most familiar with household expenses.)

While the client mainly handles and decides on use of cash of the family, purchases involving large amounts like appliances, motorcycle, etc. are usually discussed with her spouse (9 of 13 FGDs). This is done to avoid quarrels in future when client will be called to account for funds in times of financial difficulties.

In some cases, where the couple still lives with the parents, the mother manages the cash (3 of 13). There are also some couples where both husband and wife keep their incomes to themselves and take the responsibility to pay for designated expenses, for example the monthly house rental will be paid by the spouse out of his bi-monthly salary, while daily food expenses will be paid by the client out of her daily enterprise income. This is not a common practice however.

**Table 3. Gender Roles in Cash Generation, Receipt and Use**

Sources of Cash	Generating Cash		Safekeeping of Cash		Deciding over use of Cash	
	Men	Women	Men	Women	Men	Women
Business income	**	*****	-	*****	*	*****
Salary of husband and other family members	*****	-	**	*****	***	*****
Income from sideline jobs	*	*****	-	*****	**	*****
Borrowing from informal sources	*	*****	-	*****	*	*****

Table 3 shows the degree of labour distribution between man and woman to generate, handle and decide on use of cash obtained from four sources: micro enterprise, employment, side jobs, and borrowings.

The woman clearly performs the key role in the household's cash generation and management. With the responsibility for handling cash and stretching it to cover all the needs of the family, it becomes imperative for the woman to earn supplementary income when the man's income is small and irregular. If both incomes are not enough, the woman also bears the responsibility to borrow money or engage in side jobs to meet expenses. The man, on the other hand, is mainly focused in generating income. He takes a minor role in decision making on the use of cash, with his involvement usually initiated by the woman when she needs second opinion. In a few

cases, the man exercises some control in handling his income, but is not involved in handling cash earned by the woman.

What are the views of the women participants on this big responsibility entrusted them?

- Acceptance: *“Hindi gusto ng lalaki na maraming iniisip. Kaya binibigay lang palagi sa babae.”* (Men do not want to have so many things on their minds. That is why they give the responsibility to the women.) *“Pasaway ‘yung mga asawa namin kasi—umiinom, sumusugal.”* (Our husbands have vices—they drink, gamble.)
- Acknowledgement of capacity: *“Dapat’ yung marunong magdala. Kaya kung short, siya din ang maghahanap kung saan makakakuha ng pera.”* (Let the one who knows how to handle money be responsible. When money is not enough, she will also know how to find money.) *“Mas matalas ang pag-iisip ng mga babae.”* (Women’s mental skills are sharper.) *“Dahil kami ang nagbubudget sa bahay, kami lang ang may alam kapag may kulang. Sa panahon na iyon, kami ang gumagawa ng paraan para makabayad sa lahat ng gastusin.”* (Because we do the budgeting, we are the only ones who know of any shortfalls. In these times of scarcity, the women find ways to ensure that all expenses are met.)
- A right to be claimed: *“Inanakan na nga kami, dapat nasa amin ang pera nila.”* (We gave birth to [and nurture] the children, it is just right that they hand-over their earnings to us.)
- Vanguard of family reputation: *“Kung hindi kami makabayad, kami naman ang mapapahiya, hindi naman sila [asawa].”* (If we cannot repay [the liabilities], we are the ones who will be humiliated, not our husbands.)

It is worth noting that Filipino women seemed to have embraced the many roles entrusted them. For MFIs offering or considering extension of financial literacy programmes to build capacity in financial and debt management, targeting women as participants to this programme would be most appropriate.

### Ranking of Loan Payment Among Household Expenses

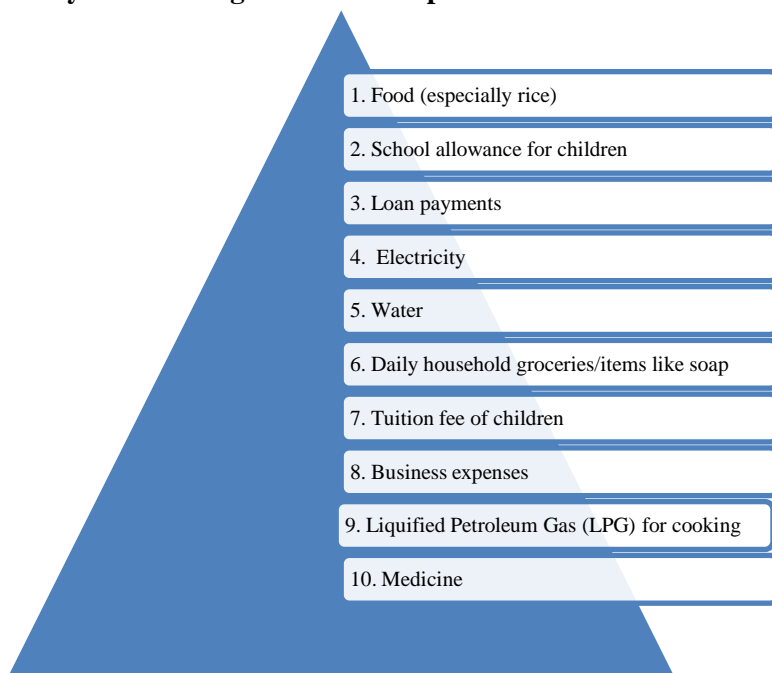


Figure 8. Weekly household expenses prioritised based on claim to cash

Clients identified loan payment as a major household expense and accords it third priority - coming after food and school allowance of children. Food is given highest priority as a healthy body enables them to work and earn. Also it keeps them from getting sick and avoid of having to spend money on medicine. *“Mahirap na kasi kung walang laman ang tiyan, nanghihina ako. Hindi ko makakayang magtrabaho. At mas lalong magastos kapag nagkasakit.”* (An empty stomach makes me weak. I will not be able to work. And it is also costly to get sick.)

Sending children to school with food money is also very important to the participants. *“Kasi mahirap na pumasok sila na walang makain, di sila maka-isip kung ganoon.”* (It is hard for children to think on empty stomach.) *“Hindi na katulad ang mga anak natin sa atin noon. Kahit walang pera, pumapasok pa rin kami. Ngayon, kailangan talagang may baon sila. Kaya nga nagsisikap kami para hindi nila maranasan ang hirap na naranasan namin noon.”*(Children nowadays are different. When we were students, we still go to school even without money. Now, they really have to have a school allowance. That is why we work hard so they do not have to experience the hardships that we underwent.)

Clients also view education as an investment with the expressed hope that when the children graduate, they could earn and contribute to the family income.

When both food and education of the family are taken care of, the remaining funds can then be allocated to loan payment. The main reason for meeting their loan obligations is to have continuing access to loans and other products and services of the MFI. Key to this is to maintain the trust of the MFI in them. *“Mahalaga sa amin ang makabayad sa [MFI] dahil kami ay pinagkatiwalaan. Ayaw naming masira, ‘di kami maka-ulit.”* (It is important that we repay the MFI, because they trusted us. We do not want to ruin the relationship or else we cannot borrow again.) *“Gusto namin na maganda ang performance namin para maganda din ang credit rating. Ito ay para makautang kami ulit at para makuha din namin ang mga incentive loans.”*(Good performance yields good credit rating. This entitles us to borrow again plus avail of incentive loans.)

### Other Ways to Repay Loans

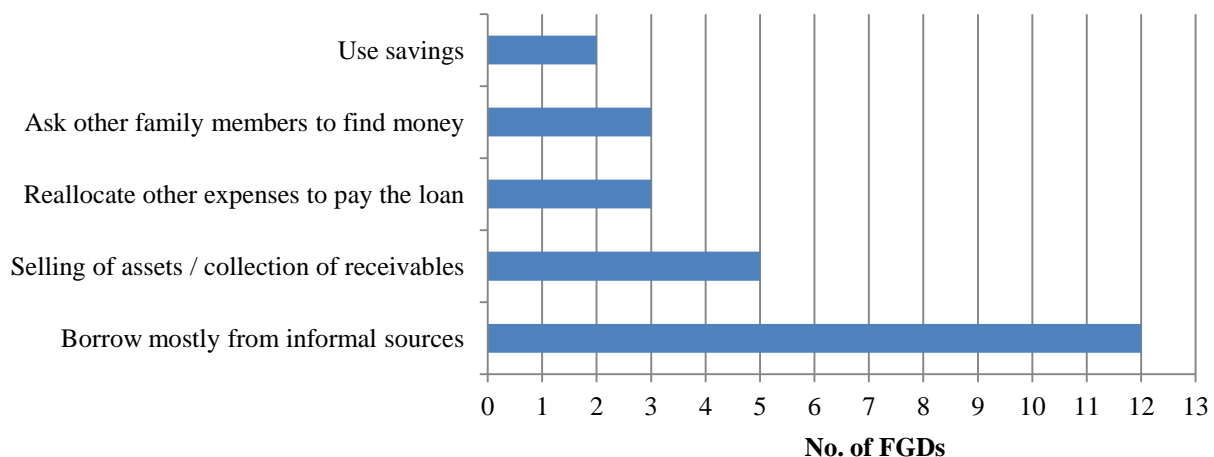


Figure 9. Sources of debt payment when regular household income is not enough

When income falls short, participants resort to several ways to come up with money for loan repayment. The most common approach is to borrow from informal sources. Most participants cited borrowing without interest from family, relatives and close friends (12 of 13 FGDs). Since the amount for a weekly amortisation is generally small, participants find it easy to borrow from family or friends with the promise to repay within a short period of time like the following day or by the next salary period covering 15 days. This type of borrowing is based on goodwill founded on a long-standing relationship. As in their MFI loans, clients honour this obligation to have continuing loan access.

Social networks are important assets that low-income clients tap in times of financial stress. MFIs that help clients build and strengthen their social network of friends, such as hosting team building activities among borrowers in groups, actually perform good service to clients. However, MFIs should be wary. There is chance that this common practice of repaying a loan from another loan may lead to over-indebtedness if left uncontrolled.

Those who do not want to borrow, or have no more creditors to approach, sell their assets, primarily livestock or collect loans receivable from customers. Some also pawn their jewellerys or appliances to receive cash.

'Belt tightening' or spending less on basic needs such as food and school allowance is the third most common way to find money for loan repayment. *"Kahit magtiis ako at magtitipid sa pagkain, sisiguraduhin kong bayaran ang mga utang ko. Mahalaga talaga ang tiwala na ibinibigay ng institusyon sa amin kahit wala kaming pangkolateral."* (Even if I have to sacrifice on quantity and quality of food, I will do so to make sure that my loan is paid on due date. It is important to maintain the trust of the institution, which did not ask for collateral.)

When the client has exhausted her network of fund sources, she asks other members of the family to get the money from their network of friends and relatives. She does this only as a last resort as she does not want her family to lose trust in her.

Savings are also used for loan payments, but with only 2 of 13 FGDs presenting this answer, this does not appear to be a common practice. This coping strategy offers an opportunity for MFIs to add value to clients by making savings more of a common practice among clients.

### On Over-indebtedness

Clients cited the following as the most prevalent drivers of over-indebtedness: loss of income, multiple borrowing, unexpected emergencies, and seasonality of income.

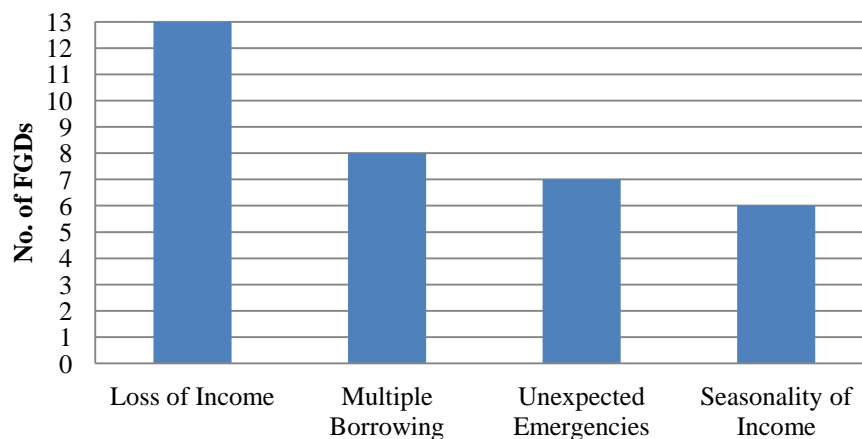


Figure 10. Drivers of debt burden

The most common reason cited for borrowing, and then borrowing more, is loss of income. Clients become over-indebted when expected income does not materialise. This may be due to irregularity, instability or vulnerability of the household's income. The unstable nature of clients' business and the employment of their spouses make the clients vulnerable to loss of income, financial difficulties and taking additional loans. All focus groups affirmed this reality.

In addition to loss of income, reduced income from seasonality of income and expenses is another driver cited by clients. *"Sa construction, kapag umuulan, walang trabaho ang asawa ko. Kapag sa panahon na'yun, alam na naming mahihirapan na kami magbayad."* (In construction, there will be no work for my husband when it rains. During those times, we already know that we will have difficulties in loan payment.) For clients whose

businesses depend on customers from the agriculture sector, sales usually dip in times of planting, and peak in times of harvest.

Seasonality of income and expenses also leads to financial difficulties and can result in over-indebtedness. This is usually experienced by families with school-aged children that require payment of tuition fees at start of school term or before mid-term and final examination. *“Ngayon nahihirapan talaga ako kasi mayroon akong nasa college. Lahat ng pera namin ay pumupunta sa gastusin ng anak para makatapos sa pag-aaral.”* (I am experiencing financial difficulties these days as I have a child who goes to college. All our money goes to the expenses of our child so he can finish his schooling.) This expense continues to increase as the school-aged children move to higher levels of education, without parents' income increasing proportionately.

When income is affected and expenses steadily increase over time, some basic expenses like food that cannot be postponed will drive clients to borrow ... sometimes beyond their means.

Another common driver of over-indebtedness is multiple borrowing. As seen in the study, loans are readily available, and borrowing can even occur within one institution on easy terms. Clients affirm that in times of sudden need, in particular, it is easier to access loans than to generate extra income.

As long as there are credit providers, clients will keep on borrowing and use this as their coping mechanism in times of need. *“Kung marami ka nang sinalihan at nangungutang ka na para bayaran ang ibang utang, hindi na malagyan ang negosyo mo, at mas lalo kang mahirapan magbayad kasi sa negosyo ka dapat kumukuha ng pambayad.”* (If you have borrowed from many sources and when you start paying debt with debt, then you cannot put money into your business. It will then be more difficult for a struggling business with limited capital to bring enough income to meet expenses.) This quote emphasises the danger of using a loan to repay an existing loan. The financial need may be addressed in the short term but in the medium term this coping mechanism can impair the client's capacity to earn. Multiple borrowing is aggravated when the client turns to the loan sharks for immediate cash despite the exorbitant interest rates involved.

An unexpected event requiring money is another common driver that leads to over-indebtedness. Among the events that clients identified are sickness and accidents. Sickness by the income earner brings 'double trouble' as it calls for money to pay for medicines and possibly hospital confinement, while it reduces income of the household from inability of the sick member to work.

### Avoiding Over-indebtedness

Many ways to avoid over-indebtedness were presented by clients. The study grouped these into two common strategies: budgeting and loan management.

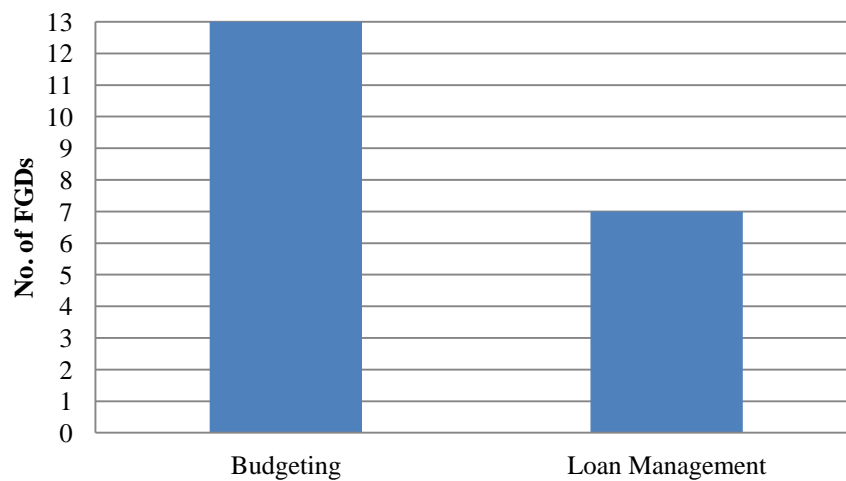


Figure 11. How to avoid over-indebtedness

In budgeting, some activities cited by clients include:

- Note the expenses to be covered for the week (some clients make a record of the expenses);
- Determine cash inflow and set-aside money for important and urgent expenses (for example, account receivables collected on Wednesday will be used to repay for the loan due on Friday);
- Spend only on needed expenses, avoid over spending by tracking items on the list; and
- Make adjustments on expenses if there is shortfall in expected inflow.

In cases where all expenses are urgent and important and income is not going to be enough, many clients will engage in side jobs. *“Dapat sumikap ka din maghanap ng kita. Hindi pwede ang pahiga-higa ka lang. Mahirap kung iisa lang ang inaasahan mo.”* (Persevere to earn. One cannot just lie around and depend on one source of income.) More proactive clients already know the value of diversified sources of business income. Those in trading make it a point to sell a variety of products to cater to different markets and different seasons.

In loan management, clients insist that one should only borrow what one can repay. Their advice is to exercise self-control. *“Dapat mangutang nang kaya lang bayaran. Dapat may control sa pag-utang, at alam mo ang kapasidad mo. Ito ay depende sa negosyo mo.”* (One should borrow within one’s capacity to pay. Be in control. Capacity to pay depends on the [income of the] business.)

Clients however are wiser after having gone through a situation of over-indebtedness. *“Napansin namin na kung dalawang loans ang kinuha, medyo kaya pa ‘yan bayaran. Pag sumobra doon, diyan na minsan nahihirapan ang tao magbayad. Huwag na dapat kumuha ng loan na malaki – dapat ‘yung kaya lang.”* (We observed that having two loans is still manageable. However, if you get more than two, you will start having difficulties. Avoid getting a large amount of loan - only that amount which you can manage to repay.)

### Overcoming Over-indebtedness

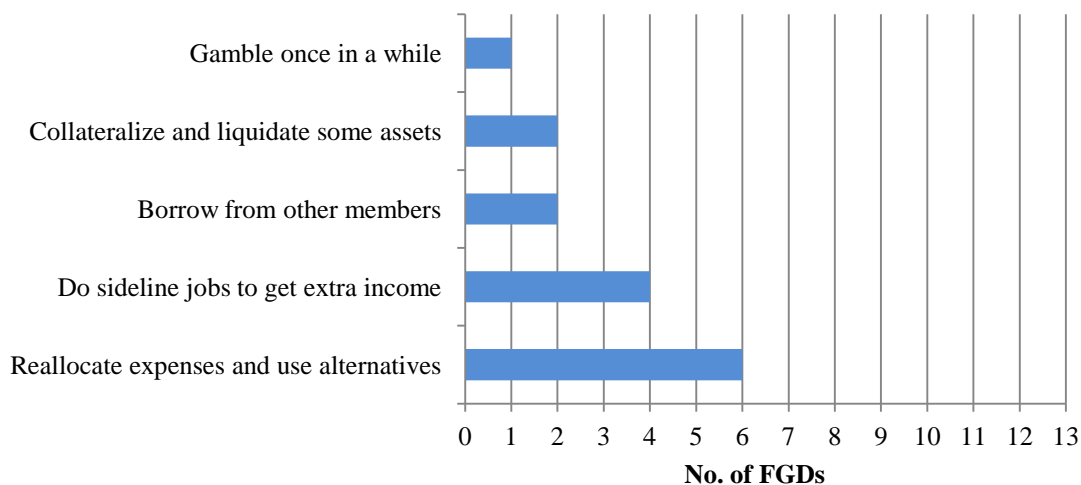


Figure 12. How to overcome over-indebtedness

The most common response of clients to overcome over-indebtedness is to reduce expenses and reallocate the savings to loan repayment. This could mean buying less food and for instance serving one kind of food instead of the usual two; using wood for fuel (P10 a bundle per day) instead of spending on a lump-sum to buy an LPG (P800 per tank of liquefied petroleum gas) or use of kerosene lamps instead of electric lights when utilities are cut off for non-payment. In some days, children may be asked not to go to school to allocate school allowance money for loan repayment. *“Dapat maghirap ka muna, at ikaw pa rin ang gagawa ng paraan para makabayad. Hindi problema ng institution ‘yun, problema mo ‘yun, kaya dapat gawan mo ng paraan.”* (One should sacrifice and find ways to repay. It is not the problem of the institution; it is that of the borrowers. That is why the borrower should find a way.)

To complement expense reduction, clients also work harder to increase income. This usually means working longer hours to take on side jobs. *“Sa mga panahon noon, lahat ng trabaho ay sinubukan ko para makakain lang kami.”* (During those hard times, I tried all kinds of job so I could feed my family.)

Even when already burdened by too many loans, other clients are still able to borrow from members of their group. A client can depend on peer support during these times especially when group members know that the client is sincere and not negligent.

Clients also dispose of assets through sale or turn them over as collateral to settle the loan. This could involve loss of production assets which further inhibits the capacity of the client to earn. To overcome debt, some clients can indeed become poorer.

In an extreme case, clients in one discussion group admitted to engaging in gambling or game of luck in hopes of getting more money out of the little they have. This response is included to highlight what clients do out of desperation.

### Information To Assess Debt Capacity

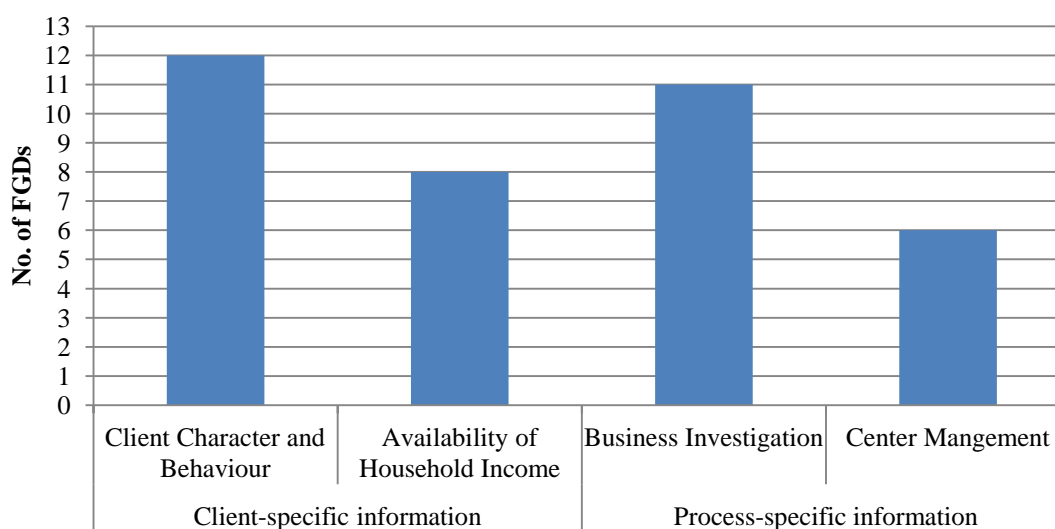


Figure 13. Information to assess capacity to repay a loan

As participants borrow under the group lending methodology, they also perform the function of assessing capacity of prospective group members to pay. Their decision to approve the entry of a new group member is usually based on client-specific information that includes character and financial position. Important character traits and qualities that clients look for in fellow clients include:

- Trustworthy; *“Dapat marunong magtupad sa obligasyon.”* (One who honours obligations.)
- Good steward of money; *“Kailangan marunong gumamit ng pera. Hindi kung saan-saan lang gamitin.”* (One who is capable of handling money; not spend on just about anything.)
- Hard working and experienced in business
- Responsible; finds solutions to problems and do not get easily defeated; children are sent to school
- Harmonious relationship in family
- Long-time resident of the area.

To assess a potential group member’s financial position, clients look for:

- Have an existing business
- Have other members of the family contributing to the family income; *“Dapat may sapat na trabaho. Iyong tipong permanente at hindi yung extra-extra lang.”* (The kind of job that is good, secured and not of irregular status).



Based on above preferences of clients for fellow clients, it is clear that the very poor members of the community whose income sources are unstable will not be given priority to join in borrowers' groups.

Clients also expect MFIs to gather client information out of two processes employed by MFIs: 1) thorough business investigation by the MFI field personnel; and 2) thorough credit investigation by the centre chief/group leader. Clients accord the task of assessing the business (i.e. if the client's business earns enough income to cover loan repayment) to the MFI due to the technical knowledge and skills required for a thorough business investigation. *"Dapat may matibay na negosyo, yung tipong pangmatagalan."* (A client should have a stable business, one that will last.)

Clients refer credit investigation (i.e. if the client has multiple membership and has other loans with other service providers) to the centre chief as she is a trusted member of the community and can draw sensitive information from other community residents and even from staff of other service providers. *"Dapat magaling ang center chief at mabusisi sa pagpili ng mga kasamahan niya."* (The centre chief should be capable and meticulous in choosing her members.)

Moreover, centre chiefs are expected to actively monitor and manage their respective centres as the risk of default by a member exists every week. Weekly discussions on each member's financial status should be conducted to track their financial capacity to repay and to assist anyone in need to avoid delinquency. *"Kahit kilala mo din at kapitbahay mo pa, hindi mo talaga masasabi kung tatakas ito. Dapat patuloy ang pag-uusap."* (One cannot be sure if someone, even a neighbour, will run away from debt obligations. There should be active communication.)

After validation from the centre, if investigation shows that the client is over-indebted, the MFI should take the hard position not to approve a loan. According to many clients met during the FGDs, not lending to an over-indebted client could be the most appropriate action for the MFI to take.

### **Implications for MFIs**

Despite the small sample, the study highlights microfinance clients' perceptions of debt as well as their debt management practices. This section presents MFIs with implications and recommendations to consider when addressing the issue of client over-indebtedness. The implications fall under three headings: 1) assessment of capacity to repay a loan; 2) continuous product development; and 3) building, tracking and using information to prevent over-indebtedness.

#### ***Assessment of Capacity to Repay a Loan***

*Focus on household-level instead of just on business level.* Loan payment does not only come from the income of the business financed, but from the pooled income of the household. As such, it is best to conduct cash flow analysis (income and expenses) of the household in assessing repayment capacity.

*Highlight stability over irregularity and variability.* Low income clients' income is characterised by irregularity and seasonality. Experienced entrepreneurial clients recognise this and engage in diversified businesses. By diversifying their businesses and risk, clients are not 'putting all their eggs in one basket'. These clients are thus able to maintain steady flow of income in case one business fails or slows down. MFIs can learn from these practices and start assessing income stability of clients.

MFIs may want to conduct studies to look at practical strategies employed by clients to build more stable flows of both business and household income, and how they manage the key expenditures (both those that are predictable and those that are not). From these practical business models and income generating strategies, MFIs can come up with a shortlist of characteristics of income stability that staff can refer to when assessing loan applications, particularly for repeat loans where higher amounts are involved. Clients who can show more stable income flow get higher rating and bigger chances of approval of loans they apply for.



***Continuous Product Development***

*More credit products to a wider market.* MFIs should constantly find ways to better meet the needs of clients. The need for increased income remains at the top of the list for clients. Many clients however are producers at the mercy of traders dictating low buying prices. MFIs can help improve this situation by getting into value chain financing that supports pro-poor livelihood value chain development. This could imply providing credit not only to low income producers, but also to a range of socially-responsible players within a livelihood value chain who will offer producers fair market prices and secured markets. Participation in the value chain will provide opportunities to improve quality and increase the volume of production among producers. This is, however, a complex and specialised discipline, for which many MFIs may need to buy in technical skills. It will also change the nature of the credit risk within MFIs' portfolio, as value chain financing will often involve larger loan sizes.

*Beyond credit products.* While many clients consider credit as the main financial instrument to grow their business and increase their income, they have other needs, such as medical care, which when unmet could reduce their income earning capacities and deplete their assets. MFIs can help clients address these needs by offering appropriate non-credit products that are affordable and accessible. These products may include insurance and savings delivered directly or indirectly by the MFI.

***Tracking and Using Information to Prevent Over-indebtedness***

*Security of basics.* Knowing the importance accorded by clients to food and educational expenses, MFIs may want to monitor client households' ability to meet these needs. Chances for loan payment are higher when the households are able to satisfy these two basic needs. Simple self-rating surveys can be administered during centre meetings. Just two questions may be asked as follows: 1. During the past 7 days, how many times has the household experienced involuntary hunger? (Answer may be selected from the following: not once, once, seldom, most of the time) 2. During the past 7 days, how many times have school-age children been absent in school due to lack of school or transportation allowance?

Monitoring these social indicators can have the added purpose of helping the institution assess its social performance (i.e. aiming to bring about improved quality of life among clients).

*Prevalence of multiple borrowing.* Monitoring of incidence of multiple borrowing among clients would also be useful not only as an early warning sign to detect potential financial stress level of clients, but also to flag the institution on appropriateness of current product offerings. Some MFIs have already come up with policies that set limits or define debt exposure in terms of number of loans, or total loan amount, that the institution should extend to clients.

Implementing such a policy at the client centre level, where available, would effectively turn over the role of monitoring to client leaders who are in the best position to know the status of internal and external borrowings of centre members. Field staff can provide key support by communicating the importance of this function, monitoring compliance, and facilitating use of information by the centre in subsequent loan reviews.

*Make budgeting a common practice.* Success in debt management is linked to effective handling of household finances. Good financial managers among clients indicate that they practice budgeting. MFIs may want to track the percentage of clients who practice weekly budgeting, and from there design a practice-based financial management programme. MFIs need not go far to find resource persons. Good financial managers among clients can be tapped to share know-how and educational aids such as experiences on which mini case studies can be developed. Indeed, a well designed system of peer-to-peer learning and mentoring amongst groups may be considerably more effective than staff lecturing clients about the importance of budgeting as offered by traditional financial literacy programmes.

## **Conclusion**

Credit is good for clients. When income falls short to meet needs, they borrow. Even in times when an outstanding loan is due for repayment and there is not enough money on hand, they also borrow from others. It is clear to clients that continuing access to credit is dependent on good repayment record. They take extra efforts to maintain a good credit record even if it means skipping a meal to come up with the amount needed.

Loss of income is identified as the main driver that turns credit from a source of relief to a burden. Getting out and staying out of over-indebtedness is difficult and time consuming, but doable, according to clients in the study. Three insights can be drawn from clients' strategies to address over-indebtedness. First, clients need assistance to build-up their income base towards stability and sustainability. A micro loan and subsequent loans can help establish and sustain income generating activities for clients and their families. Second, in times of plenty, clients will do well to save. Clients need convenient and safe savings facilities to develop the habit of saving more and borrowing less. Third, clients can benefit from access to micro insurance to prepare them to face emergencies and unexpected events.

MFIs have a big role to play in providing low income households with appropriate products and services, and thus provide a safety net to manage life's ups and downs.

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