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Innovative Transposition of Trust mechanisms in Social Lending Groups from offline to online

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Abstract

While social collateral is a familiar and common notion in the literature of microfinance, the determinants of its functioning for monitoring and controlling the members to behave accordingly are much less discussed. However, understanding its dynamism is crucial, because social collateral is not only a solution to the problem of the unbanked, it is also a source of inspiration for the fast growing social and peer-to-peer lending on the Internet.

Can the old conventional rule of group lending and social collateral be reproduced in the social lending on the Internet? What innovative transpositions would be required? The question is important because conventional social groups and on-the-internet constituted groups are essentially different in that members usually share cultural codes and common rules in the former, while in the latter individuals often get together from uncommon virtual horizons and even happen to not know each other personally.

Introduction

Today there are over 10,000 microfinance institutions that serve about 205 million families, meaning about 1 billion people with a family size of five (Maes and Reed 2012). However, there are still about 2.5 billion people worldwide who lack access to banking services. The majority of unbanked is located in underdeveloped countries: 80% of adults in sub-Saharan Africa, 67% in the Middle East, 65% in Latin America, 59% in East Asia and South East, 58% in South Asia, 43% of adults in Eastern Europe and Central Asia and about 8% of adults in OECD (Organization for Economic Co-operation and Development) countries are unbanked (Chaia, Dalal et al. 2009). Three types of reasons, not exclusive, are suggested to explain the state of being unbanked: lack of complementary human capital; transaction costs; and the poor's inability to provide collateral to reduce risks related to information asymmetries (Armendariz and Morduch 2005).

The lack of complementary human capital is related to the lack of entrepreneurial skills and basic literacy required to conduct many businesses. However, it is often shown that the poor do produce basic entrepreneurs if they are provided capital (Yunus 2003).

The high level of costs is often mentioned to explain the reluctance of the conventional banks to provide credit to the poor. Given small sizes of the loans, conventional banks simply do not think it is worth the risk or the high cost of appraising the loan (Akula 2010). Information technologies, particularly mobile telephony, have the potential of considerably reducing the average cost of small transactions (Ashta 2011; Ashta and Assadi 2011). One area of technological innovation to fulfill the sector's social responsibility to the poorest is for the Microfinance Institution to obtain financing through online platforms (Ashta and Assadi 2010; Assadi and Hudson 2010). Ashta (Ashta 2012) explains that whether an operator is providing a loan to the poor or services to the MFI (Microfinance Institution) providing a loan to the poor, the social responsibility concept is no longer