

Multiple Borrowing by Microcredit Customers: The case of Ecuador

*Development of a conceptual framework and application to the case of
Ecuador*

Master Thesis

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Executive Summary

Problem

The microfinance industry has experienced a phase of rapid growth during the last decade. Governments are supporting the sector and financial success is continuously attracting new entrants. The increasing competition has strongly changed the characteristics of the microfinance sector. One of the main changes concerns the range of microcredit products and suppliers: borrowers are now able to choose between a variety of microcredit products from multiple institutions. The freedom to choose between several possible suppliers is considered to be one of the main benefits of competition. It puts pressure on microcredit prices and forces competitors to innovate and to drive down costs. But freedom of choice can also be problematic in a microfinance environment. Borrowers can simultaneously hold loans from multiple credit suppliers, and thus engage in what is termed “multiple borrowing”. Multiple borrowing has gained a considerable amount of negative reputation during the past years. It is perceived to be one of the main causes for over-indebtedness - borrowers can take on too much debt from different lenders that they eventually may not be able to repay. The positive aspects of multiple borrowing - freedom of choice and financial flexibility - are usually left out of the discussion, although they may offer substantial potential to improve overall welfare.

Method

This paper analyzes and discusses causes and consequences of multiple borrowing. The goal is to build a conceptual framework which allows to evaluate the welfare consequences of multiple borrowing in a given microfinance market. To achieve this, multiple borrowing is first analyzed from a theoretical perspective, using classic economic concepts such as credit market theory and consumer behavior models. The theoretical analysis provides the backdrop of the conceptual framework. The concept of multiple borrowing is then split into three different but interdependent dimensions: the borrower, lender and external dimension. Each dimension is first discussed separately and finally the dimensions are merged to form the conceptual framework. In order to provide a practical application, the framework is then applied to the country of Ecuador, a country

which has experienced a rapidly growing microfinance sector during the past decade. Data on multiple borrowing is gathered using a survey among Ecuadorian microfinance institutions.

Results

Multiple borrowing is not just the consequence of lacking economic education amongst microfinance clients. The theoretical dimension shows that it can be considered a rational behavior under certain economic premises such as consumption smoothing and incomplete information sharing. Clients will decide to borrow loans from multiple sources as a consequence of distress or opportunity situations. Distress borrowing can create negative welfare effects by increasing the chances for over-indebtedness, while opportunity borrowing carries potential for positive welfare effects if correctly served. Microcredit contracts and products must become more flexible and go beyond the traditional idea of providing loans solely for productive purposes. The welfare effects of multiple borrowing depend highly on the institutional environment. Strong credit information systems, consumer protection principles and a tailored regulatory framework for microfinance can mitigate potentially negative welfare effects caused by multiple borrowing.

The conceptual framework structures the above-mentioned findings and puts them in relation to each other. The application of this framework to the country of Ecuador shows the limits of such a conceptual framework. Welfare effects of multiple borrowing in a given country can only be discussed qualitatively, no reliable answers can be given to direction and magnitude of these welfare effects. The introduction of quantitative measures, such as through index figures and weightings, may allow for more exact and reliable measures. The conceptual structure of this study may provide a useful starting point for such a quantitative index.