Long-term relationships, Reciprocity and Hold-Up in Microfinance: Experimental Evidence

(Paper by Simon Cornée, David Masclet, Gervais Thenet)

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From 4.00pm to 5.30pm

At the Salles des Conseils (ground floor)
of the Warocqué Business School
Université de Mons - UMONS

Abstract:
Microfinance is generally associated with high repayment rates. However, it is not clear whether this success results only from the use of peer lending or is also due to another characteristic of microfinance: the long-term relationship between the borrower and her incumbent lender. We contribute to the existing literature on the microcredit market by experimentally determining to what extent long-term lending relationships mitigate the moral hazard associated with repayment and project selection even in the absence of a peer group. The originality of our research lies in our introduction of variability in socio-demographic characteristics by recruiting "real people", including not only students (the typical subject pool) but also bankers from both commercial banking and microcredit institutions. Consistent with previous work, our experiment indicates that peer-lending dimension of microcredit in absence of peer-sanctioning mechanism is not sufficient to mitigate the moral hazard. In sharp contrast, we find that the opportunity to engage in bilateral long-term relationships notably improves market performance by mitigating the repayment problem (ex-post moral hazard) and thus enhancing cooperation between borrowers and lenders. Nonetheless, our results also suggest that lenders take advantage of their long-term situation by increasing their rates. The cost of credit is significantly higher under the partner treatments than under the stranger treatment. As a consequence, borrowers may have an incentive to take more risk to pay back their loan (ex-ante moral hazard). Improving information disclosure has no significant effect on cooperation. Finally, we find that social bankers are more likely to make fair credit offers to borrowers than are commercial bankers.

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Please confirm your presence by March 8th, 2011.