

**Researchers**

Dean Karlan  
Northwestern University

Sendhil Mullainathan  
Harvard University

Jonathan Zinman  
Dartmouth College

**Timeline**

2006-2008

**Sample Size**

2000 individual loans clients plus sponsors

**Research Implemented by IPA**

Yes

# Psychological Responses to Microfinance Loan Recovery Strategies in Peru

## Abstract

Microfinance clients are usually too poor to offer any property as collateral, so micro-lenders use alternative methods to encourage repayment. The most common methods are: (1) threatening to not offer loans in the future to clients who default and (2) using peer pressure mechanisms to ensure that borrowers repay.

We have partnered with PRISMA to identify ways to implement these methods more effectively. PRISMA has recently deployed a new strategy in its individual loan program for loan recovery that involves sending written notifications to defaulters. This strategy makes use of both the promise that good payers can receive additional loans from PRISMA in the future and the pressure that loan recipients face from their loan guarantors.

## Details of the Intervention

In the study, clients are randomly assigned to two groups. Two thirds of the clients receive written notifications if they fall in default (treatment group), while the rest of the clients do not receive any additional written notifications (control group). Within the treatment group, clients receive letters with either "gain" or "loss" frames, telling the client either that rectifying his credit standing will allow him access to credit in the future or telling him that his continued default will keep him from accessing loans in the future and threatening legal action. Additionally, in some cases both the sponsor and the client receive a letter, while in other cases only the client does.

## Results and Policy Lessons

The study followed PRISMA's loan clients from March 2006 to January 2008. We found that letters significantly reduce default rates and are most effective when messages with a loss frame are sent to both clients and their guarantors.

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