Causes and Solutions to Microfinance Loan Losses in the Kwahu Afram Plains North District. An Exploratory Study.

Ansah Daniel¹, Francis Srofenyoh², Justice Djokoto² & Ferguson K. Gidiglo²
¹Former student of Department of Agribusiness Management, Central University, Accra, Ghana.
²Department of Agribusiness Management, Central University, Accra, Ghana.

Abstract: Microfinance Institutions (MFIs) in Ghana currently provide significant financial services including microcredit facilities particularly to the rural and semi-urban areas across the country. Granting of microcredit facility (Loan) is a major activity of the MFIs and the loan portfolio constitute a significant proportion of the assets of the MFIs. Undoubtedly, the MFIs derive most of their interest incomes from loans, however, not all loans granted to beneficiaries perform well and earn the expected returns and this tend to have adverse effect on the quality of the loan portfolio. In the light of the key role that MFIs have assumed in the national economy, the study was conducted to establish the causes of bad loans and redesigning workable strategies to improve credit policy and loan recovery in MFIs in the Kwahu Afram Plains North and beyond. The impact of Non-performing loans (NPLs) on the operations of MFIs with particular focus on Kwahu Afram Plains North is very crucial for the sustenance of the rural and semi-rural economy. The study specifically focused on the causes of bad loans and the redesigning workable strategies that have the capacity to reducing to the barest minimum the incidence of loans going bad. Only primary data was used for the study. The study found a number of reasons why loans go bad in MFIs in the Kwahu Afram Plains North district. These include short period within which borrowers have to repay their loans, high interest rates and lack of enforcement of loan agreements. This study recommends investing in highly qualified credit officers, treating loan agreements as enforceable contracts and soliciting feedback from clients periodically among others.

1.0 Introduction

Certainly, microfinance is not a new concept in Ghana. It has always been common practice for people to save and/or take small loans from individuals and groups within the context of self-help in order to engage in small retail businesses or farming ventures (BOG, 2007). Research suggests that the first credit union in Africa was probably established in Northern Ghana in 1955 by the Canadian Catholic missionaries that were there at the time (BOG, 2007). However, Susu, which is one of the microfinance schemes in Ghana is thought to have originated from Nigeria and spread to Ghana from the early 1900s (BOG, 2007). Over the years, the microfinance sector has thrived and evolved into its current state; thanks to the various financial policies and programmes such as the provision of subsidized credits, establishment of rural and community banks (RCBs), the liberalization of the financial sector and the promulgation of PNDC Law 328 of 1991(Financial Institution Non-Banking Act, 1991). These allowed the establishment of different types of non-bank financial institutions, including savings and loans companies, finance houses, and credit unions etc. (BOG, 2007).

According to the Ghana Microfinance Policy Document, there are three broad types of microfinance institutions in Ghana. These include:

- Formal suppliers of microfinance (i.e. Rural and Community banks, Savings and Loans companies, Commercial banks);
- Semi-formal suppliers of microfinance (i.e. Credit Unions, Financial Non-Governmental Organizations (FNGOs), and Cooperatives);
- Informal suppliers of microfinance (e.g. Susu collectors and Clubs, Rotating and Accumulating Savings and Credit Associations ROSCAs and ASCAs), traders, moneylenders, and other individuals).

Microfinance has been a new phenomenon in the Kwahu Afram Plains North District, even though...
certain individual money lenders have been in the system for all these while. In the last decade, the district has seen more professional interventions. Some of these interventions include the MASLOC (a central government initiative) and another operated by the Afram Rural Bank Ltd. referred to in the local parlance as “sobonana”, APDO (2012). All these interventions were meant to provide access to cheaper micro-loans to those in the informal sector that have been neglected by the traditional banking system to create employment and also expand existing businesses. The sustainability of these interventions is based on an excellent strategy for recovery of the micro-loans that have been granted the people.

In the last few years however, a more sustainable way has emerged by way of savings and loans. This has helped many locals create more jobs and also expanded existing businesses. This notwithstanding, they have also had their fair share of challenges as would be discussed latter.

Ringtho (1998) observes that credit terms are normally looked at as the credit period, terms of discount and the amount of credit and choice of instrument used to evidence credit. Credit terms may include; length of time to approve loan, this is the time taken from application to the loan disbursement or receipt. It is evaluated by the position of the client as indicated by the ratio analysis, trends in cash flow and looking at capital position. Maturity of a loan, this is the time period it takes loan to mature with the interest there on. Cost of loan, this is the interest charged on the loan. This varies from one micro finance institution to another depending on the competition.

The Chartered Institute of Bankers (GH) lending text (1993) advises lending institutions to consider amount given to borrowers. Robinson (2001) pointed out that the maximum loan amount per cycle is determined based on the purpose of the loan and the ability of the client to repay (including guarantee). All these notwithstanding, microfinance institutions have not been able to sustain agribusinesses and themselves as a result of customers either refusing or not being able to repay credits granted them. The reasons have been wide and varied. Whatever it is, it has created a serious loss of confidence amongst the populace within the Kwahu Afram Plains North District with regards to micro-finance institutions, (feasibility studies by Redeemer Microfinance Ltd.).

Managers of these MIFs cited the problem was as a result of inadequate application of the tools of credit management and loan recovery strategies on the part of the management locking up a large and increasing proportion of nonperforming loans. According to them, this did not only erode the institutions’ ability to recycle their financial resources but also caused their eventual collapse (Redeemer Microfinance Ltd. feasibility studies, 2012). Therefore the study attempt to address the following objectives: identify lapses in the application of credit policies and loan recovery strategies, redesign workable credit policy and loan recovery strategies.

2.0 Literature review

This section reviews relevant literature with the aim of gaining insight into the factors that cause loans default and the strategies to overcome them within microfinance institutions. The concept of Microfinance, Evolution of the micro finance sub-sector, various categories of Microfinance institutions in Ghana, Performing and non-performing loans in MFI’s, Microfinance and development, Causes of NPLs, (Bad loans), Reducing the incidence of NPLs and the Challenges facing microfinance institutions in Ghana.

The Concept of Micro Finance (MF)

Wood (1998) defined MFI’s as institutions that provide financial services to low income earners. These financial services may include savings, loans, insurance transfer and payment services to enhance growth of small scale enterprises.

According to Graham et al (1997) MF refers to the provision of financial services to the low income earners who do not earn or obtain their services from the formal or traditional banks because of their business savings levels and credit needs are very small.

Evolution of the Microfinance Sub-Sector in Ghana

With almost thirty per cent of Ghanaians living below the poverty line, microfinance has been identified as an important means of providing financial services to the population. It is therefore not surprising that the country’s present and past governments have perceived microfinance as central to achieving the greater goal of poverty reduction.

Through microfinance, the various governments have aimed to provide the poor, who do not have access to the formal financial sector, with greater access to customized financial services. The Government of Ghana is committed to the goals of the Millennium Development Goals and one of the strategies is the building of a robust and sustainable
microfinance industry which addresses poverty reduction, women’s empowerment and household welfare. Micro-entrepreneurs constitute about 66% of the labour force in the country and, thus, represent a vital economic force (Adjei, 2010). Increasing the access to financial services by this group deepens the financial sector and also links them to the economic mainstream. Indeed, the concept of microfinance is not new in Ghana. There has always been the tradition of people saving and/or taking small loans from individuals and groups within the context of self-help to start businesses or farming ventures. For example, available evidence suggests that the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries. However, Susu, which is one of the microfinance schemes in Ghana, is thought to have originated from Nigeria and spread to Ghana in the early twentieth century. Over the years, the microfinance sector has thrived and evolved into its current state thanks to various financial sector policies and programmes undertaken by different governments since independence. Among these are:

- Provision of subsidized credits in the 1950s;
- Establishment of the Agricultural Development Bank in 1965 specifically to address the financial needs of the fisheries and agricultural sector;
- Establishment of Rural and Community Banks (RCBs), and the introduction of regulations such as commercial banks being required to set aside 20% of total portfolio to promote lending to agriculture and small scale industries in the 1970s and early 1980s;
- Shifting from a restrictive financial sector regime to a liberalized regime in 1986;
- Promulgation of PNDC Law 328 in 1991 to allow the establishment of different categories of non-bank financial institutions, including savings and loans companies, and
- Credit unions.

These policies have led to the emergence of three broad categories of microfinance institutions. These are:

- Formal suppliers such as savings and loans companies, rural and community banks, as well as some development and commercial banks;
- Semi-formal suppliers such as credit unions, financial non-governmental organizations (FNGOs), and cooperatives;
- Informal suppliers such as susu collectors and clubs, Rotating and Accumulating Savings and Credit Associations (ROSCAs and ASCAs), traders, moneylenders and other individuals.

In terms of the regulatory framework, rural and community banks are regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated under the Non-Bank Financial Institutions (NBFI) Law 1993 (PNDCL 328). The Bank of Ghana has since 2011 designed operational guidelines and licensing requirements to help streamline the operations of MFIs in the country. In the 1970s government agencies were the predominant method of providing credit to those with no previous access to credit facilities – people who had been forced to pay usurious interest rates or were subject to rent-seeking behaviour, (Social Investment Fund, 2004).

Governments and international donor agencies assumed that the poor required cheap credit and saw this as a way of promoting agricultural production by small landholders. In addition, to providing subsidized agricultural credit, donors set up credit unions inspired by the German Raiffeisen model developed in 1864, (Social Investment Fund, 2004).

Beginning in the mid-1980s, the subsidized, targeted credit model supported by many donors was the object of steady criticism, because most programmes accumulated large loan losses and required frequent recapitalization to continue operating. Evidently, market based approaches then considered microfinance as an integral part of the overall financial system. Emphasis shifted from the rapid disbursement of subsidized loans to target populations towards the building of local, sustainable institutions to serve the poor, (SIF MF Operation & Management Training Manual, 2004).

At the same time, local NGOs begun to look for a more long-term approach than the unsustainable income generation approaches to Community Development. (SIF MF Operation & Management Training Manual, 2004). In Asia, Dr. Mohammed Yunus of Bangladesh led the way with a pilot group-lending, whereas the 1970s and much of the 1980s were characterized by an integrated package of credit and training which required subsidies, (SIF MF Operation & Management Training Manual, 2004).

Most recently, microfinance NGOs including KW-Rep in Kenya, WWBG in Ghana have begun transforming into formal financial institutions that
recognize the need to provide savings services to their clients and to access market funding sources, rather than rely on donor funds, (SIF MF Operation & Management Training Manual, 2004). This recognition of the need to achieve financial sustainability has led to the current “financial system” approach to microfinance.

This approach is characterized by the following beliefs:

- Subsidized credit undermines development;
- Poor people can pay interest rates high enough to cover transaction of the imperfect information markets in which lenders operate;
- The goal of sustainability (cost recovery and eventually profit) is the key not only to institutional permanence in lending, but also to making the lending institution more focused and efficient;
- Because loan sizes to poor people are small, MFIs must achieve sufficient scales if they are to become sustainable, and
- Measurable enterprise growth, as well as impact on poverty cannot be demonstrated easily or accurately; outreach and repayment rates can be proxies for impact. (SIF MF Operation & Management Training Manual, 2004);

One of the main assumptions on the above view is that many poor people actively want productive credit and that they can absorb and use. But as the field of microfinance has evolved, research has increasingly found that in many situations poor people want secure savings facilities and consumption loans just as much as productive credit, and in some cases, instead of productive credit. MFIs are beginning to respond to these demands by providing voluntary savings services and other types of loans (SIF MF Operation & Management Training Manual, 2004).

The Mandate of MFIs
The mandate of MFIs according to the operating rules and guidelines as issued by the Bank of Ghana are;

- To mobilize from surplus unit (Susu, Savings, Fixed Term) – Deposit mobilization
- To disburse to the Deficit Unit (Micro loans, Business Loans, SME Loans, Special Arranged Loans etc.) – Loans (Bank of Ghana, 2014)

Size of the Microfinance Industry in Ghana

There are 447 microfinance companies, 63 money lending companies and 8 financial non-governmental organizations (bog.gov.gh). However, economists say looking at the size of Ghana’s market, the figure 518 is too huge for 24 million people (the Chronicle Newspaper, 2014). These MFIs are competing with about 27 major commercial banks in Ghana for the same customers, according to them.

According to the World Bank, a survey was conducted in 1996 and was found out that about US$ 7billion in outstanding loans and had been provided to more than 13 million individuals and groups. In addition, more than US$ 19 billion had been mobilized in 45 million active deposit accounts (World Bank, 1996). The general conclusions were;

- Commercial and savings banks were responsible for the largest share of the outstanding loan and deposit balance;
- Credit Unions represented 11% of the total number in the sample and 13% of the outstanding loan balance;
- NGOs made up of more than half of the sample, but they accounted for only a percentage of the total number of the outstanding loans and 4% of the outstanding loan balance;
- Sources of funds to finance loan portfolios differed by types of institution. NGOs relied heavily on donor funding or concessional funds for the majority of their funding. Banks, savings banks and credit unions funded their loan portfolios with clients and member deposits and commercial loans;
- NGOs offered the smallest loan sizes and relatively more social services than banks, savings bank or credit unions (World Bank, 1996).

The study also revealed the basic accounting capacities and reporting varied widely among institutions, in many cases revealing an inability to report plausible cost and arrears data. This shortcoming, notably among NGOs, highlights the need to place greater emphasis on financial monitoring and reporting using standardized practice (World Bank, 1996).

Overall, the findings suggest that in combination, the following factors contribute to the success and sustainability of many MFIs.

- Favourable macro-economic condition;
- Managed growth;
• Deposit mobilization, and
• Cost control, (World Bank, 1996).

Repayment Frequency and Default in Microfinance
The typical repayment schedule offered by an MFI consists of weekly repayment starting one to two weeks after loan disbursement. Weekly collection of repayment instalments by bank personnel is one of the key features of micro-finance that is believed to reduce default risk in the absence of collateral and make lending to the poor viable - Vogelgesang (2003). In addition, frequent meetings with a loan officer may improve client trust in loan officers and their willingness to stay on track with repayments.

Rural Area Credit Provision Challenges
The literature reviewed presents a comprehensive list of challenges affecting rural finance institutions and also offers interesting and innovative ideas to address them. Some challenges faced by rural institutions are similar to those facing any microfinance organization while others are specific to rural institutions offering loans for farm-based activities. Some factors unique to rural and agricultural markets that constrain both the supply and demand for finance in those areas include.

• Poor client assessment procedures, clients are given loans without assessing the character, capacity and collateral of the borrower;
• Low supervision, clients need to be supervised on how to utilize the loans advanced to them;
• Low incentive to save, Ghana has low domestic saving to gross domestic product (GDP) of 20.51% as of 2012 (World Bank, 2012).
• High interest rate, the higher the interest rate, the more income to microfinance institutions but, also means that the higher cost to borrowing to the clients, (Stem, 1991). If customers fail to pay on time, the rates cannot yield income. Demand of credit is a function of interest, in accordance to the law of demand (Brook, 1993). Customers will stop borrowing if interest rates are high. Other challenges include;
• High transaction cost for both borrowers and lenders;
• High risk faced by potential borrowers and depositors due to variability of income, exogenous economic shocks and limited tools to manage risks;
• Seasonality- heavy concentration on agriculture and agriculture related activities exposes clients and situations to multiple risks;
• Lack of reliable information about borrowers and lack of market information and/or market access;
• Weak institutional capacity including poor governance and operating system.

Credit Policy
A credit policy is an institutional method for analysing credit requests and its decision criteria for accepting or rejecting applications (Girna, 1996). Credit policy is important in the management of accounts receivables. A firm has time flexibility of shaping credit policy within the confines of its practices. It is therefore a means of reducing high default risk, implying that the firm should be discretionary in granting loans (Pandey, 1995).

Policies savings time by ensuring that the same issue is not discussed over and over again each time a decision is to be made. This ensures that decisions are consistent and fair and that people in the same circumstances get treated in the same manner (Khandkar and Khan, 1998).

According to Me Naughton (1996), credit policy provides a framework for the entire management practices. Written credit policies are the cornerstone for good credit management, they set objectives, standards and parameters to guide microfinance officers who grant loan and manage loan portfolio. The main reach for policy is to ensure operations consistency and adherence to uniform sound practices. Policies should be the same for all and, it’s the general rule designed to guide each decision making process. A good credit involves effective initiation analysis, credit monitoring and evaluation.

Loan Processing in MFIs
There is an element of risk in any loan granted because the expected repayment may not occur. Lending involves a lender providing a loan in return for a promise of interest and principal repayment in future, Kay Associate Ltd, (2005). Because of this risk of default in loan repayment, lenders needs to project into the future and make sound judgment that will ensure that repayment is effected at the agreed date. Available literature places so much importance on the lender’s role in ensuring good decisions relating to the granting of loans in order to minimize credit risk. The lender must always aim at assessing the extent of the risk associated with the lending and try to reduce factors that can undermine repayment. The lender should therefore assemble all the relevant
information that will assist him/her in arriving at a sound credit decision. In view of the possibility of non-payment which leads to NPLs, MFIs have adopted a standard loan request procedures and requirements usually contained in credit policy manual to guide loan officers and customers. Some of the factors that the MFIs consider before granting loans include the following which are often referred to as the canons of good lending:

1. The character of the prospective borrower;
2. Amount being requested by the customer;
3. Margin (Interest margin, commissions and relevant fees.);
4. The purpose of the loan;
5. Ability of the borrower to manage business successfully;
6. Repayment(source of repayment must be credible);

Character

The bank has the responsibility to make sure that it has taken the right decision by granting the loan facility or otherwise. In so doing, the customer’s trustworthiness and his track record with the bank or any other bank if necessary, are checked thoroughly (this can be done by way of status enquiry/opinion) to establish the customer’s credibility. Normally the bank will require the historical financial performance if it is a going concern and/ or projections in the case of start-ups.

Ability (Management)

In checking or assessing ability the bank looks out for certain key ingredients and they are; the customer’s capability, capacity and most importantly, the viability of the project the loan facility is intended for. In other words, the core management team of the business enterprise must have the professional competence, skills, and the know-how to execute the project the loan is meant for.

A strong, dynamic, highly committed team must be entrepreneurial enough to execute the business plan profitably. The team must have a clear and realistic strategic vision of the business’ future growth and be familiar with sound management techniques.

Margin (Interest rate)

This has to do with the interest rate that is charged on the loan facility. The amount of interest rate charged on the loan facility depends on three factors; the risks, amount of money involved and duration of repayment. The higher the risks, the higher the interest rate. The smaller the amount involved the more expensive it becomes to service the loan, and hence the higher the interest rate. The shorter the duration of repayment of the loan, the more expensive it is to service the loan and of course, the higher the interest rate would be.

Purpose

This regards the purpose for which the facility is intended. It requires that the project to be undertaken with the loan must be legal and acceptable before the loan facility is given out. For example a farmer who applies for a loan to undertake a marijuana project will certainly not only have his loan application turned down but will also be handed over to the police because the purpose for the loan is being secured is prohibited in the face of the law.

Amount / Loan size

The bank will also do due diligence on the adequacy of the money being requested for in relation to the project to be undertaken. The bank will want to avoid a situation where it will be forced to give out more money into the project when it really does not want to, (this situation is better known in the banking circles as “fait accompli”).

Repayment

One other important factor that is thoroughly checked is the possible source of repayment, duration and cash flow (solvency). You cannot lend when source of repayment, duration and cash flow/liquidity (solvency) cannot be determined with certainty. Solvency in this context means when a customer’s net asset is more than his net liabilities. In other words, a MFI will not lend to a customer whose business is insolvent bottom line is that it must sustainable.

Insurance/Security

This is anything that can be offered as collateral for loan. It is a borrower’s pledge of specific property to a lender, to secure repayment of a loan. It is however important to note that a bad security will not make a good loan become a bad one and vice versa.

In all of this however, the experts say that the most important factor among them is the repayment and the least important is the insurance/security, because, at the end of the day, if the MFI is able to recover the loan and the interest, the issue of the security would be unnecessary. Breth (2000) stated that before a deal is signed, a loan application is to be completed. This provides risk protections by
enabling the lending institutions to follow up when the borrower fails to honour the agreement.

**Indicators of Credit Policy**

Pandey, (2000) observes that credit policy refers to a combination of three decision variables. These variables determine who qualifies for the loan. They include credit standards, credit terms and collection efforts on which the financial manager has influence.

**Credit Standards**

This is a criteria used to decide the type of client to whom loans should be extended. Kakuru (1998) noted that it is important that credit standards be based on the individual credit application by considering the character assessment, capacity conditions, and collateral and security capital. Social group members can guarantee the loan when they know the character of each client. If they have any reason to doubt the character of any member, then the client is likely to default. Saving habits involve analysing how consistent the client is in realizing own funds saving promotes loan sustainability of the enterprise once the loan is paid.

**Credit terms**

Ringtho (1998) observes that credit terms are normally looked at as the credit period, terms of discount and the amount of credit and choice of instrument used to evidence credit. Credit terms may include the following; length of time to approve loan, this is the time taken from application to the loan disbursement or receipt. It is evaluated by the position of the client as indicated by the ratio analysis, trends in cash flow and looking at capital position. Maturity of a loan, this is the time period it takes loan to mature with the interest there on. Cost of loan, this is the interest charged on the loan. This varies from one micro finance institution to another depending on the competition. The chartered institute of bankers lending text (1993) advises lending institutions to consider amount given to borrowers. Robinson M. S. (2001) pointed out that the maximum loan amount per cycle is determined based on the purpose of the loan and the ability of the client to repay (including guarantee).

**Collection Effort**

Mc Naughton (1996) defines collection effort as the procedure an institution follows to collect past due account. Collection policy refers to the procedures micro finance institutions use to collect due account. The collection process can be rather expensive in terms of both product expenditure and lost good will (Brigham, 1997).

Effort may include attaching mandatory savings, forcing guarantors to pay, attaching collateral assets, court litigation etc. (Myers, 1998). Micro finance institutions may send a letter to such individuals (borrowers) when say ten days elapse or phone calls and if payment is not received within thirty days, it may turn over the account to a collection agency (Myers, 1998). Collection procedure is required because some clients do not pay the loan in time, some are slower, and others never pay. Thus collection efforts aim at accelerating collections from slower payers to avoid bad debts. Prompt payments are aimed at increasing turn over while keeping low and bad debts within limits (Pandey, 1995). However, caution should be taken against stringent steps especially on permanent clients because harsh measures may cause them to shift to competitors (Van Horn, 1995).

**3.0 Methodology**

**Research Design**

The study adopted descriptive research design where both qualitative and quantitative data was employed to gain an in-depth understanding of credit policy and loan recovery in MFIs in the Kwahu North district of the Eastern region of Ghana. Qualitative data helped to draw conclusions and recommendations; it further enabled the understanding of effectiveness and efficiency of the credit policy and loan recovery while quantitative design was used to evaluate facts from the field.

**Area of Study**

The study was carried out in the Kwahu North district of the Eastern region of Ghana. This area was chosen for the study because within a period of one year, two (2) Microfinance Institutions had to fold up. This created a situation of anxiety amongst the indigenes because economic activities were picking up. Consequently, more people were borrowing money to expand their businesses etc. therefore, the results from the Kwahu North district could be generalized to other parts of Ghana.

**Population Size**

The study population consisted of 70 individuals from six villages within the district under study who have benefited from MFIs from 6 different communities all in the Kwahu North district in the eastern region of Ghana. The researcher used a stratified random sampling technique during the study. Stratified random sampling is a process of sample selection which involves dividing the population into none overlapping groups called strata or selecting the sample from each stratum using a simple random technique. The choice was
made in order to enable the researcher get adequate representation of the whole population. With a stratified random sampling, the sample can be kept small without losing its accuracy.

**Sample Design**

The researcher used a stratified random sampling technique during the study. Stratified random sampling is a process of sample selection which involves dividing the population into none overlapping groups called strata or selecting the sample from each stratum using a simple random technique. The choice was made in order to enable the researcher get adequate representation of the whole population. With a stratified random sampling, the sample can be kept small without losing its accuracy. Besides this, the characteristics of each stratum can be estimated and hence a comparison between the two variables is easily made. This is because it is not possible to survey the entire population due to financial and time constraint.

| Table 1: Sample composition of population respondents |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|            | DONKORKROM | ATAKORA   | ADEEMRA   | AMANKWA   | KODIDI    | AGORDEKE  | TOTAL     |
| MALES      | 10         | 4          | 4          | 4          | 3          | 3          | 28        |
| FEMALES    | 15         | 6          | 6          | 6          | 5          | 4          | 42        |
| TOTAL      | 25         | 10         | 10         | 10         | 8          | 7          | 70        |

*Source: compiled by author 2014*

**Data Collection**

**Instrument for data collection**

The main data collection instrument was questionnaire. The design include multiple-choice questions, fill-in-questions and questions that require ranking of answers. The questions were clearly simplified and structured in a manner void of any ambiguity and technical details. The questionnaire was drawn to elicit information/data on general management, research and development and general information on the activities of MFIs in the area.

**Sample Procedure**

By stratified method the researcher formed strata and the respondents from each stratum were selected using a simple random sampling for instance how much one borrows.

**Sources of Data**

Data were both primary and secondary. Primary data was collected by the use of questionnaires while the secondary data came from the review of works of people, books, the internet etc.

**Data collection methods**

The major techniques that were used to collect data from the respondents were semi-structured questionnaires which were largely closed-ended questionnaires. This was done with the help of researcher’s or a chosen person’s guide to cater for persons who would be in hurry or those who might not understand what exactly the question meant and those that the researcher thought should provide more information than questionnaires ask for.

**Data processing and analysis**

Raw data was processed into meaningful information. The process involved editing, tabulation and analysis with a view of checking the completeness and accuracy of the information.

**Editing**

This was intended to detect and eliminate errors that occur. Only relevant, correct and crucial information was identified and used to draw conclusion.

**Tabulation**

Some data was presented in table to enable analysis and identification of relationship between variables.

**Analysis**

The findings of the research were written down and worked out, edited and analyzed using comparison and percentage approaches with the help of SPSS computer program to draw conclusions and recommendations. This helped the researcher to determine the extent of relationship between variables that is credit policy and loan recovery in light of research objectives and literature review.

**Questionnaire Design**

The questionnaire was designed based on the following:

- Reasons why loans or credits become bad
- How do we overcome the challenges identified above?
The reasons why the loans/credits fail and the solutions suggested by the interviewees will be compared with the secondary data that would obtained from some selected traditional banks on rules and procedures for granting loans/credits as applied in those institutions. Before the questionnaire is designed the researcher will meet with about 5-10 people, talk to them and, find out their level of understanding in the issues concerned. This is to help the researcher design the questionnaire in a language (choice of words) they will appreciate better and thereby give appropriate responses for the needed results.

The variables that would be used in the design of the questionnaire are:

- Loan Application selection criteria;
- Rules and procedures for loan/credits recovery;
- Purpose of acquiring a loan/credit, and
- Suitability or otherwise of interest rates charged.

The questionnaire was pre-tested to ascertain the suitability or otherwise of the wording and whether indeed it will deliver the desired responses.

The Survey Team

A team of five (5) members was set up to conduct the interviews. The researcher himself supervised the team, coordinated their activities and managed them. Before the surveyors start their work, they will be taken through short training to understand every bit of information on the questionnaire and the importance of the assignment they are being given. The researcher believes that in this way, they will do a thorough job than a shoddy one.

Secondary data was also obtained for use in the analysis. As shown in the tables above, 55 individuals of 20 males and 35 females will be interviewed in addition to 18 groups in the district were engaged in the, focus group discussions, making a grand total of 73 respondents.

The Survey: - Appointment of Survey Team

A team of five (5) members have been set up to conduct the interviews. The researchers supervised the team, coordinate their activities and manage them.

Training of Surveyors

Before the surveyors start their work, they were taken through short training to understand every bit of information on the questionnaire and the importance of the assignment they are being given.

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Secondary data has also been obtained for use in the analysis that would be done.

Analysis

The Analysis of the Objectives

- The study seeks to identify the lapses in the application of credit policies and loan recovery strategies. The study intends to use the responses from the respondents through the administration of questionnaires to ascertain the existence or otherwise of lapses in the application of credit policies and loan recovery strategies by frequencies and percentages using the Statistical Package for the Social Sciences (SPSS).
- The second objective is to redesign workable credit policy and loan recovery strategies.

As part of the questionnaire design, an open ended question is posed to the respondents to suggest steps they believe must be done in order to improve on the application of credit policy and thereby enhancing loan recovery. Five of the most recurring suggestions have been selected and analysed using the Statistical Package for the Social Sciences (SPSS) and then frequencies and percentages have been used to test their popularity.

4.0 Result and Discussion

Gender

Only 40% of the total number of respondents were males and 60% were females. The inference is that majority of the people engaged in microfinance activities are women though there are a good number of men in there as represented by figure 1. This can be attributed to the fact that more women are involved in petty trading than their male counterparts, which respondents explained were the major target of MFIs. They also said women are more likely to pay back loans than men and that is MFIs target them.
Figure 1: Percentage distribution of gender

Source: field data, 2014

Marital status

About 44.3% were married people, 48.6% were single. Only 4.3% and 2.9% were divorced and the widowed respectively. It is clear from the figure 2 below that microfinance is widely accepted both married and single people, with very few divorced and widows. The respondents attributed this to the fact that they were not tied to any “family obligations” and so can easily move from one location to the other even if their creditors decide to take legal action against them.

Figure 2: Percentage distribution of marital status

Source: field data, 2014

Age

Figure 3 shows that 18.6% were under 25 years, while 61.4% of them were between the ages of 26-35, 14.3% of the respondents were between the ages of 36-45 and only 5.7% were between the ages of 46-55. This means that a vast majority of the people in the microfinance industry are between the ages of 26-35, known as the very productive years. It also implies that majority of people in this age bracket are the most economically productive sections of society and so would want to do something for themselves, the study revealed.

Figure 3: Percentage distribution of age

Source: field data, 2014

Level of education

The study shows that 42.9% had only elementary education, 41.4% had education up to the secondary level and 15.7% had education up to the tertiary. Figure 4 reveals that almost all the people involved in the microfinance have up to secondary level of education with a few tertiary graduates. The study also confirmed that the informal sector, dominated by petty traders in this part of the country is the major target group of MFIs and almost all these people have education up to the secondary level.

Figure 4: Percentage distribution of level of education

Source: field data, 2014

Reasons why loans go bad

Loan application selection procedure

The study sought to find out if in their opinion MFIs have loan application selection procedure and these were the results; 11.4% of the respondents strongly believe they do. About 28% also agree they do, but 30% said they were not sure if the MFIs have while 11.4% and 18.6% responded they disagree and strongly disagree respectively. By inference, there is no clear cut procedure when it comes to loan application selection and this is one of the major reasons why loans go bad.
### Table 1: Loan application selection procedure

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>8</td>
<td>11.4</td>
</tr>
<tr>
<td>Agree</td>
<td>20</td>
<td>28.6</td>
</tr>
<tr>
<td>Not sure</td>
<td>21</td>
<td>30.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>8</td>
<td>11.4</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>13</td>
<td>18.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>70</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: field data, 2014

### Table 2: Character in assessing loans

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Agree</td>
<td>12</td>
<td>17.1</td>
</tr>
<tr>
<td>Not sure</td>
<td>34</td>
<td>48.6</td>
</tr>
<tr>
<td>Disagree</td>
<td>13</td>
<td>18.6</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>9</td>
<td>12.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>70</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: field data, 2014

### Character in loan application assessment

The study also tried to find out if MFIs consider borrowers’ character when they are assessing loan applications of prospective borrowers. As the results below indicate, 2.9% of all respondents strongly believe they do and 17.1% believe they do. About 48.6% said they were not sure MFIs consider the character of their prospective borrowers in assessing their eligibility for loans. It also emerged that 18.6% disagree that they consider character while 12.9% strongly disagree they do. In the table 2 below, majority of the respondents are not sure if a prospective borrower’s character is considered in assessing his/her eligibility for a loan.

### Table 4: MFIs consider prospective borrowers' creditworthiness

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agree</td>
<td>20</td>
<td>28.6</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>19</td>
<td>27.1</td>
</tr>
<tr>
<td>Not sure</td>
<td>17</td>
<td>24.3</td>
</tr>
<tr>
<td>Disagree</td>
<td>9</td>
<td>12.9</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>5</td>
<td>7.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>70</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: field data, 2014

### Purpose of loan

The next crucial question was to ascertain if MFIs consider the purpose for which loans are procured. The study revealed that 7.1% strongly agree they do. It further showed that 12.9% of total respondents also agree. From the figure 5 below, 44.3% are not sure while 20% and 15.7% disagree and strongly disagree respectively. The study shows that here again, many people are not sure if purpose for loan is considered by MFIs. It also means that it does not feature much in loan application assessment. It can also be inferred that this is also a major reason why loans go bad.

### Creditworthiness

The study further sought to find out if MFIs in assessing loan application prospective borrowers consider their credit worthiness. The results in table 4, revealed that 28.6% and 27.1% of all respondents strongly agree and agree respectively. About 24.3% were not sure. However, 12.9% responded they strongly disagree while only 7.1% said they strongly disagree. Majority of the people at least believe that the creditworthiness of prospective borrowers is considered in the assessment of their eligibility for loan facilities. The study can safely establish that credit worthiness of prospective borrowers is not a reason for loans going bad in the area under study.

### Loan repayment

The study also posed the question to find out if MFIs give borrowers enough time to repay their loans. It emerged that 10% and another 10% said they strongly believe and believe respectively that they are given enough time to repay their loans. About 8.6% said they were not sure. Further, 44.3% believe they are not given enough time to pay back their loans, while 27.1% strongly believe that they are not given enough time to repay their loans. The inference from figure 6 is that a vast majority of the people believe that borrowers don’t get enough time to repay their loans. According to
the respondents, even though they do their best to pay back their loans on time, most of the time they do not have enough time to do so and as a result they are overwhelmed by the accumulation of penal interest leading to the loans going bad.

**Figure 6: Borrowers get enough time to repay loan**

Source: field data, 2014

**How much applicants request**

Respondents were asked how much they borrowed and the results indicate the following: 52.9% borrow between 200-1000 (Ghs), 28.6% borrow between 1000-2000 (Ghs), 7.1% borrow between 2000-3000 (Ghs), 10% borrow between 3000-5000 (Ghs), while only 1.4% borrow more than Ghs 5000. Respondents revealed that how much they requested depended on the purpose for which the loans were contracted and their ability to repay. The table below therefore is a reflection of the fact that majority of petty traders will need between 200 and 1000 Ghana cedis to trade and etc.

**Table 5: How much do applicants request?**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>200-1000</td>
<td>37</td>
</tr>
<tr>
<td>1000-2000</td>
<td>20</td>
</tr>
<tr>
<td>2000-3000</td>
<td>5</td>
</tr>
<tr>
<td>3000-5000</td>
<td>7</td>
</tr>
<tr>
<td>Above 5000</td>
<td>1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>70</td>
</tr>
</tbody>
</table>

Source: field data, 2014

**Interest rate**

Respondents were also asked about their opinion on the interest rates that are charged on loans. It emerged from 30% strongly agree the interest rates that MFIs charge are high, 41.4% agree interest rates are high. But 18.6% thought the interest rates were fair. However, 8.6% believe the interest rates are rather low, while only 1.4% believes interest rates are very low. As represented by the figure below, over 71% of all respondents believe that the interest rates that are charged on loans are high. The study can conclude that high interest rates is also a major reason why loans go bad.

**Figure 7: How do you describe interest rates charged?**

**Repayment schedule**

Respondents were asked how MFIs require borrowers to repay their loans. About 38.6% said daily deposits are required, 32.9% also said weekly, 5.7% said biweekly, 20% said monthly payment are required, 2.9% said no structured arrangement was required. The study revealed that most of the people pay back their loans through daily and weekly deposits. Respondents explained that repayment schedule when followed helps the borrower to repay the loan in bits which they said is more comfortable and convenient as established by Vogelgesang (2003). The study can say that repayment schedule is not one the reasons why loans go bad, except credit officers fail to monitor and take appropriate action timeously.

**Table 6: Repayment schedule**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daily</td>
<td>27</td>
</tr>
<tr>
<td>Weekly</td>
<td>23</td>
</tr>
<tr>
<td>Biweekly</td>
<td>4</td>
</tr>
<tr>
<td>Monthly</td>
<td>14</td>
</tr>
<tr>
<td>Any how</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: field data, 2014

**Mode of reminder in case of default**

The study shows from the figure below that only 2.9% were reminded via letters, 55.7% said they are reminded through telephone calls and 41.4% said they are reminded through personal visits. Respondents largely agreed that MFIs use telephone calls and personal visits to remind clients in case of default. Respondents also said that when credit officers call them on phones or visit them personally, they talk to them in languages they understand and that helps them to redeem their default amounts. Mode of reminder in case of
default is not a reason for loans going bad.

Figure 8: Mode of reminder

![Mode of reminder chart]

Source: field data, 2014

The use of legal means
The study tried to find out if MFIs use legal means to deal with recalcitrant defaulters and it emerged that 12.9% strongly believe they do, 14.3% also they do. 24.3% said they were not sure, 28.6% disagree, 20% of all respondents strongly disagree they do. The table below suggests that legal means in loan recovery is not very common with most MFIs. The failure to enforce a loan agreement by legal means when all efforts have failed is certainly a reason for loans going bad.

Table 7: MFIs use legal means as last resort

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>9</td>
</tr>
<tr>
<td>Agree</td>
<td>10</td>
</tr>
<tr>
<td>Not sure</td>
<td>17</td>
</tr>
<tr>
<td>Disagree</td>
<td>20</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>14</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
</tr>
</tbody>
</table>

Source: field data, 2014

Multiple borrowings
The study also wanted to find out if borrowers engaged in multiple borrowing and all respondents, that is 100% said yes. It is therefore an established fact that borrowers engage in multiple borrowings at the same time. This obviously is a recipe for bad loans.

Figure 9: Do borrowers borrow engage in multiple borrowing?

![Multiple borrowing chart]

Source: field data, 2014

5.0 Conclusions and Recommendations
Existence of lapses in credit policy and loan recovery strategies in MFIs in the Kwahu Afram Plains North District
The study revealed that most of the clients have a negative perception about the existence of credit policies applied in order to manage exposures or risks of loan default that results in bad loans. This is in compliance with the view made by Pandey (1995) that lending institutions employ a combination of three decision variables namely credit standards, credit policy and collection efforts in order to have maximum recovery and reduce in the incidence bad loans.

Girma, (1996) says that MFIs by employing solid credit policy, they are empowered to analyze credit request from their customers and provide an objective decision for accepting or rejecting loan application. Ssewagudde (2000) also stressed that these credit policies provide parameters, define procedures and directives through which loans are disbursed.

Workable credit policy and loan recovery strategy
With this overwhelming response, the study went further to find out the reasons why borrowers will do that. The study sampled the most recurring 4 suggestions. About 25.7% of the respondents blame it on lack of credit bureau, 21.4% believe that MFIs don’t care how their businesses do and so don’t train their borrowers to profitably manage their resources, 38.6% said that MFIs don’t assess prospective borrowers’ financial needs before they grant them the loans and so, whether the monies requested are adequate or not, they care. A further 14.3% believe that they take multiple loans to repay existing loans. Multiple loans is perhaps one of the major reasons why loans go bad. The reasons why borrowers do that present an understanding and background to develop some strategies to prevent the practice and thereby reducing the incidence of bad loans.
Table 8: Why do borrowers borrow engage in multiple borrowing?

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of credit bureau</td>
<td>18</td>
<td>25.7</td>
</tr>
<tr>
<td>Lack of training for borrowers</td>
<td>15</td>
<td>21.4</td>
</tr>
<tr>
<td>Inadequate assessment of borrowers financial needs</td>
<td>27</td>
<td>38.6</td>
</tr>
<tr>
<td>They use it to repay existing debts</td>
<td>10</td>
<td>14.3</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: field data, 2014

Having been able to ascertain or identify the existence of lapses in the credit policies and the loan recovery strategies, it is imperative for MFIs to do more to avoid multiple borrowing by prospective borrowers, if they are to succeed in their operations. It is therefore clear that MFIs must do proper due diligence, be interested in the businesses of their clients and also bear the responsibility to train their clients for maximum results.

Table 9: Steps to improve loan recovery

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFIs must invest in highly qualified credit officers</td>
<td>16</td>
<td>22.9</td>
</tr>
<tr>
<td>MFIs must do due diligence on prospective borrowers</td>
<td>14</td>
<td>20.0</td>
</tr>
<tr>
<td>MFIs should solicit feedback periodically from clients</td>
<td>16</td>
<td>22.9</td>
</tr>
<tr>
<td>MFIs should deal each individual on their own special circumstances</td>
<td>9</td>
<td>12.9</td>
</tr>
<tr>
<td>MFIs must treat loan agreements as legally binding documents</td>
<td>15</td>
<td>21.4</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: field data, 2014

Respondents strongly believe that the strategies in table 9 have the capacity to strengthen the institutional framework of MFIs to reduce to the barest minimum incidences of loan default if well adopted and vigorously implemented.

Microfinance in the Kwahu Afram Plains North district in spite of its enormous benefits have also come with huge challenges both to the MFIs themselves and their customers. It is imperative to understand these challenges as the major reasons why MFIs are unable to recover the loans that are granted to these clients as identified above. The reasons for loans default include lack of proper character assessment for prospective borrowers, high interest rates, inadequate time within which to pay back loans, multiple borrowing at the same time, just to mention a few. The need to adopt strategic credit policy that works cannot be over emphasized. The issue of borrowers engaging in multiple borrowing was pushed further for the reasons and main revelation was that there is no credit bureau for cross-referencing assessment of loan applicants, putting MFIs at risk of getting their monies back. A number of strategies have also been suggested to make MFIs strengthen their credit policy and loans recoveries. Some of these include investing in highly qualified credit officers, doing due diligence, periodically soliciting for feedback from clients and enforcing loan agreements, etc.

The study has established that indeed MFIs in the Kwahu Afram Plains district face a huge challenge but they can also take steps to overcome them as discussed above. At this stage of the study, it is appropriate to proffer recommendations and they are as follows: MFIs should endeavour to hire highly qualified credit officers to avoid any compromise on the quality of the they will do; MFIs should treat all loan transactions as legally binding contracts with their clients to ensure enforcement; Due diligence (thorough background checks) customers must be done to ascertain their credit worthiness, character and also to avoid multiple borrowing; MFIs should solicit feedback from clients from time to time to understand current trends, and It is also recommended that further research should focus on the managerial capacities of the managers of MFIs themselves and the effects they have on the success or otherwise of the MFIs.
References


