Innovations for Poverty Action

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Timeline
2019-2021

Study Status
Results

Study Type
Randomized Evaluation

Sample Size
68,461 loans originated between January 2019 and August 2021 by six lenders in Kenya

Research Implemented by IPA
No

Examining the Impact of Loan Modifications on Borrowers in Kenya During COVID-19

Given the global economic consequences of COVID-19, many lenders have set up forbearance or repayment plans programs for borrowers experiencing financial hardship. While loan modification reduces loan losses by 35.8 percent,[1] there has been some disagreement about how to modify loans to reduce loan losses when they are in default. On one hand, researchers found that lowering the principal balance improved financial and labor market outcomes for borrowers more than if the payments were reduced to aid borrower liquidity.[2] However, other studies have found that principal reductions didn't change default and that decreases in short-term monthly payments make the most difference for borrowers' ability to pay. [3]

Six microfinance institutions (MFIs) in Kenya deployed a variety of loan modification programs in response to COVID-19. Researchers analyzed 68,461 loans originated between January 2019 and August 2021 to compare the delinquency and repayment rates of loans across the different MFIs.

Results showed that MFIs without modifications had higher delinquency rates than those that did provide loan modifications. While both experienced increases in delinquencies, the average gap between them doubled. The modifications did not seem to change the average delinquent amount for MFIs 3 or 5 from the start of the intervention while the modifications by MFI 1 may have. Of the loans that started repayment for MFI 1, they were most likely to restart 1 month after the programs were implemented whereas the loans that started repayment for MFI 5 were most likely to restart 3 months after the programs were

implemented. MFI 3 did not see any increase in repayment, but it had the most extensive programs so this could be due to classification.

A caveat to the results is that researchers could not separate the effect of the repayment programs from other confounding factors. It could be that the MFIs that had the best repayment and lowest delinquency rates also had the best quality borrowers. The researchers were also unable to determine which loans received modifications and if multiple modifications were available, which were applied.

Sources

1. Maturana, Gonzalo. "When are modifications of securitized loans beneficial to investors?." The Review of Financial Studies 30, no. 11 (2017): 3824-3857.

2. Dobbie, Will, and Jae Song. "Targeted debt relief and the origins of financial distress: Experimental evidence from distressed credit card borrowers." American Economic Review 110, no. 4 (2020): 984-1018.

3. Ganong, Peter, and Pascal Noel. "Liquidity versus wealth in household debt obligations: Evidence from housing policy in the great recession." American Economic Review 110, no. 10 (2020): 3100-3138.

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