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Over-Indebtedness of Microborrowers in Ghana

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Over-Indebtedness of Microborrowers in Ghana

An Empirical Study from a Customer Protection Perspective

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Preface

Providing access to finance for those excluded from the formal financial system was and still is the mission of microfinance. What has changed, however, are the main challenges on the way to success. In the past, the financial sustainability of the service was the main hurdle to be cleared. Today, responsibility in service provision claims more of our attention.

This is because something has happened that seemed virtually impossible only a few years back. In some parts of the world where microfinance services have expanded rapidly, the problem is no longer too little access to finance, but too much. A phenomenon that has previously been known exclusively in industrialized countries has reached the developing world: over-indebtedness.

Over-indebtedness has to be taken very seriously, particularly since in many countries where microfinance operates, customer protection and social safety nets are not well developed. Accordingly, a customer with an unsustainable debt burden cannot file for insolvency and expect official procedures to pave the way to a fresh start. Few debt counseling agencies exist, and in most places there is no social security system to provide a subsistence income for the family if a microfinance client fails. In a nutshell, when a microfinance client becomes over-indebted, she is on her own.

This is why microfinance institutions carry all the more responsibility to protect their customers. These institutions have a social mission to assist their customers in improving their lives through access to financial services—provided in a responsible way. To give guidance on how to live up to the standard of responsible finance, the Smart Campaign (www.smartcampaign.org) developed the Client Protection Principles with widespread industry participation. Prevention of over-indebtedness is one of these principles. Undoubtedly, most leading MFIs are firmly committed to this principle, as evidenced by the fact that the overwhelming majority of the MIX 500 largest MFIs have endorsed the Smart Campaign. However, commitment is not sufficient to put a principle into practice. This is especially true when there are large knowledge gaps, as is the case with over-indebtedness. This paper makes an important contribution to deepening knowledge on this elusive topic.

It is surprisingly difficult to agree on a firm definition of over-indebtedness, and just as difficult to determine the point at which a specific individual becomes over-indebted. Financial service providers generally identify over-indebtedness with chronic delinquency. They see debt stress as a client's inability to make regular loan repayments, and move into action only when overdue collections or restructuring becomes necessary. In some respects, this approach resembles the curative rather than preventive approach to medicine. More recently in highly competitive markets, multiple loans from several different providers have become a concern.

In order to be effective at preventing over-indebtedness, it is essential to know more about the clients' situation. This is exactly what the research presented here is aiming at, choosing the urban microfinance market in Ghana as an example. This study works from a client perspective, defining over-indebtedness in terms of the frequency and severity of sacrifices clients make to repay debts. Ghana was chosen as a market that has not experienced an over-indebtedness crisis, but that has a number of significant microfinance institutions addressing the same clients. The study reveals that while the incidence of multiple lending and delinquency does not indicate a market in crisis, there are nevertheless many clients in good standing who make serious and frequent sacrifices in order to repay debt. There is thus a gap between the providers and the clients in the perception and experience of over-indebtedness. This gap challenges providers to take greater care in observing the situation of clients, while avoiding the pitfall of restricting access to finance (and therefore pulling back from their mission). This is not an easy challenge.

Even though these results are restricted to a single country and certainly do not answer all our questions, they offer new insights from the clients' perspective that must be incorporated into our understanding of over-indebtedness. These insights will serve as valuable inputs to improve MFIs' efforts, in Ghana and in similar contexts, to make the prevention of over-indebtedness work in practice.

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Special thanks go to our partner MFIs in Ghana who supported us in sampling their clients for the interviews: ProCredit Ghana, Opportunity International Ghana, Sinapi Aba Trust, EB-ACCION, and Advans Ghana. We also thank the National Bank of Ghana, the Ghanaian credit bureau XDS data, and our research assistants from MEL Consulting. This project would not have been possible without them. Finally, we are extremely grateful to the Ghanaian borrowers who shared their sorrows and aspirations with us and gave us insight into their financial situations. Many have done so in the belief that telling us about their struggles would improve the experiences of microborrowers in the future, and we share this hope with them.

Part I. Empirical Research on Over-Indebtedness in Ghana

Since its beginnings, the microfinance industry has aimed to provide access to financial services for underserved micro and small entrepreneurs and other low-income households excluded from the formal financial market. The main challenge lay in expanding outreach and providing access to as many clients as possible. While there was always some awareness that for single customers credit may not turn out well, there was generally no concern about "too much credit," but rather about "too little." While expanding to reach more and more low-income developing country populations, the sector has moved away from its original charity approach and its focus on microenterprise lending to provide a broad range of financial services. The majority of microfinance institutions aim to combine commercial viability with a social mission, and some institutions even follow a purely commercial approach.

Recognizing that the growth and commercialization of microfinance require conscious efforts to keep and strengthen the industry's focus on serving and benefiting above all its vulnerable client group, the Smart Campaign represents a global effort of microfinance leaders to protect microfinance customers. It has developed a living set of Client Protection Principles[1] and implementation guidelines and is in a constant dialogue with the industry's leading institutions. Putting clients first, the Smart Campaign aims to help the microfinance industry remain both socially focused and financially sound.

Protecting customers against over-indebtedness

One of the most urgent customer protection principles is to prevent over-indebtedness. If over-indebtedness were left to spread, it would represent a serious risk to the impact of microfinance on borrowers' lives; on the financial sustainability of microfinance institutions (MFIs); and on the industry's reputation with governments, donors, and investors. The 2011 "Microfinance Banana Skins" report on microfinance risks has ranked highest three risks that are all closely related to the challenge of over-indebtedness: credit risk, reputation risk, and competition.[2]

An urgent need for research. The recognition of over-indebtedness as an industry priority and the willingness of MFIs and investors to invest in protection against over-indebtedness is an important step toward client protection in microfinance. However, for efforts to be effective, the industry needs a sound understanding of the phenomenon; of the meaning of over-indebtedness from a perspective of microfinance clients; of the prevalence of the phenomenon outside of crisis markets such as Bosnia, Nicaragua, and certain regions in India; and of the mechanisms that may put clients at risk. To evaluate which prevention measures are most helpful among the typical suggestions such as introducing credit bureaus, conducting literacy campaigns, or tightening lending standards, we need to gain a sound understanding of what over-indebtedness is about for microfinance customers on the ground.

This paper is based on a study that the author has conducted as part of her PhD research.[3] The research project was designed and implemented with the support of the Independent Evaluation Department of the German development bank KfW Entwicklungsbank and of the Smart Campaign, hosted by the Center for Financial Inclusion at ACCION. It aims to address the most urgent questions about over-indebtedness from the viewpoint of the clients of microfinance. Instead of working with the usual risk management indicators of over-indebtedness, it uses an over-indebtedness definition based on the subjective experiences of microborrowers with their loans.

The purpose of this paper is to inform decision makers who are promoting financial inclusion in developing countries about the over-indebtedness challenge and to support their efforts to protect poor borrowers. It aims

1. See Appendix 1 for the list of Client Protection Principles. After focusing on microcredit initially, they have been revised as of July 2011, to include all financial products.
2. Lascelles and Mendelson (2011).
3. Watch the author's upcoming academic publications for more detail on over-indebtedness definitions, causes, and predictors.

to enrich the public debate with direct insights from microfinance clients. The paper:

- Pinpoints the **experiences of microborrowers** in repaying their loans.
- **Measures the prevalence** of debt struggles in a microfinance market that, while starting to experience competition, is far from the exceptional levels of debt found in recent crisis countries.
- Suggests what the **drivers of over-indebtedness** may be and refutes some common assumptions of the current over-indebtedness debate.
- Offers guidance to the industry in how to think about the phenomenon of over-indebtedness from a customer protection perspective and how to **identify over-indebtedness risks** in other markets.
- Identifies **opportunities for preventing over-indebtedness**.

Learning reaches beyond Ghana. While the results are of course specific to the urban Ghanaian microfinance market where this study was conducted, we believe that they can inform the over-indebtedness debate on a much broader level. It being the first empirical study that analyzes the client perspective on over-indebtedness in such detail, the audience for this paper includes MFIs in all countries that have reached the minimum level of financial inclusion and competition at which over-indebtedness may emerge, investors in microfinance, governments and regulators, as well as consultants and advisors in financial inclusion. Given its product-specific findings, its contribution in canvassing client voices and its focus on a rather "average" microfinance market that is still not in crisis, the paper may be of interest to MFIs in younger microfinance markets as well. It can contribute to product development that will improve the borrowing experience of microfinance customers anywhere in the world.

The microfinance market in urban Ghana

Ghana has developed an active microfinance market over the past years, serving 358,717 borrowers at the end of 2009 with a gross loan portfolio of $US131.2 million.[4] The MFIs in Ghana have started feeling signs of competition, especially in the most common urban markets such as the center of Accra. Loan officers report an increase in repayment difficulties. In 2009, two of Ghana's MFIs conducted a small study on multiple borrowing and found reasons for concern that borrowers might start getting too indebted and combining loans from several lenders at the same time.[5] Also, relying on several highly preliminary indicators of potential over-indebtedness risks in microfinance markets, a study by the University of Zurich's Center for Microfinance describes Ghana as a market with a medium to slightly higher risk of over-indebtedness.[6]

No signs of crisis. However, the penetration of microfinance in Ghana's low-income population is still rather low: Of its working-age population below the poverty line, only 9 percent have microloans. In Kenya, this figure is at 14 percent, in Ecuador at 21 percent, and in Mongolia at 51 percent.[7] The Center for Microfinance study mentioned above finds that Ghana has the lowest microfinance market penetration rate of all 12 countries in its sample. The FINSCOPE survey that was recently conducted to measure financial access in Ghana finds that 44 percent of Ghanaian adults are unbanked. They access neither formal nor informal financial services. In the urban markets of Accra, this figure still amounts to 30 percent, leaving room for further growth of the microfinance sector.

Furthermore, Ghana's main MFIs stick to a rather careful lending methodology. We have found no evidence of them deliberately poaching clients of competitors or pushing customers to take more or larger loans than they may need. Instead, the MFIs in this study routinely restrict loan sizes, rarely disburse the full amount a customer applies for, and emphasize detailed evaluations of repayment capacity. They tend to limit their lending to business purposes, educating their borrowers to be careful with their loan use and ensure that they will earn the returns to repay their debt. Borrowers also report strong messages from MFIs to be careful about multiple borrow-

4. www.mixmarket.org. The site provides self-reports of limited liability but represents the best available data source for this high-level sector overview. Figures may somewhat underestimate the scope of microfinance in Ghana, as not all institutions are reporting to the MIX Market. All data are reported as of 2009 unless indicated otherwise.

5. Grammling (2009).

6. Kappel et al. (2010).

7. These are high-level estimates based on data from the MIX Market and CIA World Fact Book, counting microfinance coverage only. They would probably be slightly lower if reduced for borrowers with more than one loan.

ing. At the same time, multiple borrowing is simply not an option for many: While interviewers tried to motivate clients to tell the truth about their number of loans, they often met with a lack of understanding: *"But nobody else would lend to me! If it wasn't for my MFI, I don't have anyone who would give me any other help,"* clients replied. *"How can I borrow money from somewhere? I don't know anybody!"*

Learning from a normal market. This research analyzes a microfinance market that is not yet suffering from an explicit over-indebtedness crisis. The market in Ghana has reached a certain level of development, but one that may count as rather "usual" in the microfinance industry. Instead of highlighting the downsides of extreme cases, the project informs readers about the common experiences of microborrowers with their debt under ordinary circumstances. It emphasizes that risks are an inherent feature in every borrowing and lending activity and that the microfinance methodology can still improve and adapt increasingly well to these risks.

At the same time, it is good news that in the given market segment the results do not portray microfinance in Ghana as seriously overheated. With this research we are able to challenge some of the original concerns about emerging lender overlap in Ghana, at least among the most professionally managed lending institutions. Most of their borrowers are not currently going through extreme debt levels, vicious cycles of borrowing from multiple sources, and high levels of default. Nevertheless, we will show that there is a need for improved customer protection measures to avoid that microborrowers struggle with their loans.

How to learn about over-indebtedness from a customer perspective

The over-indebtedness debate being relatively new to the promoters of financial inclusion, there still is a lot of ambiguity about the concept. Before we are able to understand the causes and consequences of over-indebtedness in more detail, it is thus necessary to agree on a measurement to identify which borrowers are over-indebted.

A sacrifice approach to over-indebtedness. Working with a focus on protecting clients, this research project uses a client-focused definition of over-indebtedness, rather than common proxies like debt-service ratios or default/delinquency. It considers debt-service ratios too imprecise and inflexible to take the individual circumstances of each borrower into account. While some families regularly spare 30 percent of their income for debt repayments, for others this can be a serious struggle. Default as an approach for measuring over-indebtedness is equally inappropriate to our purposes: It reflects only the last stages of over-indebtedness, whereas problems have almost always started much earlier. Default assesses the consequences of over-indebtedness from a risk management perspective but does not take into account the struggles of microborrowers who are often going to great lengths to pay back their loans.[8]

In fact, from a client perspective, microborrowers who manage to repay only at unacceptably high costs such as going hungry, selling essential household assets, or taking their children out of school should count as over-indebted. While strong repayment incentives are an important success factor of the microfinance methodology, from a client protection point of view, there are limits to the sacrifices borrowers should have to make. In developed countries, insolvency regulations include a minimum existence level, but most microborrowers do not benefit from such protection or live below a minimum existence level to start with.

As a result, this study works with this definition: *"A microfinance customer is over-indebted if he/she is continuously struggling to meet repayment deadlines and structurally has to make unduly high sacrifices related to his/her loan obligations"* (Schicks, 2010). The term *"structural"* refers to a certain permanence of problems over time to avoid counting borrowers with one-off repayment problems as over-indebted (see below). To avoid imposing our own cultural views on clients in Ghana, the only ones who can determine at what point sacrifices get *"unduly high"* are borrowers themselves. Client protection is about preventing clients from getting hurt, and suffering is a very subjective

8. See Schicks and Rosenberg (2011) for a discussion of over-indebtedness definitions and Schicks (2010) for a more academic perspective.

experience. To truly understand how clients feel and to what extent they may suffer, we therefore rely on their subjective judgement.[9]

Our measurement in practice. To put this definition of over-indebtedness into practice, we conducted 531 structured questionnaires and 10 qualitative interviews with microborrowers in Accra, the capital of Ghana and the heart of its microfinance industry. The project was enabled by the participation of Ghana's credit bureau XDS as well as five of Ghana's leading microfinance institutions: ProCredit Ghana, Opportunity International Ghana, Sinapi Aba Trust, EB-ACCION, and Advans Ghana. Together our partner MFIs make up nearly half of the Ghanaian microfinance market in terms of numbers of customers (45 percent in 2008, 44 percent in 2009) and in terms of gross loan portfolio (46 percent in 2008, 43 percent in 2009) as reported on the MIX Market.

From all active microborrowers in the Accra branches of our five partner institutions, we drew a random sample of microfinance customers and contacted them with an independent team of researchers for anonymous interviews at a site of their convenience.[10] We oversampled delinquent customers according to the MFIs' management information system (MIS) data. For purposes of evaluation, we corrected for this bias as well as the response rate of different groups with sample weights.[11] All data reported in this study result from weighted analysis and are thus representative of the research population.

Our detailed interview guide covered:

- Sociodemographic and economic information about the borrowers and their households
- Information about all their outstanding loans, formal or informal
- The detail of all sacrifices the borrower experienced in the past year to repay loans
- A test of financial literacy
- An experiment to test risk aversion
- General questions about the experience of borrowers with MFIs.

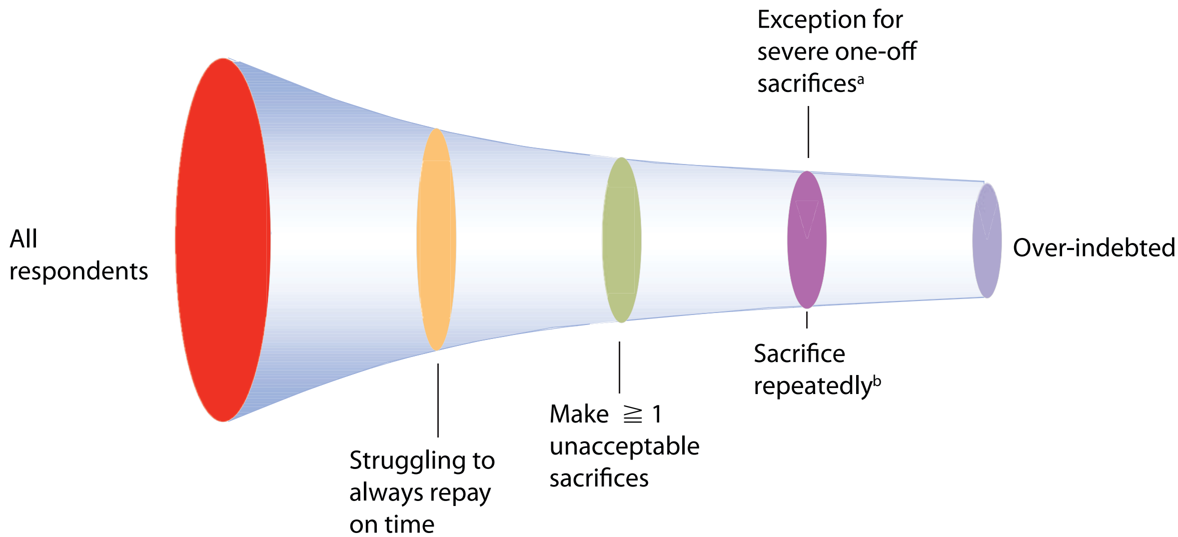
The most innovative part of these interviews—and the core of our analysis—is the table of borrower sacrifices. Letting borrowers brainstorm first and then checking for additional items with the help of a predefined list, the interviewers obtained information about the struggles borrowers experience to repay their loans and about all the sacrifices they make in relation to repayments. The list of sacrifices appears in Appendix 2. Respondents weighted each individual sacrifice by its frequency (*"how many times did you have to make this sacrifice?")*[12] and by its acceptability (*"was this sacrifice acceptable to you for the purpose of the loan?").*[13] As a result, someone might report that "cutting down on his food" was totally acceptable, such as when it simply implied substituting cheaper food for meat. Another borrower might report that reducing his food was not really acceptable, given that he was cutting down to only one meal per day and staying hungry most of the time.

Following the above definition, borrowers are over-indebted if they struggle to repay their loans on time and structurally make unacceptable sacrifices. Sacri-

9. The appropriateness of over-indebtedness definitions depends on their purpose. In spite of its value in a research context, a subjective measurement is, for example, not suitable for juridical procedures such as insolvency regulations.
10. We defined as microborrowers all MFI customers with active personal loans below 5,000 Ghana Cedis (GH¢); rough exchange rate 1 GH¢ = 0.7 USD. For most of our partner institutions, all loans in their portfolio are below 5,000 GH¢. More than half of all loans in the sample are below 1,000 GH¢ and nearly all are below 2,000 GH¢. Interviews were usually conducted at the respondent's home or workplace.
11. The oversampling aimed at a sufficiently large number of observations from clients with serious repayment difficulties, given their low share of the population and an expected response rate below that of the average borrower. With some MFIs, oversampling of group customers implied oversampling delinquent groups rather than individuals. For the analysis, to ensure a representative sample, all respondents were assigned individual case weights according to their lending institution, delinquency status, and lending methodology. There were no disparities in gender to correct for.

12. "Once in past year," "1–3 times in past year," "> 3 times but not often," or "Frequently in past year." For a respondent cutting down on food at several points for a week at a time, instead of every individual day, each week would count as one occurrence. In this paper sacrifices experiences >3 times count as "repeated" or "frequent" sacrifices.
13. "Easily acceptable," "Only just acceptable," "Not really acceptable," or "Not acceptable." In this paper we summarize the first two categories under "acceptable" and the latter two under "unacceptable."

Figure 1. Measuring Over-Indebtedness by Customer Protection Standards



Source: Schicks (2010).

a. No repeated experience required for unacceptable sacrifices of suffering an asset seizure, taking a new loan to repay, or selling/pawning assets.

b. Either >3 unacceptable sacrifices, or ≧ 1 unacceptable sacrifice made > 3 times.

fices count as structural when they have been made repeatedly, more than three times. Typical one-off sacrifices such as a seizure of assets, taking a new loan to pay off an old one, and selling or pawning one's assets to repay count as over-indebtedness triggers even if the respondent experienced them only once. In these cases, a one-off occurrence is a sign of structural repayment problems.[14] Figure 1 visualizes this measurement in a graphical funnel entered by all 531 respondents. At each filter, those borrowers who do not meet the respective criteria for over-indebtedness drop out. In the end, only those respondents on the right side of the funnel that fulfill all over-indebtedness criteria are counted as over-indebted.

14. These sacrifices either have long-term effects (e.g., help to repay several installments) or are only triggered by long-term problems (e.g., a seizure after 90 days' delinquency). Only unacceptable occurrences of loan recycling and therefore severe sacrifices act as a trigger, excluding, for example, simple loan juggling for liquidity management purposes. As is true for all sacrifices, the severity of the loan recycling criterion may differ in other research contexts/countries; our respondents in Ghana try to avoid it at all means. In any case, this exception does not substantially impact results.

A word of caution. Before we describe our findings in the next section, we would like to point out a potential source of misunderstanding: Our respondents have indicated that they perceive their sacrifices as related to loan repayments. Also, 86 percent of them state that they had suffered no or fewer sacrifices before borrowing. Nevertheless, our analysis does not track causality. We are not saying and cannot tell from our data that the microloans caused the borrowers' struggles. Increasing financial difficulties might also have been the reason for some to start borrowing. Similarly, difficulties in the course of the loan term are not necessarily related to the overall impact a loan has on borrowers' lives in the long run. In fact, the vast majority of our interviewees, even if struggling, stated that they do not regret the amount they borrowed, and many of them wish they could have borrowed more.[15]

15. Part of this phenomenon may be due to a number of biases that we will discuss in the next section. Nevertheless, we should take the borrowers' judgement seriously and not be too quick with customer protection efforts that are in fact patronizing and not to the borrowers' benefit, maybe overly reducing financial access again.

Part II. The Sacrifices of Microborrowers

The next section will report the voices of microborrowers in Ghana, providing unprecedented insights into the experiences of borrowers struggling with their loans. We will first describe typical Ghanaian borrowers as we found them in our sample. We will then report which sacrifices borrowers are making, what are the most common coping strategies to keep up regular repayments, and what experiences borrowers most suffer from. Those borrowers that exceed the threshold for sacrifices defined above are considered over-indebted. We will discuss how these struggles relate to the borrowers' perception of their loans. At the end of the section, the paper will suggest some first indications of what the causes of over-indebtedness might be.

Microborrowers in Ghana

The microborrowers in our Ghanaian sample can generally be considered typical microfinance customers: 72 percent of our respondents are female, most of them married. The most frequent ethnicities are those predominant in Accra, especially the Akan (65 percent), the Ewe (14 percent), and the Ga (12 percent). Nearly without exception, our microborrowers' main source of income is self-employment. The majority of businesses (82 percent) are active in trading, either importing goods from abroad or buying wholesale and selling in small convenience stores or on the markets. Services such as hairdressing and manufacturing account for only a small share of microbusinesses. Only seven borrowers (1.3 percent) have permanent employment as salaried workers.

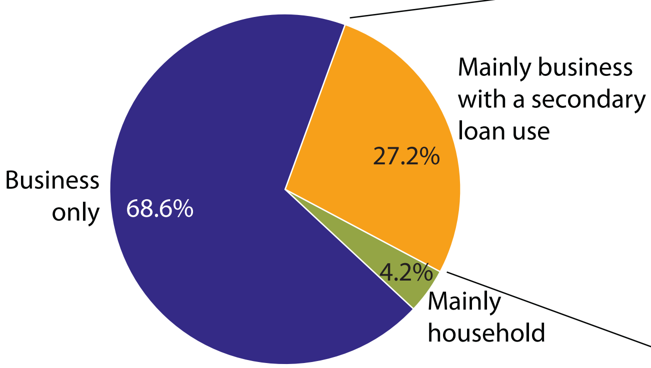
Poor but not extremely poor. The sample confirms that, while living vulnerable lives on low incomes, the typical microfinance clients are not extremely poor. On average, a respondent household lives on 500-650 GH¢ per month, about US$400. With ~five members per household, this is clearly above the local poverty line (World Bank, 2011) or the international poverty line of US$2 per person per day. The median of personal assets of all households in our sample of microborrowers amounts to ~6,000 GH¢. More than half of the loans (59 percent) are less than 1,000 GH¢ at the time of disbursement and most of them (87 percent) are below 2,000 GH¢.

Careful and experienced borrowers. Once borrowers have access to an MFI, they tend to borrow repeatedly, many following the traditional model of loan cycles in group lending or coming back for individual loans demonstrating that they value the services of MFIs. In our sample, 68 percent of borrowers have previous experience with borrowing from (semi-)formal institutions, 41 percent having borrowed for several years in a row. Nevertheless, the group of borrowers who have had only a single semi-formal loan so far (32 percent) is a relevant portion of the sample.

The sample is about evenly split between group (48 percent) and individual (52 percent) loans. However, practices differ between lending institutions. NGOs and lenders with NGO roots give more group loans, while some of the more commercial MFIs focus almost exclusively on individual lending. In terms of loan use, the emphasis on enterprise loans is very strong; 96 percent of loans are used at least partly for business purposes.[16] Repeating the messages of lenders, many borrowers claim that they would never do otherwise, as consumption loan uses make repayments far too difficult. They tend to be quite curious but rather incredulous about interviewers potentially thinking otherwise. Nevertheless, 27 percent of all borrowers do admit that—besides investing in their business—they also used part of their loan for a personal or household use. Of these, education (37 percent) and day-to-day consumption (22 percent) are by far the most common loan uses. They are followed by expenses for housing or land (10 percent), emergencies (9 percent), special consumption such as a mobile phone (9 percent), and the acquisition of durables for the household (6 percent).

16. This is approximate information only, as it does not account for the fungibility of money, borrowers investing less of their household resources in their business when they get the loan and thereby implicitly cross-subsidizing their consumption. Also, many borrowers report not investing the full loan amount but holding a substantial part of it back for the first repayments, without perceiving or reporting this as using their loans for consumption purposes.

Figure 2. A Detailed Split of Loan Uses by Microborrowers



Most common secondary loan uses	%
• Education	37
• Day-to-day consumption	22
• Housing expenses or land	10
• Emergencies	9
• Special consumption (e.g., mobile)	9
• Household durables (e.g., fridge)	6
• Give money to someone else	3
• Social purpose (e.g., wedding)	2
• Pay off a loan (own or for someone)	1
• Other	2

Borrowers are either very careful about taking multiple loans or simply constrained in terms of access: The maximum number of loans reported by any borrower at the same time is three. Only 8 percent of borrowers take loans from more than one lender in parallel, of which less than 1 percent borrow from three lenders at the same time. While self-reports may understate difficult-to-admit phenomena such as multiple borrowing, delinquency, and sacrifices, we do not find evidence of borrowers lying about their loans, at least with regard to formal borrowing: Their information is consistent with what we find in the MIS of the participating MFIs. Instead, the low level of multiple borrowing may to a large extent be due to the sound lending decisions of the participating institutions and may thus not apply to other MFIs in the same lending market.

Helpful loans. While this study is not an impact study, we asked borrowers to provide a subjective assessment of their returns on investment. Out of all borrowers that invested their loans in their business, 43 percent state that their earnings increased significantly and on a regular basis due to the investment; 40 percent claim increases in income that were not sufficient or not stable enough to cover repayments, at least over the period of the loan. The remaining 17 percent of respondents did not experience a permanent increase in earnings as a result of their loan.

On the whole, while we were looking for the many challenges of debt repayment in this study, it was comforting to see how many borrowers were surprised at our questions. For quite a significant number, the benefits of borrowing were absolutely obvious and repayments sufficiently easy to consider our concerns about the distress of borrowers rather strange.

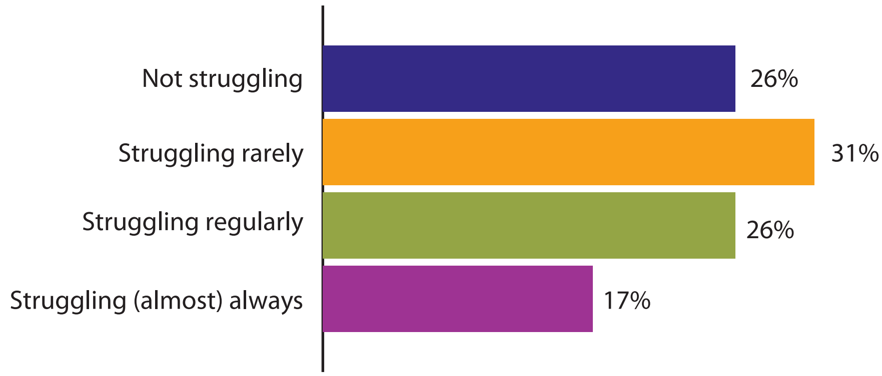
Over-indebtedness, coping strategies, and sacrifices

Taking a loan always comes at a certain risk. Especially for the typical microfinance borrower who lives on a low and volatile income, repaying a loan is not necessarily easy. It implies regularly assembling the cash for repayments and managing this cash demand among many other competing needs for money.

In our sample in Ghana, 26 percent of all respondents find it easy to repay their loans. Some do not make sacrifices at all (17 percent of total sample); others make only minor sacrifices that do not give them an overall sense of struggling. However, many borrowers experience repayments as a challenge. About one-third of borrowers are struggling to repay at certain occasions, 26 percent struggle regularly over the course of the loan but not all the time, and 17 percent permanently struggle with (almost) every single installment. Figure 3 displays the prevalence of repayment struggles among our respondents.

High tolerance for sacrifice. The tolerance of Ghanaian microborrowers for sacrificing for their loan repayments is rather high. Ghanaians have a strong sense of obligation and, for many, making every possible effort to keep their repayment records clean

Figure 3. The Prevalence of Repayment Struggles among Microborrowers in Accra, Ghana



is a question of honor. Also, borrowers consider sacrifices acceptable because choosing this specific hardship is still better than the consequences of default (e.g., assets seized, shop closed, and creditworthiness lost). Some borrowers state that pretty much "anything" would be acceptable for them, once they have incurred the obligation to repay a loan. We met borrowers who go hungry or take their children out of school and still do not want to complain. Ninety-two percent of our respondents identify with the claim "I do everything I can to repay on time," prioritizing loan repayments above most other cash needs. Only 7 percent admit that they sometimes prioritize other urgent expenses over a loan repayment, and only 1 percent admit sometimes paying late even if they do have money—usually in cases where they travel and cannot come to group meetings or MFI premises on the exact day of payment. One respondent explained her willingness to sacrifice as follows:

> *"They were ready to give me money! So I also have to adjust, to compromise and eat only once a day or twice a day. I always manage. Because I needed the money."*

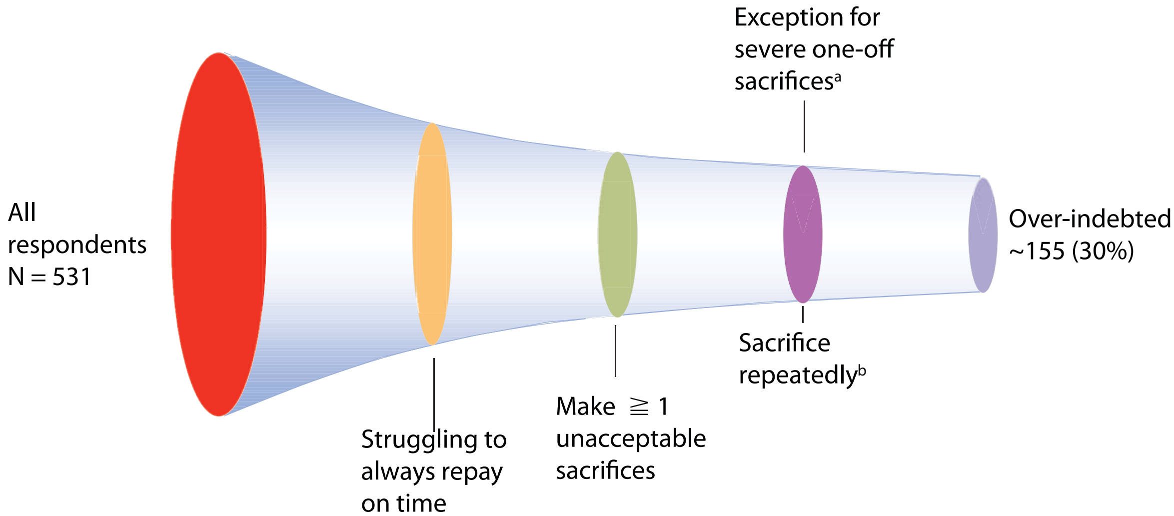
Also, as in many countries, speaking about personal financial hardships is difficult in the Ghanaian cultural context. Our interviewers made every effort to create an atmosphere of trust, guarantee absolute anonymity to the respondents, and show a personal interest in their experiences. As a result, many borrowers opened up and told us their complex personal stories of indebtedness. Nevertheless, we believe that borrowers rather understated their sacrifices on the whole, hesitating to admit that sacrifices were unacceptable to them.

Concerns about over-indebtedness. If we apply our customer protection definition of over-indebtedness to our sample population in Ghana, we find that over-indebtedness from the clients' point of view is a matter for concern. While delinquency levels are still acceptable among our partner MFIs and multiple borrowing is hardly prevalent in the sample, many customers struggle with their repayments**.** *Thirty percent of all the borrowers that we interviewed fulfill the sacrifice criteria for over-indebtedness* (Figure 4). They struggle to repay their loans on time, and they repeatedly make unacceptable sacrifices.

The Ghanaian microfinance market does not appear overheated or in crisis. Still, this level of borrower struggles is worrisome from a perspective of customer protection. The microfinance industry will need to find ways to address these client concerns. This is all the more true as not all but some of these struggling borrowers are likely to slip into delinquency at some point: Among those that are not yet over-indebted according to the sacrifice-based definition, very few borrowers fear that they won't be able to keep up their payments at their current level of sacrifices. Among the over-indebted, in contrast, 8 percent were already convinced at the time of their interview that their level of efforts was not sustainable and admitted that they wouldn't be able to meet their future loan obligations. Protecting customers from getting into the kind of repayment difficulties that cause over-indebtedness in terms of sacrifices is therefore also good risk management.

Coping strategies. Of course, sacrificing starts much earlier than at the level we call over-indebtedness. The next paragraphs will examine the sacrifice ex-

Figure 4.The Over-Indebtedness of Microborrowers in Ghana



a. No repeated experience required for unacceptable sacrifices of suffering an asset seizure, taking a new loan to repay, or selling/pawning assets.
b. Either >3 unacceptable sacrifices, or ≧ 1 unacceptable sacrifice made > 3 times.

periences of Ghanaian borrowers in more detail. Figure 5 provides an overview of how many times the borrowers in our sample reported each of the common sacrifices. For each sacrifice, it details the percentage of borrowers who made this sacrifice and considered it unacceptable as well as the percentage who made the respective sacrifice frequently over the course of one year. The graphical representation of how many borrowers made which sacrifice and to what extent they considered their efforts acceptable shows that, as a collective, microborrowers behave according to rational expectations: They make those sacrifices first that, on average, are easiest to accept, and resort to harder measures only when they have no other option.

When repaying a loan gets challenging, the typical coping strategies of microborrowers in Accra are to work harder in their businesses (61 percent of all borrowers), to postpone other expenses (54 percent), and—if available—to deplete existing savings (34 percent). These are the types of efforts that most borrowers consider acceptable: 68 percent of those who had to work harder considered their efforts acceptable, as did 67 percent of those who postponed important expenses and 63 percent of those who depleted their savings. Therefore, they choose to meet their challenges with these less painful measures first and apply them rather frequently as regular coping strategies. Out of the borrowers who increased their work load, 72 percent did so more than three times in a year. For those who postponed expenses, 60 percent did so more than three times. If depleting savings is a less frequent strategy (28 percent), this is most likely because after the first occurrence there are simply no savings left and it is difficult for most microborrowers to build them up again in better times.

If these sacrifices are classified as coping strategies, that is because they are common reactions by borrowers to debt problems and not necessarily a sign of over-indebtedness. Most borrowers easily accept that they have to make an extra effort for the purpose of their loan. Some may have even made a conscious choice of working harder in their business when they get the loan, hoping for their efforts to bear fruit. These cases are not yet a reason to worry about over-indebtedness.

Of course, the spectrum of subjective experiences is broad, and in some cases these same coping strategies reach the extent where we would call them serious sacrifices. For those borrowers, for example, who consider working harder unacceptable, this does not imply that they are lazy: Some borrowers reported that they had started working day and night, hardly finding time to sleep and finding no time at all to take care of their children. Working at night can come at enhanced personal danger. Others reported that they could no longer go to church and participate in their local communities, because they had to continue working even on Sundays. They had to continue working when they were seriously ill, simply because they could not afford losing their daily income. In these cases, a useful coping strategy may have been overextended under the pressure to keep up repayment performance, and a legitimate effort has turned into a serious sacrifice.

Serious sacrifices. The more painful sacrifices are, the more borrowers try to avoid them. When the easier coping strategies are no longer sufficient to meet repayment deadlines, many borrowers resort to cutting back on food. For those who do sacrifice on food, this usually becomes a repeated experience.[17] Twenty-eight percent of all borrowers who have to cut down on eating consider the sacrifice acceptable, but most of them perceive it as a real hardship.

17. For 63 percent of those who sacrifice food, it occurs during more than three periods throughout the year.

Another common step for Ghanaian microborrowers who can no longer cope with their debt is to ask their friends and family for help. It is clearly a measure that most borrowers prefer to avoid, being similarly difficult to accept as going hungry. It seems that the feeling of dependence on others, the obligation to return favors in the future, and the shame of admitting that one cannot cope alone are strong impediments to asking others for support. The barriers to discussing financial matters with others, as well as to admitting that one is in debt, might pose other hurdles. Of those who do ask others for help, only 21 percent resort to this option more than three times in a year—the availability of support is probably limited, and when asking too often a borrower's personal network risks getting overextended.

Sometimes, when there are no other options left, borrowers resort to taking a new loan elsewhere to repay an old one, selling or pawning some of their household or business assets, or taking children out of school because they cannot afford the school fees or need their children as a workforce too urgently. Only 10-20 percent of the microborrowers experiencing such a situation still consider their sacrifices acceptable. This is the stage where some borrowers experience serious

Figure 5. The Acceptability and Frequency of Borrower Sacrifices

NUMBERS (%) OF BORROWERS MAKING EACH SACRIFICE[a]	SACRIFICES	% OF BORROWERS FINDING SACRIFICES UNACCEPTABLE[b]	% OF BORROWERS MAKING SACRIFICES FREQUENTLY (>3 TIMES)[b]
325 (61%)	Work more than usual	32%	72%
240 (54%)	Postpone important expenses	33%	60%
179 (34%)	Deplete savings	38%	28%
96 (18%)	Reduce food quantity/quality	72%	63%
67 (13%)	Use family/friends' support	73%	21%
51 (10%)	Suffer psychological stress	80%	53%
26 (5%)	Reduce education	80%	53%
20 (4%)	Borrow anew to repay	85%	50%
20 (4%)	Sell or pawn assets	90%	40%
15 (3%)	Feel threatened/harassed	100%	44%
14 (3%)	Suffer from shame or insults	100%	23%
4 (1%)	Seizure of assets	100%	33%

a. Out of all borrowers in the sample.
b. Out of the borrowers who made each respective sacrifice.

psychological stress from the pressure and the fear of not being able to repay their loans. Unfortunately, 19 percent of our respondents have experienced one or more of these tough sacrifices over the course of one year. Here is what one borrower said in describing her psychological stress:

> *"My mind is not clear because always I am thinking of that money […] I am having severe headaches. Sometimes I do not hear it when people talk to me. […] When the tension gets high, a lot of thoughts [of suicide] come to me. Then all that I do, I either take the Bible and read or sing some gospels to calm down and to forget about the evil intentions that have come to me."*

Finally, the indebtedness experiences that no borrower is willing to accept are being threatened or harassed, suffering from shame and insults, and losing their assets in a seizure. This shows how personal honor and integrity can be more important than financial hardships and material sacrifices. Nevertheless, 5 percent of the borrowers in our sample were not able to avoid this level of sacrifice, some even experiencing these repeatedly. As an inherent risk to any lending activity, some customers will always end up unable to repay despite their best efforts. As much as collections have to be strict, our findings underline the importance of treating those borrowers with dignity.

Experiences differ among borrowers. Comparing the sacrifice situation for borrowers who have been delinquent at any point during their current loan to those who have managed to always repay on time, we find that that those delinquents suffer from sacrifices much more frequently.[18] This is in line with our customer protection approach to understanding over-indebtedness that considers (nonfraudulent) delinquency as a late stage of over-indebtedness. Depleting their savings and relying on the help of friends and family are the only sacrifices that delinquent borrowers do not make significantly more often than those with a clean repayment record. The reason might be that for many borrowers these resources are simply not available or, as good tools of liquidity management, have already been sacrificed at an earlier stage of debt struggles. As a result, those borrowers are more likely to slip into arrears.

Independently of their status with regard to over-indebtedness and delinquency, we find that female borrowers differ from their male peers in several ways: Men resort to external solutions more often, taking new loans to repay old ones and selling or pawning assets. This might partly be due to their easier access to alternative loans and assets. In contrast, women have a higher likelihood of reducing their food intake. They are probably the ones that are responsible for the family's meals and in difficult times try to keep up their children's eating habits by compensating for problems with their own nutrition. For all other sacrifices, wherever we have sufficient observations to judge, we do not find a difference between the experiences of men and women. Equally, in spite of a tendency for less delinquency and more sacrifices in groups, there are no significant differences in delinquency and the total amount of sacrifices between group customers and individual borrowers. However, group customers deplete their savings more often, rely more on the support of friends or family, and suffer more psychological stress than individual customers. These differences may result from peer pressure.

Neverending optimism. As we have indicated earlier, our respondents value their access to loans, even in spite of their sacrifices. Many of them are hoping to borrow again and still wish that MFIs would give them larger loans. Only 4 percent of borrowers admit that they regret the amount of debt they took. We believe that the reasons for this seemingly inconsistent picture are threefold.

On the one hand, this is the point where personal embarrassment comes most strongly into play when the research methodology is based on interviews. Admitting to suffering serious sacrifices may be difficult, but at least in showing that they are doing all they can to live up to their obligations, respondents can keep up their self-respect. It is in admitting that they have made a mistake and borrowed too much that borrowers are really embarrassed. Instead of

18. For borrowing anew to repay, selling or pawning assets, asset seizures, and suffering insults or harassement, we do not have sufficient observations to confirm this relationship statistically.

admitting their regret about an error of their own judgment, they prefer to rationalize that they were simply unlucky this time and that their decision was justified as they could not foresee their bad luck.

On the other hand, Ghanaians seem to live with a strong sense of optimism; probably over-optimism in some cases. Many borrowers refuse to answer our backward-looking question regarding their current loan but focus instead on their determination to try again and be more successful with their next loan. The fact that a loan has been a negative experience does not spoil their fundamental belief that more investment will help in the long run. They even argue that now that their troubles have worsened over the first loan, they need a larger loan even more urgently.[19]

Both motivations lead to similar arguments that attribute the repayment problems to a factor other than the decision to borrow: Taking a loan was correct, but

- The investment went wrong or started paying off too late compared to the installments
- An emergency made repayments difficult
- The interest was too high or installments too frequent
- The amount disbursed was too low for the required investment or was disbursed too late.

Based on these arguments, borrowers do not regret their loans as such but they regret the specific problem they attribute their struggles to. One woman told us that she won't manage to repay and never wants to borrow again—but instead of regret about her loan she still indicated the wish to have borrowed more, hoping that with more credit her business would have been more successful.

Finally, borrowers' lives are shaped by a constant need for cash—they simply value their creditworthiness and access to credit so highly that they prefer to keep up the borrowing relationship to the MFI even when borrowing experiences can be more painful than immediate loan impact may justify. Borrowers may still be better off with access to finance than without. Some Ghanaians seem to perceive a loan as something so precious that they would take it without reflection, no matter what the cost. This is a strong message not to overreact to over-indebtedness: Customer protection should aim to reduce borrower sacrifices. But customer protection measures that overly reduce poor people's access to loans may not always be the right response. Instead, a redesign of loan products seems to be called for.

The causes of over-indebtedness

While lives in poverty are a continuous struggle and we will have to accept that repaying loans is not always easy for the target clientele of microfinance, we are concerned to find one-third of borrowers struggling repeatedly and heavily to repay their loans. At the same time, borrowers clearly indicate their continued need for access to credit. Simply reducing microlending therefore may not be to the average client's benefit.

To develop appropriate customer protection mechanisms, the industry will need to understand much better what is causing the borrowers' difficulties and what the contribution (as well as alleviating effect) of microfinance is. The answers may well be country and context specific. This section develops some first hypotheses of what the causes of over-indebtedness are in Ghana and which borrowers are particularly at risk.

Some groups experience more over-indebtedness than others. Looking at the distribution of over-indebtedness across different subgroups of our population, without paying attention to statistical significance just yet, we find an above-average share of 44 percent over-indebtedness among minority ethnicities.20 Potentially, ethnic outsiders face additional economic challenges in terms of business opportunities and safety network. There also is slightly more over-indebtedness among borrowers living without a marital partner (34 percent) than among married bor-

19. This is in line with insights from behavioral economics that humans often do not make fully rational decisions, inter alia, when deciding to borrow (see, e.g., Banerjee and Duflo [2007] on microborrowers' financial lives). To a certain extent it represents a call for increased financial literacy.

20. Minority borrowers indicated their ethnic background as Gurma or Other. The majority ethnic groups (Akan, Dagbone-Dagomba, Ewe, and Ga) have an over-indebtedness share of 29 percent.

rowers (28 percent). Health problems (27 percent), including severe health problems (2 percent), are more common among the over-indebted than among those who are managing their debt without serious sacrifices (22 and 1 percent, respectively). Thirty-six percent of the borrowers with an educational level at or below primary school are over-indebted, versus 'only' 28 percent of borrowers with middle school or higher education. Similarly, over-indebtedness is higher among people who borrow from several lenders in parallel (44 percent versus 29 percent among single borrowers) and among first-time debtors who lack previous borrowing experience (35 percent vs. 28 percent among experienced borrowers).

However, the findings above do not stand the test of statistical significance, mostly because the subgroups where over-indebtedness is more prevalent are too small to allow for reliable econometric results. Some of them might only be coincidental differences in our sample. In the next paragraph, we use simple statistical tests to analyze which factors are related to over-indebtedness and find that, in particular, economic and loan-related factors, but also some personal characteristics, are correlated with over-indebtedness.

Several economic and personal factors are related to over-indebtedness.[21] Of all our potential over-indebtedness causes, the factor with the strongest statistically significant relationship to over-indebtedness is a low return on an investment loan,[22] followed closely by partial or total loan use for nonproductive purposes. This is not surprising: It is harder to repay a loan when it does not cause any or only low investment returns (Gonzalez, 2008). Similarly, we find a comparably strong relationship for adverse shocks to a borrower's financial situation, especially sudden drops in income and, for a lack of assets, most importantly savings that could serve as a buffer for difficult times. "Living on a low income" comes up as a relevant factor in only one of the tests and "volatility of income" not at all.

In addition to these economic factors and hardships that may well be typical causes for making borrowers struggle with their loan repayments, we find that borrowers' personal financial literacy is related to their over-indebtedness risk. The lower their score on our financial literacy test, especially in the section with debt-specific questions, the higher the share of borrowers that is over-indebted. This is in line with findings from Godquin (2004) that access to literacy services can improve repayment rates. Finally, we conducted an experiment on the risk preferences of our respondents.[23] The resulting risk aversion score is correlated to our main over-indebtedness measurement, but does not provide consistent findings about the direction of the relationship. It seems that at least extreme levels of risk aversion are rather counterproductive and related to higher over-indebtedness risks. This might be due to overly restrained business decisions but could also be a question of reverse causality, with debt problems reducing the willingness to take risk.

In spite of the importance of financial literacy and previous findings that delinquency goes down with the number of past loans a borrower has had (Schreiner, 2004), in Ghana a lack of borrower experience does not seem to increase over-indebtedness risks. Also, our findings challenge the assumption that over-indebtedness corresponds to multiple borrowing (McIntosh and Wydick, 2005; Roesch and Héliès, 2007; Reille, 2009; Venkata and Veena Yamini, 2010). At first sight there is a higher share of over-indebtedness among cross-borrowers, but at least at the low level of multiple borrowing in our sample, taking more loans is not statistically correlated to over-indebtedness. Figure 6 provides an overview of factors related to over-indebtedness in a contingency analysis. Cramer's V and Kendall's Tau-c indicate the strength of the relationship that is relevant in all cases except total assets, though each

21. Using contingency analysis with Chi Square and Cramer's V for our main over-indebtedness measurement and with Kendall's Tau-c for an alternative approach where we have broken the measurement down into four categories of severity. Upcoming academic publications of the author will provide more detailed econometric analysis. Correlations do not prove causality.
22. Self-reported investment returns by borrowers in three categories (earnings increased significantly and regularly; the increase was not sufficient or not stable enough to cover repayments; no permanent increase in earnings from the investment).

23. Borrowers could choose from two bags of marbles with higher/lower chances of getting lower/higher returns. The probabilities and payoffs varied over five rounds. It is not guaranteed that such a game can measure actual risk behavior of borrowers in their businesses.

Figure 6. Potential Causes of Over-Indebtedness

	CRAMER'S V	KENDALL'S TAU-c[a]	RELATIONSHIP CONFIRMED
Income	0.170***	—	(✔)
Income volatility	—	—	—
Assets	n/a	–0.056*	(✔)
Savings	0.156**	–0.111***	✔
Adverse shocks (esp. to income)	n/a[b]	0.199***	✔
Borrowing experience	n/a	—	—
Multiple/Cross-borrowing	n/a	—	—
(Partial) Nonproductive loan use	0.173***	0.161***	✔
ROI (if only invested)[c]	0.211***	0.102**	✔
Financial (esp. debt) literacy	0.180***	–0.126***	✔
Risk attitude	0.191***	—	—

a. Tau-c based on an ordinal over-indebtedness definition for robustness check.

b. Chi Square invalid due to lack of observations in > 20% of contingency table. However, highly significant also in other robustness checks.

c. Relationship stronger (always 1% significance) for all investment loans. This analysis avoids collinearity with loan use excluding even partial nonproductive loan use.

of the factors is obviously just one influence factor among several others. It is probable that nonliquid assets are of little help and liquid savings make a bigger difference to borrowers' struggles. One star denotes a 10 percent statistically significant level, two stars 5 percent, and three stars 1 percent.

Lending institutions may also play a role. In addition to the influence that borrowers and their circumstances have on over-indebtedness risks, the MFIs and their products and policies may also play a role. Indeed, many borrowers complain that their repayment difficulties are due to product features such as the high interest rates on microloans, loan amounts being too small, or grace periods being too short for investments to start paying off.

While most borrowers consider their MFI's treatment as fair, their terms and conditions as transparent, and their evaluation of repayment capacity as fair and sound, borrower opinions are split when it comes to specific product features. Many borrowers state that MFIs disburse loans too late for their investment opportunities (53 percent), offer too-short maturities (51 percent), insist on too-frequent installments (47 percent, mainly those that are on weekly instalment schedules),and do not provide fair rescheduling options for borrowers in honest difficulties (58 percent). These are clear messages to product developers in MFIs, not only from a customer protection, but also from a customer satisfaction point of view. Nevertheless, this is not a clear call for product changes in favor of those who currently complain: Even if 51 percent of borrowers consider maturities too short, 49 percent do not want longer maturities that would increase their interest charge on a given loan amount and would delay their access to a follow-up loan. It is therefore rather a call for more flexibility. The standardized microfinance product offer does not match every borrower's cash flows and makes repayment more difficult for many of them than is actually necessary.[24]

Furthermore, borrower sacrifices are often made out of a constant fear of the consequences of delinquency, especially of tough collection practices. Once borrowers reach the stage of arrears, harsh collection practices make their over-indebtedness experiences worse. Augsburg and Fouillet (2010) describe allegations of overly harsh collection prac-

24. Flexibility requires careful experimentation to keep up strong repayment incentives and needs to be weighed against the increase in operating costs that may result from the additional complexity.

tices in the Indian context. In our sample, 49 percent indicate that loan officers threaten borrowers or use abusive words, although only 24 percent say that MFIs are generally impolite in the collections process. This seeming contradiction probably results from the general politeness of loan officers except in especially difficult repayment situations. Borrowers' fears may be linked more to hearsay and the experience of others than their own. After all, only 3 percent of borrowers listed threats or harassment as their own sacrifices in the past year. Also, some borrowers do not classify threats as impolite but consider them necessary loan officer behavior.

Ghanaian borrowers[25] expect that delinquents will experience pressure from their fellow group members (64 percent), being subjected to public blame (40 percent), group meetings getting extended for hours (35 percent), and finally and most prominently, their assets being seized (72 percent). While collections need to be strict and a seizure of assets is an appropriate step in case of default on a collateralized loan contract, there seems to be widespread confusion in Ghana: Some loan officers seem to use threats of asset seizures as a tool to pressure borrowers who lack the financial literacy to properly understand their rights and obligations. According to client interviews, they sometimes pretend to be able to seize assets much earlier than 90 days after missed payments or to be able to seize any belongings of the borrowers. One woman reported that her MFI had seized her main business assets and personal kitchen equipment although she had not been aware of her loan contract including any collateral. Another borrower said that the MFI had seized all of his merchandise, exceeding the 1,800 GH¢ outstanding value of his loan and still coming back for a second seizure when he had just started rebuilding his shop. When he finally repaid his dues, the MFI returned his assets only partially and in a deteriorated condition.

> *"They said they are needing the money. So if I couldn't get the money I should go and borrow it. If I couldn't borrow the money then they would come and pack my goods. […] They just came without my information. They just packed, they packed all my goods away. […] After they took my phones, I have got another money and put another goods. Then they came to pack it again. […] I went to a friend and borrowed money. He couldn't give me the amount that I was needing, he just gave me 400 Ghana Cedis. So I went, I asked them if I bring that 400 Ghana Cedis, would they give me the goods and he say yes. I went borrow money, 400 Ghana Cedis and deposit the money with them, they said "no". I should pay all before they would give me. […] So as for my goods, they just wasted it. […] some gotten lost, and some gotten spoiled and things. […] Later it was not value."*

Our findings indicate a clear call for flexibility of microfinance products, for fairness in MFI policies, and for improving clients' understanding of contract terms and financial matters in general. Striking the right balance between setting strong incentives and accommodating customer needs will require careful experimentation with extending and developing the microlending methodology in the future. More research should be done on the relationship of product features and other lender characteristics such as growth rates and profitability to over-indebtedness. It will inform the development of solutions to the over-indebtedness challenge so that remedies can address the most important levers.

25. For measures that are specific to the group lending methodology, percentages apply to group borrowers only. They may understate borrower expectations as not all respondents were familiar with the effects of delinquency in group lending.

Part III. Outlook for the Industry

What have we learned about over-indebtedness?

This paper has offered insights into the repayment experiences of 531 microborrowers in Accra, Ghana. It has revealed the sacrifices that many borrowers are making to repay their loans and used a sacrifice-based definition of over-indebtedness to assess the extent to which borrowers are over-indebted from a client protection perspective.

In fact, we learned that only 26 percent of our respondents manage to repay their loans without struggle and make no or only minor sacrifices. The other 74 percent do struggle, and for 17 percent of all borrowers struggle is a permanent companion for (almost) every installment they make. At the same time, we found that borrowers in Ghana have a rather high tolerance for such sacrifices. While personal experiences and struggles are of course subjective, many borrowers express a strong will to meet their repayment obligations, keep a clean credit history, and invest whatever it takes to maintain their honor and creditworthiness.

When repayments get challenging, the average borrower first resorts to easily acceptable coping strategies such as working harder, postponing important expenses, and depleting savings if there are any. These reactions to repayment difficulties are very common and not necessarily a reason for concern. When the coping strategies above are not sufficient for a borrower to meet the loan obligations, sacrifices become more serious. Borrowers cut down on food, try to find family or friends who can help them out at least temporarily, and sometimes take their children out of school. They only partially consider this level of sacrifice acceptable. With increasing debt problems, borrowers suffer from psychological stress, get threatened or harassed, and suffer from shame and insults. In the final stages of repayment problems, borrowers resort to taking new loans to pay off old ones or selling or pawning their personal and business assets. The ultimate experience of debt problems when a borrower actually defaults is of course losing one's belongings in a seizure of assets. These experiences are less frequent, but also more severe, and are hardly ever acceptable to microborrowers.

Applying our sacrifice-based definition of over-indebtedness to our population sample from Accra, we found that about 30 percent of all borrowers sacrifice to the extent that they fulfill all our over-indebtedness criteria. In our sample of strong lending institutions, delinquency and multiple borrowing are low, but one-third of borrowers struggling that seriously to keep up their loan repayments is reason for concern. We do not argue that microloans are necessarily what caused these sacrifices, but we do call for attention to the difficulties that repaying loans imply for MFI customers. At the same time, the paper found strong optimism of most microborrowers about taking future loans. This finding represents a warning to the microfinance community not to overreact: While it should certainly address the challenges of loan repayment in its client protection efforts, borrowers value their access to microloans very highly and do not want to lose it over protective measures.

In looking for the potential causes of over-indebtedness, we found that borrower sacrifices seem related mainly to the economic challenges of failed business investments, loan use that does not earn returns, adverse shocks that reduce the borrower's income, and a lack of assets, especially savings, to serve as a buffer against delinquency. Even if shocks cannot be fully anticipated, these items require lenders to focus on sound due diligence. A lack of financial literacy, and particularly debt literacy, among borrowers also drives over-indebtedness risk. Interestingly, this does not apply to being a first-time borrower, having a volatile income, or to taking loans from more than one institution at the same time.

With regard to lender influences, it seems that, besides standard complaints about interest rates, borrowers consider inflexible product features a main reason for their sacrifices. Installment schedules don't always fit the borrowers' cash flows, and a strict application of the zero-tolerance policy can prevent rescheduling where it would actually be appropriate. Also, disbursements may be too late for productive investments. Of course, customers in repayment difficulties frequently complain about the high level of interest on microloans. When borrowers reach the stage of delinquency, collections practices may in some instances be too tough and aggravate the over-indebtedness experiences of microborrowers.

Among the target group of microfinance that is living on low and volatile incomes, difficulties in regularly assembling the cash for loan repayments are not surprising. For a long time, these customer experiences haven't earned much attention, seeming less relevant in the face of a strong belief in the positive impact of microfinance on borrowers' lives. Nevertheless, cash demands are a challenge for the poor, and credit is always a risk as well as an opportunity. In the context of the industry's current focus on responsible finance and client protection, it needs to pay attention to the hardships that some microborrowers go through and try to reduce them. At the same time, given the value even struggling borrowers place on further access to loans, simply stopping or reducing microcredit does not seem an appropriate reaction in the Ghanaian context. While some measures may involve smaller loan sizes or recognizing that not everybody needs a loan, other measures may rather be about improving credit products to make repayment easier.

What are the prospects for microfinance in urban Ghana?

There have recently been concerns about over-indebtedness risks in Ghana, one study raising concerns about multiple borrowing, another applying high-level early-warning indicators to the market and concluding that over-indebtedness risks in Ghana are not yet extreme but on a medium to high level given market characteristics. Also, local MFIs are aware of increasing competition and borrowers struggling to repay their loans.

On the other hand, neither the penetration of the Ghanaian market with microloans or with access to finance in general, nor the competitive behavior of our partner MFIs, represents a reason for concern. In fact, the lending policies of the main Ghanaian MFIs are rather conservative, and many MFI customers are still credit-constrained in terms of both volume and access to alternative loan sources. There are no excessive levels of delinquency, nor did we find an issue with multiple borrowing, at least among the market's top institutions.

Nevertheless, this paper has shown that many borrowers are indeed facing severe challenges in repaying their loans; 30 percent of them struggle so much with their repayments that we call them over-indebted from a customer protection perspective. These findings represent a call to Ghanaian MFIs to focus more on customer satisfaction and borrower experiences, meeting their clients' financing needs more precisely. This will probably imply rethinking features of their product portfolio. At the same time, there seems to be a need for improved client literacy and for more transparency about the rights of borrowers in the collection process.

The Ghanaian microfinance industry is not in a stage of crisis. Nor does it seem very close to a wave of delinquency among its well-managed MFIs. Nevertheless, the repayment struggles that borrowers have reported in this survey may be a sign of increasing delinquency problems. And the situation in other market segments that do not benefit from the top MFIs' skills to identify the best borrowers may well be of more concern. It is therefore a good time for Ghanaian MFIs to take action, from both a motivation of customer protection and of risk management.

What are the policy implications for the wider microfinance sector?

The fundamental learning from this paper for the microfinance sector is that we need to pay more attention to the experiences of microborrowers in repaying their loans. A continued demand for loans and strong repayment statistics do not guarantee that customers are well and that they are sufficiently protected from suffering.[26] In spite of the large demand gap in microfinance and of the potential benefits of microloans to the poor, the downsides of repayment difficulties represent an inherent risk to every debt. Any responsible lending institution, but especially those with a social mission, should pay attention to this downside risk and take appropriate customer

26. See Schicks and Rosenberg (2011) for the challenges in drawing conclusions about over-indebtedness from MFIs' repayment statistics.

protection measures to reduce the potential for over-indebtedness—not only in terms of portfolio quality but also in terms of borrower sacrifices.

This paper highlights the experiences of microborrowers with their loans and aims to raise awareness of their repayment struggles. At the same time, it contributes to the microfinance industry's understanding of what over-indebtedness means from the perspective of clients and how we can assess it empirically. While getting reliable information from customers about their sacrifices represents both a challenge and a large effort, this paper suggests an innovative way to identify over-indebtedness risks from the viewpoint of microfinance clients. We will need many more research projects of this type to get a more comprehensive understanding of borrower experiences, also in other countries and cultural contexts. In the long run, we will need to identify proxies of over-indebtedness that are easier to track for MFIs and regulators.

There are also policy implications from this research for the development of customer protection mechanisms and especially for preventive measures against over-indebtedness. The findings are of course limited to the Ghanaian context, but are likely to be of relevance to other markets as well: Even significant levels of over-indebtedness in a microfinance market do not automatically imply that there should be no more microlending. In fact, microborrowers in Accra continue to express a strong interest in borrowing in spite of their struggles. Looking at the causes of over-indebtedness can inform us about better reactions to the over-indebtedness challenge. Both borrower sacrifices and delinquency may result not only from too much access to credit but alternatively from access to inappropriate loan products. In addition to sound due diligence, making products more flexible and tailoring loan disbursements, grace periods, and installment schedules to the borrower's investment cash flows have the potential to significantly reduce over-indebtedness risks. It can improve both the experience of microborrowers with their loans and their repayment performance. Further research will be necessary to test this hypothesis and understand the implications and feasibility of product flexibility in more detail. The same applies to the promotion of savings products that may reduce the need for loans or the risk of repayment difficulties.

Finally, there is a message in our findings about loans used for consumption. Unsurprisingly, we find the commonly assumed relationship between using a loan for consumption purposes and experiencing repayment difficulties confirmed. In light of the recent trend toward seeing the benefits of microfinance in terms of consumption smoothing rather than productive investment (Collins et al., 2009), the relationship between over-indebtedness and borrowing for consumption doesn't necessarily mean there shouldn't be consumption loans, especially for emergencies. Also, Ghana provides a good example of how preventing consumption loan use is not a practical option. Money is fungible, and borrowers will always use parts of their loans for nonbusiness purposes or will reduce their household's investment in their business as a consequence of having the loan. Nevertheless, it is not surprising that paying back without investment returns is more difficult and we should keep these challenges in mind. We will need to improve our understanding of how the risks and benefits of borrowing balance and how we can best support borrowers in managing their finances and their lives in poverty.

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Appendix I: The Client Protection Principles

- **Appropriate product design and delivery**
  Providers will take adequate care to design products and delivery channels in such a way that they do not cause clients harm. Products and delivery channels will be designed with client characteristics taken into account.
- **Prevention of over-indebtedness**
  Providers will take adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, providers will implement and monitor internal systems that support prevention of over-indebtedness and will foster efforts to improve market-level credit risk management (such as credit information sharing).
- **Transparency**
  Providers will communicate clear, sufficient, and timely information in a manner and language clients can understand so that clients can make informed decisions. The need for transparent information on pricing, terms, and conditions of products is highlighted.
- **Responsible pricing**
  Pricing, terms, and conditions will be set in a way that is affordable to clients while allowing for financial institutions to be sustainable. Providers will strive to provide positive real returns on deposits.
- **Fair and respectful treatment of clients**
  Financial service providers and their agents will treat their clients fairly and respectfully. They will not discriminate. Providers will ensure adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents, particularly during the loan sales and debt collection processes.
- **Privacy of client data**
  The privacy of individual client data will be respected in accordance with the laws and regulations of individual jurisdictions. Such data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client.
- **Mechanisms for complaint resolution**
  Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients and will use these mechanisms both to resolve individual problems and to improve their products and services.

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Appendix II: List of Borrower Sacrifices

Interviewers asked each respondent about the following list of sacrifices:

1. Reduce food quantity/quality
2. Reduce education
3. Work more than usual
4. Postpone important expenses
5. Deplete your financial savings
6. Borrow anew to repay
7. Sell or pawn assets
8. Seizure of assets
9. Use family/friends' support to repay
10. Suffer from shame or insults
11. Feel threatened/harassed by peers/family/loan officer
12. Suffer psychological stress yourself or in your marriage
13. Other

Respondents ranked the acceptability and frequency of each sacrifice on a scale from 1 to 4.

- Acceptability:
  Easily acceptable, Only just acceptable, Not really acceptable, Not acceptable at all.
- Frequency:
  Once in past year, 1-3 times in past year, > 3 times but not often, Frequently in past year.

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