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Building a Future Together: Targeting Young Clients at Fundacion Paraguaya

The possibilities for a long-term relationship with a huge new market of under-banked clients is perhaps one of the most compelling reasons to enter the youth market. Relatively few MFIs target youth or provide them with microloans. Usually, youth clients are considered riskier because they are less experienced in business. In addition, there is a common belief that young clients typically take smaller loans, which, makes them, as a group, less profitable than other client segments. *But is this always the case?*

Fundación Paraguaya (FP), a Paraguayan MFI, has been offering tailored youth loans since 2000. FP is known for its strong social mission and for its commitment to serving youth. As of December 2010, FP was serving 6,858 clients between the ages of 18-25 with a tailored loan product and accompanying non-financial services. These youth clients comprise 14.8% of its total loan clientele and 7.5% of its total loan portfolio.

A first quick segmentation of its data suggests that those skeptical of youth clients' profitability are right to be doubtful. In fact, the two tables below suggest that youth clients are relatively unattractive in that young borrowers (1) take smaller loans and (2) have worse repayment rates than their non-youth counterparts.

Table 1: Fundacion Paraguaya, Average loan size for Youth and Non-Youth Clients (USD)

AVERAGE LOAN	AMOUNT
Youth Clients (< 25 years)	447
Non Youth Clients (≥ 25 years)	942

Table 2: Fundacion Paraguaya, Portfolio at Risk for Youth and Non-Youth Clients (days past due % of portfolio)

TOTAL PORTFOLIO	PAR>1	PAR>30	PAR>60	PAR>90	PAR>120	PAR>150	PAR>180
Youth Clients (< 25 years)	9.62%	4.01%	1.86%	0.81%	0.25%	0.20%	0.02%
Non youth clients (≥ 25 years)	4.81%	1.68%	1.14%	0.66%	0.30%	0.13%	0.02%

However, through some deeper mining of data, a more nuanced picture emerges. In table 3 below, we analyze the average loan size of young people with a longitudinal perspective and segment clients by smaller age ranges. The analysis shows that while young people typically start with smaller average loan sizes, this is chiefly due to the fact that youth clients are more likely to be first time borrowers. In order to gain a clearer picture of how youth loans evolve over time, we assess the change in loan size between 2008-2010 of individual clients (those who stay with the institution) by age range and find that those young people who began with smaller loans in 2008 had the highest loan size growth of all age groups (nearly 90%) and quickly "caught up" to the loan size of older borrowers over the two years. The types of businesses young people enter might be a factor. According to Kimanthi Mutua, Managing Director of K-Rep Bank in Kenya, their institution has observed that young people enter more innovative

sectors in areas such as technology and services that can offer greater investment and growth opportunities than those of older microentrepreneurs. David Mukaru, Head of Microcredit for Equity Bank Limited, also notes that “when you start with youth at the bottom of the pyramid, you may not be profitable because of the administrative costs involved in these loans. However, as young clients become more confident and graduate into bigger businesses, then the whole youth financial eco-system stabilizes and there is an improvement. This becomes a sustainable business.”

Table 3: Fundacion Paraguaya
Loan Size for Youth and Non-Youth Clients by Age Group (PYG)

Age Group	AVERAGE DISBURSED AMOUNT 2008	AVERAGE DISBURSED AMOUNT 2010	% of growth
Youth Clients (< 25)	2,959,556	5,620,778	89.9%
Non Youth Clients (25-29)	4,044,072	5,441,303	34.6%
Non Youth Clients (30-34)	4,868,439	6,311,144	29.6%
Non Youth Clients (35-39)	5,900,950	6,545,509	10.9%
Non Youth Clients (40-44)	5,793,447	5,541,890	-4.3%
Non Youth Clients (45-49)	6,229,613	6,140,047	-1.4%
Non Youth Clients (50-54)	6,125,985	7,050,556	15.1%
Non Youth Clients (55-59)	5,347,202	7,950,591	48.7%
Non Youth Clients (60-64)	4,662,295	7,499,493	60.9%
Non Youth Clients (>=65)	5,769,346	7,214,162	25.0%

Large loan growth can be a powerful incentive for financial institutions to lend to young entrepreneurs, but only if portfolio quality can be kept under control. Practices to control portfolio quality are thus essential to profitably lending to youth. In table 4 below, we segmented all of FP’s clients by age range and further analyzed the repayment performance of these clients. Young clients (between 18-25 years of age), represent a high portfolio at risk ratio for more than one and more than 30 days. In fact, the ratios are almost two times larger for young clients than for any other age group. However, if we look at the clients who are behind by several installments (PAR>60 and above) the youngest clients are no longer the worst performers. For example, if we look at PAR>60, non-youth clients between 35-39 years of age have a worse repayment rate than youth clients. The same is true if we look at PAR>90, where we see that clients between 30-34 and 35-39 years of age have worse repayment rates than youth clients. These data suggest that although youth clients fall behind in their repayment more often than non-youth clients, most of them repay before 60 days. This is important because NGOs such as this begin to provision for losses after 30 days of delayed payments. Thus, while the delays might be administratively costly, young borrowers, in particular, vis-à-vis other age groups, have limited impact on the cost of provisioning, which can have a significant influence on the MFI’s overall profitability.

Table 4: Fundacion Paraguaya

Portfolio at Risk for Youth and Non-Youth Clients by Age Group

Age Group	PAR>1	PAR>30	PAR>60	PAR>90	PAR>120	PAR>150	PAR>180
Youth Clients (< 25)	9.62%	4.01%	1.86%	0.81%	0.25%	0.20%	0.02%
Non Youth Clients (25-29)	5.96%	2.06%	1.42%	0.78%	0.54%	0.20%	0.00%
Non Youth Clients (30-34)	5.85%	2.23%	1.43%	0.88%	0.40%	0.11%	0.00%
Non Youth Clients (35-39)	6.40%	2.64%	2.20%	1.24%	0.38%	0.23%	0.03%
Non Youth Clients (40-44)	4.42%	1.33%	1.07%	0.66%	0.27%	0.11%	0.00%
Non Youth Clients (45-49)	3.55%	1.35%	0.53%	0.34%	0.08%	0.03%	0.00%
Non Youth Clients (50-54)	3.54%	0.80%	0.68%	0.41%	0.21%	0.18%	0.11%
Non Youth Clients (55-59)	4.36%	1.47%	0.95%	0.40%	0.31%	0.21%	0.00%
Non Youth Clients (60-64)	2.77%	0.75%	0.16%	0.14%	0.09%	0.03%	0.00%
Non Youth Clients (>=65)	4.79%	1.46%	0.57%	0.38%	0.35%	0.00%	0.00%

Young borrowers at FP are asked to provide the guarantee of an adult, typically a parent, for their loans. Young borrowers and savers cannot be expected to be as “financially literate” as their elders without support. Where parents are not available, other support mechanisms and coaching can prove to be effective. Fundacion Paraguaya notes that those young borrowers that are part of village banking groups that receive some training on financial literacy and borrowing over perform in comparison to those that receive only individual loans without this support.

Fundacion Paraguaya, with its trajectory of committed efforts to adapt products and services for young people, can offer lessons to those institutions that are still cautious. Its experience demonstrates that the upfront costs of managing higher repayment risk and providing additional training and mentoring to young clients actually does pay off over the medium term. This case also highlights the importance of considering parents as key partners in lending and suggests requiring group or parental guarantors where other guarantees are not available.