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Determinants of Intra-group Insurance in Microfinance: Evidence from Joint Liability Lending Programs in Malawi

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Abstract

The success of group lending with joint liability has been partly attributed to its ability to induce group members to provide mutual insurance when a member fails to repay. Although theorists have proposed conditions under which group lending with joint liability encourages group members to provide mutual insurance once some group members fail to repay their loan, very little empirical research has been conducted to test the validity of such theories. The objective of this study was, therefore, to examine the extent to which intra-group insurance occurs and to investigate the underlying determinants of the willingness of group members to offer mutual insurance. The data used in the study was collected in Malawi by the International Food Policy Research Institute (IFPRI) in collaboration with the Rural Development Department (RDD) of Bunda College of Agriculture. The data is from 99 farm and non-farm credit groups of the Malawi Rural Finance Company (MRFC). The determinants of intra-group insurance were investigated using a Probit model. The results revealed that although 89 percent of the borrowers accepted the fact that they were to contribute to repay loans for defaulting group members, only 42 percent expressed willingness to offer that support. An analysis on factors influencing the willingness of members to provide mutual insurance revealed that factors of production as well as pre-existing social ties increased the likelihood that group members would be willing to support each other. The results further indicated that the likelihood of providing mutual insurance among group members varies with dynamic incentives and risk pooling factors while peer monitoring is statistically insignificant. The presence of new members in the group, which potentially introduces a matching problem, works against mutual insurance. The cost of insurance, captured by the variation in loan size among group members, reduces the willingness of peers to contribute to repay defaulted loans of their peers.

Keywords: Dynamic incentives, intra-group insurance, joint liability, Malawi