MicroSave Briefing Note # 57

Games Loan Clients Play

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> 'Games' as used in this briefing note refers to the ways in which clients either test controls, exploit weaknesses in the financial service provider's system or test the institution's capacity to live up to its promises.

MicroSave has worked with many institutions and has observed several issues related to accessing financial services. Interactions, observations and interviews over this period have led to a better understanding of why clients do some of the things they do. Clients are much smarter than institutions may realise, they take ingenious actions to improve their access to services, particularly loans. Below is a summary of observations, or "games" that loan clients' play and some possible solutions for the financial service providers. These "games" are organised by the loan methodology (Group [G] and/or Individual [I]).

Game	What MFIs / Banks Can Do
Some clients **mobilise ghost clients and family members** to meet the required group size and thereby access loans. This can involve collusion with the Credit Officer. In one of *MicroSave*'s Action Research Partners this resulted in writing off US$1.0 million because the bank could not identify many clients registered in the group. [G]	• **Use basic internal audit checks and supervision** visits to verify existence of group members. • **Institutionalise a product development** process that considers risks before starting operations to improve the internal control environment. • Carry out a **Loan Portfolio Assessment**[2].
Group methodology in some institutions forbids clients from missing a repayment, which leads clients to **borrow from each other to manage repayments**. In an extreme case, moneylenders were seen on the premises of one MFI in Tanzania. [G]	• Ensure clients have **manageable loan sizes** and instalments by flexing the repayment period. • **Surveillance and constant feedback** to identify signs of stress decay of group cohesion and existence of external parties like moneylenders.
Servicing loans of dropouts so that the group advances to the next loan cycle, then the remaining clients default and disappear after the next loan is disbursed. [G]	Institutions must **monitor the performance of individual members** within a group and as much as possible have an Officer attend the group meetings.
Clients borrow neighbours' stock during appraisal to access a larger loan. This mainly happens with shopkeepers who need to demonstrate a strong cash flow position. OR: **Pledge collateral that (knowingly) is not in their names** and to different institutions. [Primarily I]	• **Surprise checks** on businesses before, during and immediately after disbursement, including photographs of stock. • **Require proof of ownership documents & trade license** to ensure legal names match. • **Register or "Perfect" security** for larger loans.
Clients sometimes have **relatives and friends take out loans on the same business from different MFIs**. During assessment they claim not to have the necessary documentation to show ownership. [I+G]	• Obtain **business license** during appraisal of the loan. If in doubt, obtain independent **opinions** from neighbours without the knowledge of the client. • **Surprise visits** before and immediately after disbursing the loan to verify ownership.
Clients can choose to **prepay the first loans as they go through the institution's initial loan cycles**; this action sometimes involves using the same money to prepay the loan. Such clients may ultimately end up defaulting when they receive a larger loan. [I+G]	• **Establish standards** on the earliest a loan can be repaid. • As part of **monitoring**, confirm proceeds were used for intended purpose • Institutions should try and **match the loan with the client's need** but this has to be in line with the client's capacity to repay.
Institutions have a maximum loan amount they are willing to risk with an individual borrower, which can be insufficient for the client's needs. Consequently, clients seek **membership in multiple institutions** to have access to additional loan capital. [I+G]	• Ensure that you are the **preferred service provider** by understanding and responding to their needs through **market research** and product development. Also provide the **best customer service,** it builds loyalty and retention..

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[2] Visit www.*MicroSave*.net for more information about the Loan Portfolio Assessment.

Game	What MFIs / Banks Can Do
	• In some cases, assist client to graduate to another institution; this will create goodwill, too. • Establishing working relationships with other MFIs to share less sensitive information like blacklisted clients
Patching from different institutions to address different needs. Clients borrow from a bank for capital development projects, have an MFI loan for working capital needs and manage the day to day cash flow needs from friends, family and money lenders. This results in a lost opportunity for the MFI to provide larger loans and risks client over-indebtedness. [I+G]	• Buro in Bangladesh has a Development Loan, Working Capital Loan and an Emergency Loan and allows clients to have more than one loan at a time. This ensures **people can meet emergency needs even during existing loan obligations** and protects the client's capacity to service the larger loan. • **Build into the loan application process methods to establish existing indebtedness** such as: obtaining client's bank statements (lookout for standing orders), independent checks from people close to the client, reconciliation of disclosed cash flows and establishing relationships to share information with other MFIs.
Creating illegitimate guarantors, especially fake spouses for security consent. In many institutions spousal consent is required legally before pledging a family asset as collateral for a loan. [I]	• During loan appraisal, **obtain a marriage certificate** or consult local authorities to verify legal relationships. • Obtain background data on guarantor (account relationship with MFI, cpacity to make good in case of default, etc.
Frequent deposits and withdrawal of the same cash flow to depict a healthy cash flow position, if an MFI uses cash flow as a basis for credit decisions. [I]	**Probe for sources and verify existence of real cash flow** before approving a loan. This analysis may need to be repeated even after disbursement.
Clients can **deliberately fail to make a repayment to assess the MFI's follow up mechanisms**. If the organisation has poor follow-up mechanisms, the loan can easily fall delinquent. Multiple borrowers interviewed have indicated that in case of a temporary shortage they pay institutions with strict follow-up mechanisms first and pay the lenient ones later. [I]	• Have **incentives for on-time repayment**, for example interest rebates / waiver, pegging next loan size to on time repayments of the previous loan. • **Prompt follow-up in case of default** has no substitute, preferably within the same week of the missed instalment demonstrating excellent systems and intent to collect.
Clients take advantage of the **weak legal system** that stipulates that there will be no repayments when a case is in court. [I]	**Court action should be taken as a last resort**. Default management measures should target what is valuable to the client in the initial stages. **Publicise court cases**.
Clients **inflate financial performance** to obtain larger loans. [I]	Loan officers must conduct thorough assessments and ask for records to **crosscheck information**.
Salaried clients process their salary for some time through the institution. **Once they get a loan they transfer their salaries** to another bank. [I]	**Screen potential employers** and deal with well-established companies which undertake to provide assurances for their staff, normally against terminal benefits. Maintain regular contact with employers.
Group customers bribe a loan officer to give them **loans under forged names**. [G] Or, in individual lending: Customers offer **kickbacks to loan officer to falsify application** information. [I]	• Monitor loan officers continuously. Some institutions **transfer loan officers regularly** which can identify ghost clients. • Supervisors and Branch Managers should **periodically follow up defaulters** and maintain detailed records of their efforts. • Supervisory monitoring visits. • **Strong institutional culture** for integrity supported by an enforced disciplinary policy for wrongdoing • **Balance growth and portfolio quality in incentive scheme**
Former defaulters present themselves under different names to acquire new loans. [I]	A good **MIS that matches new loan data against existing and historic records** (National IDs or TINs) may identify such customers, as might review of new loan applications by long serving officers.

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