# *MicroSave* Briefing Note # 114

## A Closer Look at Multiple Borrowing in the Philippines

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### Background

With increasing cases of over-indebtedness among microfinance clients, multiple borrowing is getting its share of unfavourable limelight. Research on the Indian microfinance sector, for instance, identified product design constraints such as mismatch between the size of the loan and the financial needs of the clients, as one main reason for turning to other sources of funds.[1] This is confirmed by a study in Uganda, which found borrowers to take on multiple loans to manage cashflow, and to smooth the timing of loan repayments.[2] For many, multiple borrowing ensures a reliable and steady source of funds to cope with financial pressures. It thus makes rational economic sense.

Multiple borrowing brings many benefits to clients, but too much can also bring problems. Lack of control and discipline in multiple borrowing can lead to over-indebtedness where the borrower takes more loans than she can repay. When loans are not paid, financing is cut off. Without continuing access to funds, micro enterprises stop growing or even go bankrupt.

In this Note, we present summary results of a study which looked at this phenomenon in the Philippines. The study aimed to contribute to the body of knowledge to better understand multiple borrowing and its link to over-indebtedness. *MicroSave* partnered with Tulay sa Pag-unlad, Inc. (TSPI), one of the leading MFIs in the country with 250,000 clients and 30 years of services to micro and small entrepreneurs. The study administered a detailed questionnaire to 151 urban women micro entrepreneurs with outstanding loans from TSPI.

### Respondents' Profile

Sixty-two percent (62%) of the respondents are more than 41 years old, and a majority at 89% are or have been married with average household size of 5. Typical of Filipino micro entrepreneurs, 71% of respondents are engaged in petty trading, with 32% operating *sari-sari* stores (community-based shops) and mini groceries which sell different kinds of food and non-food items on retail. Nearly half (45%) earn a weekly gross family income of not more than P3,000 (US$71), which is close to the household poverty income threshold set by the government at P2,760 ($66) in 2008. Self-rating on income adequacy showed 1/3 of respondents were experiencing income shortfall sometimes.

### Borrowing Habits

Twenty percent (28%) of borrowers had two loans, while 15% have three loans or more. The average loan amount for single loan borrowers is P10,425 (US$250) – this rises to P16,700 ($388) among multiple borrowers. Converting the weekly loan payment for all borrowers to a percentage of estimated weekly gross income, the study found the average weekly repayment for single-loan borrowers at 18%, compared to multiple borrowers, at 33%.

Most of the multiple borrowers had obtained additional loans from non-bank financial institutions (44%). This indicates that the availability of many MFIs does facilitate the incidence of multiple borrowing. The next major source identified is family members and relatives (30%), followed by individual moneylenders (24%). Only one had borrowed from a bank.

### Views on Multiple Borrowing

Respondents cite good reasons for taking additional loans. The top four reasons are: 1. additional capital for business (37%); 2. keep children in school and pay for the education of a family member (33%); 3. medical expenses for the family (11%); and 4. meet basic household needs (11%).

Respondents, however, recognise the risks involved in taking more than one loan. They acknowledge the stress and mental burden that goes with multiple borrowing when expected income does not come and there is not enough money to cover the needs of the family, business and lenders. Testimonies shared by respondents during informal discussions highlight this stress, which leaves borrower sad and depressed, short tempered and often angry, having fights among family members, and losing the affection of friends and loved ones.

Overall, the majority (80%) of respondents do not recommend multiple borrowing and offer the advice to stick to one loan at a time. The minority 20% appear to be risk taking-types and the practical ones who find no problem going into multiple borrowing provided that money is put to good use - notably to seize opportunities for business growth.

The view of this minority group is supported by recent studies from Uganda[2] and India[2, 3, 4] which show the reasons that drive the poor to multiple borrowing. These include:

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[1] **Krishnaswamy**, Karuna, "Competition and Multiple Borrowing in the Indian Microfinance Sector", Institute for Financial Management and Research, Centre for Micro Finance, India, 2007.

[2] **McIntosh**, Craig, **de Janvry**, Alain, and **Sadoulet**, Elisabeth, "How Rising Competition Among Microfinance Lenders Affects Incumbent Village Banks", Economic Journal, vol. 115(506), pp. 987–1004, 2003.

[3] **Morduch**, Jonathan, and **Rutherford**, Stuart, "Microfinance: analytical issues for India", a report for the World Bank, South Asia Region – Finance and Private Sector Development, April, 2003.

[4] See India Focus Note 33 "Why Do Microfinance Clients Take Multiple Loans?"

continuity, convenience, flexibility and reliability of access to financial services. Some clients thus borrow from more than one MFI to have a continuous source of credit to meet their needs. In a study involving interviews with credit officers from several major MFIs in Uganda, similar reasons were highlighted, particularly to smooth household cash flow.

**Implications for the Industry**

While the study covers a small sample, it is troubling that the rate of multiple borrowing recorded is not far from the rates of countries that have experienced a microfinance repayment crisis after a period of high growth.[5, 6] Although many factors have played a part in the repayment crisis in these countries, multiple borrowing has been cited as a relevant indictor, or key symptom, prior to a repayment crisis. MFIs would do well to look at the incidence of multiple borrowing as an indicator of financial stress of clients. It can also be used to help the institution mitigate credit risk.[7]

| Country[2,3] | % Multiple Borrowers |
|---|---|
| Nicaragua (2009) | 40% |
| Morocco (2007) | 40% |
| Bosnia and Herzegovina (2009) | 40% |
| Pakistan (2009 at areas where the repayment crisis occurred) | 30% |
| Ecuador (2009) | 25% |
| Peru (2009) | 45% |
| Philippines (2010, limited sample only) | 43% |

In Latin American countries for instance, fast growth has led to intense competition among the MFIs. Reckless lending by fast growing MFIs fuelled over-indebtedness among clients.[2,5] MFIs deliberately competed in concentrated geographic areas with greater economic activity and higher population density.

The focus on commercialisation often leaves out low potential and remote areas also in need of financing. MFIs with social missions could benefit from adopting social performance management systems and pursuing a systematic process of deepening outreach among marginalised groups.

MFIs in the Philippines and elsewhere may want to consider the following activities to better respond to the target market and prevent multiple borrowing to lead to over – indebtedness:

*Continuous innovation of products and services*. The financial activities of low-income families are usually driven by 3 main needs, as mentioned in “Portfolios of the Poor” by Collins et al.:

(1) Managing basics: cash-flow management to transform irregular income flows into a dependable resource to meet daily needs; (2) Coping with risk: dealing with the emergencies that can derail families with little in reserve; and (3) Raising lump sums: seizing opportunities and paying for big-ticket expenses by accumulating usefully large sums of money.[8] The needs of low-income families in the Philippines are not any different. This calls for MFIs to pursue continuous innovation in products and services to meet clients’ varied financial needs. Clients need not always turn to borrowing when given options with other appropriate products such as savings and insurance.

*Client protection strategies*. As active financial managers, many clients do employ systems to avoid over indebtedness. If they have to get into multiple borrowing, they only borrow small amounts or they try to borrow loans with terms that make repayment low cost and affordable. But not all clients do so. This calls for MFIs to adopt strategies to protect clients, especially from over indebtedness. Careful screening of loan applications is critical, especially in areas where many MFIs compete for the same type of clients. MFIs should develop policies on maximum debt exposure levels, and train their staff to conduct simple client repayment capacity assessments. MFIs should monitor multiple borrowing among clients and align their systems and processes to be able to help clients in financial distress and keep other clients from falling into the debt trap.

Client protection will be effective when it becomes part of core business processes. This relates to balancing targets of outreach and portfolio size with extending the right loan amount to clients based on capacity to pay. To operationalise client protection in the institution, the SMART Campaign, the Social Performance Task Force, and other global initiatives have developed a wealth of information and tools for MFIs.

*Information sharing at the industry level*. In Nicaragua, Ecuador, and Peru, MFIs continuously provide borrower information to credit bureaux, helping them validate the relationship between over-indebtedness, multiple borrowing and social and financial performance metrics such as write-offs, product offerings and growth. This has helped them study in detail the multiple borrowing phenomenon and make adjustments to their systems to address the current issues.

In the Philippines, collective efforts have started to bring to reality the microfinance credit information bureau mandated by Republic Act (RA) 9510 or the Credit Information System Act which was passed into law 3 years ago.

**Conclusion**

MFIs and the microfinance industry can look to multiple borrowing as an early warning sign of the need to improve products and services to better meet and serve the needs of the low income market. MFIs would do well to heed the warning.

[5] **Chen**, Greg, **Rasmussen**, Stephen, and **Xavier** Reille, “Growth and Vulnerabilities in Microfinance,” CGAP Focus Note 61, CGAP, 2010

[6] **Martinez**, Renso and **Gaul**, Scott, “Measuring Cross-indebtedness in Microfinance – Evidence from Latin America,” CGAP March 8, 2011http://microfinance.cgap.org/2011/03/08/measuring-cross-indebtedness-in-microfinance-evidence-from-latin-america/

[7] See India Focus Note 39 “Diagnosing Financial Stress in Group Methodology”

[8] See India Focus Note 60 “Speculation on the Future of Financial Services for the Poor in India”