Theory and Empirical Evidence of the Microcredit Lending Process: A Case Study from Namibia

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Executive Summary

The objective of this thesis is to study a specific microfinance institution (MFI) in Namibia and the theoretical concepts of microlending used in the microcredit product design and delivery methods. A special focus is put on how the MFI in Namibia is handling the repayments and managing to have a low portfolio at risk. The theory is then compared with the practice at the MFI to see how far the standard processes respond to the inherent credit- and business risks of microlending.

The methodology includes a review of the existing literature and information about the microcredit product design and delivery methods, as well as the microloan process. The main part of the on site research consists of participatory observations and assessments of available information gathered at a MFI in Namibia.

A first finding is that it is of great importance to know the vulnerability and the poverty of the clients in order to understand their preferences and needs for financial products. With the help of this information an institution can shape a microcredit product which meets the needs of the potential clients and allows the establishment of a sustainable MFI in a developing country.

The institution in Namibia has therefore created two microcredit products so as to meet the needs of the people. One product is being used in joint liability groups and the other one is being used individually. In the first product there are three major mechanisms which gives the group members the correct incentives and ensures high repayment rates and a high portfolio quality: A guarantee fund, the denial of loans to other group members and the use of a flexible collateral for every loan disbursed. Good repayment rates by the individual microcredit borrowers are mainly due to the very careful studies of the clients and to the incentives the product creates. Most importantly the denial of future loans in the case of default is a very strong incentive to pay back, as funds from other institutions, banks or people are almost not available.

A close relationship with all clients is also a key point for high repayment rates and portfolio quality. Just calling on a delayed member is not enough. The loan officer needs to go and see the client face to face and to discuss the problem. This situation, together with social pressure of the group members, is usually enough to ensure repayment the next week, if the money is available.

Efficiency is ensured by overcoming the transaction and information problems by forming joint liability groups for small loans. The members of these groups are responsible for screening the

good clients, to collect, pay back the money and to manage the biggest part of the default procedure.

The institutions microcredit products contain many elements described in the theoretical part of this paper. The loans use most of the dynamic incentives explained, such as threatening to stop lending, progressive lending, frequent installment collection, flexible approach to collateral, financial collateral and social sanctions. Women are targeted both as clients and as loan officers in order to achieve a lower portfolio at risk, as the theory suggests.

Comparing the theoretical concepts of microlending with a successful institution in Namibia shows that the concepts described in theory respond well to the inherent credit and business risk of microlending. As already highlighted, understanding the demand side is a pivotal issue for a MFI. Therefore the theoretical concepts should be used as a framework and need to be adapted to the demand side. This leads to microcredit products, which include most of the incentives and mechanisms described in the theory, but which are much more sophisticated due to the adaption to the demand side. A good example of such a product is the micro business loan or the small business loan of the institution in Namibia.