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Optimization of Group Lending - Based Village Banking - Saving Loan Association (VB-SLA) Financing Model

(A Case Study in Rattan Handicraft Industrial Center, Medan, Indonesia)

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Abstract: VB-SLA Group Lending model is a financing model for the combination of Village Banking (VB) model and Saving Loan Association (SLA). This group lending-based model prioritizes internal funds as starting funds to finance group lending. This model enables external fund such as bank, foundation, and NGO to be used when the savings of the group members is inadequate; however, if they have already had enough funds, the external funds can be eliminated. The objective of the study was to establish optimal VB-SLA Group Lending model. It was focused on establishing optimal group lending. The observed variables consist of joint liability group, group size, sequential lending, social collateral, including group pressure, cooperation, and social ties. The data were obtained from observation, using questionnaires, and focus discussion group (FGD). The samples were 50 rattan craftsmen. The result of the research shows that all group members took mutual responsibility to settle the loan. Each group has 5 members and all of them agree to establish in sequential lending, to remind to one another when they fail to make repayment, to be ready to make code of ethics for reminding any member (s) who fail to pay installment, and there is good cooperation and high social bond among them.

Keywords: Optimization, VB-SLA Model, Group Lending

INTRODUCTION

One of the failures usually faced by Small Medium Enterprises (SMEs) is the failure in financing. It is because the applied model is not in accordance with the characteristics of SME so that the failure occurs in paying loan installment. Therefore, it is very important to design an accurate financing model which matches with SME which will be given the loan. KOPINKRA (Rattan Handicrafts Industrial Cooperative) is a cooperative which consists of 50 small businesses which operate in making rattan handicrafts in Medan, Indonesia. Based on the preliminary observation, it was found that this rattan handicrafts industry had great difficulty to obtain loan; in consequence, it is very difficult to increase its sales.

Some prominent characteristics of rattan handicrafts industry, among others, are: the whole respondents have the same professions; rattan craftsmen – classified as manufacture activity, they are adults and as family heads, they relatively reside in the vicinity of Medan and know one to another, on the average the sale is below Rp. 25 million per month so that they are classified as micro cluster, the mechanism of payment intended by members is the mechanism of payment through group leaders appointed by them, and they are ready to write their savings accounts as the prerequisite for getting loan.

From these characteristics, the previous research recommended that the funding model which was the most appropriate with the characteristics of the rattan craftsmen as SME's (Small Medium Enterprises) business people in Medan which became the samples of this study, are *Group Lending-based Village Banking-Saving Loan Association (VB-SLA) Funding Model* (Siregar, Hasrul, May Handri, 2015, pp. 971-990). This model prioritizes internal funding which comes from members' savings which is required for all members. However, this model still gives the opportunity for using external funding which can come from any Non Government Organizations (NGOs) or from any banking institutions which give micro loan for starting loan scheme before internal funding which comes from members' savings is obtained.

The objective of this study was to analyze what attributes which should be considered in establishing *VB-SLA Group Lending* model and how about the operation of the VB-SLA Group Lending model which is related to the policies on savings and loan is applied so that it can yield an optimal VB-SLA Group Lending. It is expected that this study will become the reference for Micro Finance Institutions (MFIs) in giving loan to their members.

2. THEORITICAL ANALYSIS

Variation of Group Lending Model

Unlike individual lending, group lending has some variations of model. Waterfield, Charles and Duval (1996) have classified them into some forms as they are seen in the picture below.

Grameen Bank Model

This model is the most famous solidarity model. It was established by Muhammad Yunus in Bangladesh in 1976. It had its highest achievement with 2 million borrowers in 1992 and the interested rate of 12 to 16 percent. The reimbursement of loan reached to 98%. This model is carried out with the method as follows: first, the staff identifies a potential village to be provided one or two week orientation and philosophy, rules, and procedure. Then, a group of 5 people who have no relation to one another is established and selected by borrowers. Six to eight groups establish a village center which will in turn establishes Regional Branch Office. This branch office has from 200 until 300 clients, but it does not evaluate individual loan. The staff of this branch office lets the clients assume that they take their own liability for the financial service. Institution is developed in the bottom-up system.

Uniquely, this program requires social power which is included in the prerequisite for loan which is called "Sixteen Decisions". For example, borrowers have to educate their children, take care of their health and the health of their family members by boiling water before drinking it, take care of environmental sanitation, commit to consume vegetables, etc (Hokombe, Sasan, 1995).

Village Banking

Village Banking initially was to provide loan which came from financial institutions. Along with its development, the number of savings members, distribution of capital and accumulation of income from interest, increased rapidly so that external source was not needed anymore. Generally, it takes 3 years to be an independent institution administratively and financially. The mobilization of members' savings becomes an integral component in Village Banking model. Savings becomes much more important than that of Grameen Bank model. The members of Village Banking are prioritized to deposit their money in savings in order to get loan, and they have to continue their savings as long as they get the loan (Waterfield, Charles and Duval, 1996).

Village Bank manages two types of account: external account and internal account. External account consists of only the fund which is lent by financial institutions to Village Bank and internal account has fund owned by Village Bank itself. There are two principal methods in which Village Bank gathers fund in its internal account: 1) through its members' regular savings and 2) through income which has to be paid with the variance of loan interest received from borrowers with interest which should be paid to NGO or institution that gives the loan. Usually, the accumulation of funds which comes from internal account is used to increase loan for members or for covering deficit. Village Bank is expected to be an independent and democratic institution. However, it is noted that this ambition is very difficult to be carried out because the demand for loan is more rapidly increasing than that of the mobilization growth of members' savings.

Saving Loan Association (SLA)

The most important thing of this SLA model is that the fund only comes from members' savings and the contribution of its own capital; fund from external source is not accepted even though it is for the initial period. NGO can only contribute its technical assistance and training in the initial period, but fund has to come from the members.

A group usually consists of 30 to 100 members. Mobilization of members' savings is the most essential thing in this model. Each SLA makes its own rules on the amount of savings. Usually the needed amount of savings is decided in every meeting. Each SLA also determines how much money which has to be lent to its members, based on their mutual agreement. The amount of loan usually depends on the amount of savings which has been collected by a certain group or it can be made in uniform among the groups. The amount of installment is adjusted to the aim of the loan (whether for a short-term work capital loan or for a long-term loan for agriculture). Interest rate is set in the highest level with the intention to increase the group income.

Some Factors which Influence the Success of Group Lending

Joint Liability Group

Joint liability group can be meant as an informal group which includes some members of individual groups which are intended to borrow from an institution by guaranteeing one to another member. In this group lending, there is an obligation to help to each other among the group members. The loan for group members is intended to promote advancement to all of them so that each member has the liability to pay off the loan of the group. This is the difference between group lending and individual lending. Joint

liability becomes the most important feature in both models, either static model or sequential model (Aniket, Kumar, 2003).

Group Size

Group size is the number of members in each group lending. The main problem which is usually found in group lending-based microfinance is how big the number of group members is. Some say that a group should have more than two members, but the most common one is that a group consists of 5 members as what was done by Grameen Bank (Gine and Karlan, 2014). Some group lending makes smaller groups like Al Amana Group which consists of 3-4 members (Crepon et.al, 2015). Banco Sol's consists of 3-7 members (Morduch, 1999). There is a group which has 112 members, like BAAC in Thailand (Ahlin and Townsend, 2007); Spandan Group in Hyderabad has 6-10 members (Banerjee et.al, 2005), FINCA groups, a type of village bank, consists of 30-50 members (Karlan, 2007); Morduch, 1999). The result of the research by Ahlin, Christian (2015) concludes that efficiency will be gained when a group members are fewer than 10 people. The result and efficiency will increase dramatically when the members of one group are crossed with the members of another group.

Sequential Lending

Sequential lending is the method of giving loan alternately. Loan will be given to a certain group after another group has paid off its loan. This sequential group lending system will trigger each group to settle its liability. Lending type like this will increase moral hazard of the members to help each member in settling his loan.

Social Collateral

According to Rotzer (2007), social collateral is intended to increase loan reimbursement. This idea is also supported by Conning (1996) who points out that by adopting social collateral in group lending, the reimbursement will be less than what it should be. Abdul Hadi and Amrizah Kamaluddin (2015) point out that there are 4 points which can be used as social collateral: trust, network, group pressure, and training. From the loan point of view, trust will make one get loan, while from the lender point of view, trust will give him guarantee that the loan will not be nonperforming one (Olomola, 2000). Trust among group members will influence the performance of clients' payment (Cassar, Crowley & Wydick, 2007; Khandker, 2012; Postelnicu, 2012). From this analysis, it is found that trust will increase cooperation among group members, they understand other businesses, and they will be convinced that nonperforming loan will never occur. Networking among group members and friendship will increase understanding in the market opportunity and will decrease survey and supervision cost (Okton & Osili, 2004)

The same opinion is also pointed out by Woolcock and Narayan (2002) who state that networking can be regarded as microfinance program which can increase group efficiency by facilitating coordinating action. It is considered as an important device for micro clients to obtain more access to information, new clients or business network. Karlan and Valdivia (2007) point out that there is the correlation between network and loan reimbursement. It can be concluded that networking will bring about the access to better finance, the agent of the creation of business opportunity, and it can make certainty in paying off loan. Training is needed to increase individual skill, especially for those who want to start their business (Cunha,

2007; Robinson & Malach, 2004; Ying 2008). It is urgently needed by women who lag behind from men in skill. It is also needed to increase individual skill to start his business, to increase income, and to assure that the loan will be reimbursed punctually.

Group pressure is related to how leaders or members give pressure to the other members of the same group to reimburse the loan punctually according to what has been scheduled. Many researches indicate the correlation between group pressure and loan reimbursement. The stronger the pressure from the group is, the better the loan reimbursement. Besides that, group pressure which is carried out by tight monitoring is also considered as a guarantee for the success in loan reimbursement (Hill and Sarangi, 2012; Banerjeet et al. 1994). Therefore, in order to guarantee that a loan can be reimbursed, systematic group pressure is highly needed. It can be done by having regular meetings among the group members and with the members of the other groups. Meeting among members of the other groups are able to trigger them to reimburse their loan according to what has been scheduled. Meanwhile, meeting with the other groups can share information about business opportunity which can help increase their income.

According to Al-Azzam, R. Carter Hill, Sudipta Sarangi (2011), group pressure can be measured by some indicators:

- (1) Are the members willing to give pressure/warning to the other members who are late in paying off their loan?
- (2) Are the group members morally willing to be liable for the loan of the group?
- (3) The group has code of ethics/authority to punish group members who fail to reimburse their loan.

Cooperation

Cooperation in group lending is absolutely necessary to be carried out. The effect of cooperation on loan reimbursement is great (Ahlin and Townsend, 2007). The level of cooperation in groups can be measured by asking group leaders whether they work together in :

- (1) Selecting business location
- (2) Recommending customers to the other group members
- (3) Buying raw materials
- (4) Helping sell products during the loan cycle

Social Ties

Some studies reveal that the success of group lending is highly determined by the power of social ties among the borrowers (Cassar et al., 2007; Floro and Yotopolous; 1991; Karlan, 2007). It can be measured by indicating some indicators as follows:

- (1) Getting assistance from group members when it is needed
- (2) Getting mediating facility when there is a dispute with the other group members
- (3) Preferring buying and selling among group members to buying and selling with other people outside the groups (Al- Azzam, Moh'd, et.al 2011)

3. RESEARCH METHOD

The study used developmental research method. The data were gathered by conducting observation through questionnaires and focus group discussion (FGD). The research objects were 50 SME's of rattan craftsmen in Medan, Indonesia. The power of the group members in establishing group lending in the data would be analyzed.

4. RESULT AND DISCUSSION

The characteristics of group lending based on the result of respondents' responses

Joint Liability

Measuring the level of joint liability in group lending is done by identifying some indicators as follows: (1) how about the willingness of the members to help one to another in settling group lending, (2) how about the willingness of the members to warn the other members who are late in reimbursing their loan. Respondents' responses can be seen in Table 1 and Table 2 as follows:

Table 1
Members' Willingness to Help One Another in Settling Group Lending

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	45	90 %
Unwilling	5	10 %
Total	50	100 %

In general, it can be concluded that the respondents who own rattan handicraft businesses will have great liability for the other members in settling their loan if group lending is established. The data indicate that 90% of the respondents are firmly willing to help settle the loan of the other members. 10% of them state that they are not willing to do so because it will burden the other members.

Table 2
Members' Willingness to Warn Other Members who are Late in Reimbursing Their Loan

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	50	100 %
Unwilling	0	0 %
Total	50	100 %

Table 2 also indicates that there is seriousness of the members to warn the other members to reimburse their installment. The willingness to help the other members in participating in settling their loan and to warn the other members who are late in reimbursing their installment is a powerful capital for the success of group landing-based loan.

Group Size

Based on the data from the respondents, it is found that the ideal number of members is 5 members in one group. The reason is that, from the control point of view, 5 members are considered not too large so that it is easy to help and coordinate one to another.

Table 3
The Most Ideal Group Size According to Respondents

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
3 members per group	6	12 %
4 members per group	2	4 %
5 members per group	42	84 %
Total	50	100 %

From the collaboration point of view, 5 members constitute business power which can jack up the sale of group members so that it is believed that it can facilitate the settlement of installment.

Sequential Lending

Respondents' responses indicate that 80% of group members are willing to lend in turn/sequential

Table 4
Willingness to Give Loan Sequentially - Sequential Lending

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	40	80 %
Unwilling	10	20 %
Total	50	100 %

They believe that in this sequential loan, the members who have not obtained loan will push the other groups that have obtained it to be punctual in reimbursing their loan so that the other groups will immediately get loan facility. Meanwhile, 20% of the respondents disagree on sequential loan, stating that the loan is only given to those who have succeeded in their business and then get loan facility. They also think that sequential lending will arouse conflict among the groups. They suggest that only the committee that decide what group will be given the loan and not based on the pressure from the other groups. Actually, the willingness to carry out sequential lending is a powerful capital for establishing optimal group lending.

Social Collateral

The level of social collateral in this study is measured by identifying indicators as follows: (1) the willingness to warn the other members who are late in reimbursing their loan, and (2) the willingness to make code of ethics to punish members who fail to pay off their loan. From the result of the questionnaires distributed to rattan craftsmen, it was found that all respondents (100%) admitted that they were willing to warn the other members who were late in reimbursing their loan.

Table 5
Willingness to Warn other Members who are Late in Reimbursing their Loan

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	50	100 %
Unwilling	0	0 %
Total	50	100 %

90% of the respondents admit that they are willing to make code of ethics to punish the members who fail to pay off their loan installment.

Table 6
Willingness to Make Code of Ethics to Punish the Members Who Fail to Pay off the Loan Installment

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	45	90 %
Unwilling	5	10 %
Total	50	100 %

From the two tables above, it can be seen that if a group lending is established in this rattan handicraft industry, the researcher believes that the group members can give pressure to the other group members so that the two aspects can become the main capital in making this group lending successful. The respondents themselves state that the warning is at least a kind of moral pressure for the borrowers to pay more attention to their liability for their loan in order that they have to be more focused on improving their business toward a better one. In consequence, they have to reimburse their loan punctually. The willingness of the members to make code of ethics to punish the members who fail to pay off their loan installment indicates that they have mutual intention to settle the loan. This is the principal capital for the success of group lending.

Cooperation

The level of cooperation can be measured by using some indicators as follows: (1) the willingness of the members to help the other members sell their products, (2) the willingness of the members to recommend customers to the other group members, and (3) the willingness of the members to buy/borrow raw materials from the other group members. The data obtained from the respondents are shown in the following Tables:

Table 7
The Willingness of the Members to Help the other Members Sell their Products

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	50	100 %
Unwilling	0	0 %
Total	50	100 %

The table above indicates that there is the power of the groups by the willingness of the members to help the other group members sell their products. This is important because the success in selling indicates a positive attitude toward cooperation, and this is the main capital for the success in group lending.

Table 8
The Willingness to Recommend to the other Members

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	14	28 %
Unwilling	36	72 %
Total	50	100 %

The table above shows that the willingness of the members to recommend customers to the other group members is low because it is a kind of worry about the loss or the shift of customers to the other members. Here, the role of cooperation is needed to establish selling association so that there will be no worry about the shift of customers to another member. If the product standard has been established, there will be similar fixed price and customers will never move to another member. From the willingness to recommend, it is found that the level of cooperation among the members is low. In order to be successful in the establishment of VB-SLA Group Lending, the power of recommending has to be improved.

Table 9
The Willingness of the Members to Buy/Borrow Rattan Raw Materials

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Willing	50	100 %
Unwilling	0	0 %
Total	50	100 %

The level of cooperation can be measured by identifying the willingness of the members to buy raw materials from the other group members. This is an important case because each member will obtain raw materials in a very short time so that the process of making rattan furniture is not constrained in the availability of raw materials. In a small business enterprise, a business person often undergoes excessive raw materials at a certain time while in another time he runs out of raw materials. Therefore, cooperation among them is necessary. From the Table above, it can be seen that all members agree to sell their raw materials to the other members who need them. It indicates the power of supporting the success in group lending model.

Social Ties

Social ties can be measured by some indicators as follows: (1) the frequency of getting help from the other group members, (2) the frequency of getting guidance in business decision from the other group members. The result of data tabulation is shown in the following Tables:

Tabel 10
The Frequency of Getting Help from the other Group Members

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Used to	47	94 %
Frequently	0	0 %
Seldom	2	4 %
Never	1	2 %
Total	50	100 %

One of the factors of success which should be considered in establishing group lending is how powerful the group members in the cooperation among them. If its frequency is high, it can be said that their social ties is strong. From the Table above, it can be seen that 94% of the members point out that they often get help from the other group members, while 4% of them seldom get help and only 2% of them point out that they never get help. It can be concluded that the power of social ties will be very high if craftsman group of rattan industry is established. The power of social ties can be measured by identifying how strong the frequency of getting guidance in business decision. The more frequently the members get guidance is, the stronger their social ties.

Table 11
The Frequency of Getting Guidance from the other Members in Business Decision

<i>Explanation</i>	<i>Total</i>	<i>Percentage</i>
Used to	50	100 %
Frequently	0	0 %
Seldom	0	0 %
Never	0	0 %
Total	50	100 %

The Table above shows that all members (100%) frequently get guidance in business decision from the other group members. This is also an optimal enabling factor for the establishment of group lending.

5. CONCLUSION

Some important attributes which are needed to optimally support the establishment of group lending model, among others, are joint liability group lending, group size, sequential lending, social collateral, cooperation, and social ties. Some studies indicate that the level of willingness to help settle group lending is very high.

All group members are willing to warn the other members who are late in reimbursing their loan. They are also willing to do sequential lending. Besides that, it can also be concluded that if group lending is established, the group members will have high social collateral which is indicated by their firm willingness to warn the other group members who are late in reimbursing their loan and to make code of ethics to punish the members who fail to pay off their loan installment. The level of cooperation among the group

members is also high; it is indicated by their firm willingness to buy and sell raw materials from and to the other group members in order that the production process will not be constrained. The level of social ties is also very high which is indicated by the highest frequency of getting help from the other group members.

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