Abstract

Over the years, the lending procedures of microcredit has evolved. The original joint liability group lending with simultaneous financing (loans released at once) has been replaced by sequential financing (loans released one by one). Moreover, recent studies suggest individual liability lending in groups to be the optimal choice. While numerous theoretical studies provide thorough models of each of these approaches, none presents a comparative analysis. In this study, we model these three schemes using the framework by Van Tassel (1999) and compare them. Further, we add exogenous peer monitoring costs and within-group heterogeneity of loan sizes to our models. Our findings prove that, in the presence of information asymmetry, group lending with joint liability dominates individual liability lending in groups. Furthermore, the interest rate of the sequential model is more sensitive to changes of monitoring costs or opportunity costs of capital than in the sequential model. On the contrary, sequential approach allows for higher degree of within-group heterogeneity of loan sizes. It is ambiguous which model achieves higher profit and lower interest rate. Our results confirm that the choice of optimal financing approach is determined by the characteristics of borrowers.

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